
Rules of Origin As Commercial Policy Instruments? — Revisited

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... Contracting Parties shall ensure that ... rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade.²

Mexico now seems willing to accept ... a crucial provision that any cars assembled in North America would have a 60% regional parts and labour content to qualify for [NAFTA] duty-free treatment — although auto makers may be able to count such costs as executive salaries, employee uniforms, and advertising toward local content.³

1. Introduction

The *raison d'être* for rules of origin is the existence of differentiated⁴ restrictions⁵ on international trade.⁶ Indeed, in a completely open world economy, there would not be a demand for rules of origin because it would be immaterial where goods and services originate. Even in a less than open world economy, the prominence of rules of origin would be limited as long as trade-restrictive measures were applied across the board (i.e., on a nondiscriminatory basis).

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2. Article 2 (b), Agreement on Rules of Origin, Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (Dunkel Text, 20 December 1991).

3. Magnusson, *Building Free Trade Bloc by Bloc*, International Business Week, at 16 (25 May 1992).

4. The only exception to this might be rules of origin used to support quantitative restrictions. Such quantitative restrictions are not necessarily discriminatory.

5. An exception to this is the positive discriminatory GSP.

6. Compare chapter 1, section 2. Rules of origin are also used for the collection of trade statistics. In such a context, however, they have not given rise to any controversy.

The expanding importance *c.q.* use of rules of origin seems therefore directly correlated to three factors:

1. the surge in selective contingency protectionist measures
2. the regionalization of the world economy through the creation of trading blocs
3. the establishment of positive discriminatory measures (i.e., the GSP).

Few will contest that origin rules are an indispensable device to support the effectiveness of discriminatory trade regimes.⁷ However, over the past decade, rules of origin have taken on a life of their own and arguably have developed into a means *in se* of applying trade-restrictive measures where such restrictions do not necessarily, let alone automatically, follow from the application of other trade law instruments.⁸

Thus, for example, jurisdictions such as the United States and the European Communities have used rules of origin as the legal justification for imposing antidumping duties on third country exports (sometimes retroactively) following findings that merchandise produced in such third countries had not acquired third country origin but continued to have the origin of the country with respect to which antidumping duties were imposed. As such conclusions were drawn without any investigation whether third country exports were dumped and thereby caused injury, the use of rules of origin was effectively extrapolated to construct an independent shortcut for imposing antidumping duties on exports from a third country, although the international legal basis for doing so is ambiguous, to say the least.⁹

While the above perhaps might sound extreme, this author has argued previously¹⁰ that rules of origin not only have the potential of developing into trade policy instruments but will in fact *q.q.* affect on international trade flows. This seems seldom accepted by importing country administrators, who tend to claim that the formulation of rules of origin and the application of such rules to concrete cases are technical exercises in which policy considerations play no role. This makes such administrators an exploitable target for domestic special interests.

7. Although opinions might differ on the necessity or desirability of discriminatory trade regimes.

8. For a different perspective, see chapter 8, section 1, where Forrester takes the more traditional position that the controversy about the abuse of rules of origin is misplaced and that such controversy is rather the result of improper use of trade policy instruments.

9. Vermulst and Waer, *Anti-Diversion Rules in Antidumping Proceedings: Interface or Short-Circuit for the Management of Interdependence?* 11 Michigan Journal of International Law 201 (1990).

10. Vermulst and Waer, *European Community Rules of Origin as Commercial Policy Instruments?*, 24:3 Journal of World Trade, 55-121 (1990).

All jurisdictions examined in this book distinguish between preferential and nonpreferential rules of origin as far as the origin of goods is concerned. Preferential rules of origin are used to determine whether certain products originate in a preference-receiving country and hence can qualify for preferential treatment. Nonpreferential rules of origin are used for all other purposes.

The jurisdictions analyzed here do not merely have one set of preferential and one set of nonpreferential origin rules but, with the exception of Japan, in fact also have different sets of preferential origin rules. As will be seen in section 4.2., the United States has six different sets of preferential origin rules, the European Community fourteen, Australia five, and Canada six. Clearly, this variety is a major cause for the widely perceived complexity of origin rules.

This concluding comparative chapter follows the template that was provided by the editors to the authors of the country studies: section 2 will provide a general overview of rules of origin; sections 3 and 4 will go into more detail about nonpreferential and preferential rules of origin respectively; section 5 will examine the increasing importance of rules of origin in antidumping proceedings; section 6 will summarize the use of rules of origin in other contexts. Finally, the relatively long section 7 will review the progress made in the draft Agreement¹¹ on rules of origin and analyze the consequences for the future.

2. General Synopsis of Rules of Origin

To determine the origin of a product, the first question is whether the product is wholly obtained or produced in one country or whether two or more countries have been involved in the manufacture of the product. If a product is wholly obtained or produced in one country, it evidently has the origin of that country and origin in this context has not proven controversial.

However, frequent problems arise if the origin must be determined of a product in the manufacture of which two or more countries have been involved. In such cases, the general concept is that the product will have the origin of the country where the last substantial transformation took place. There are three main methods that are used to ascertain whether substantial transformation occurred:

- an ad valorem percentage rule, often called the percentage criterion test
- a CTH test
- a technical test

11. It would appear that the rules tentatively agreed on in the Uruguay Round with respect to rules of origin will be embodied in an agreement rather than a code. Comment of Martin Rudduck (23 June 1992).

The term *process criterion* is sometimes used to describe the latter two methods.¹²

Table 1 provides a schematic overview of the tests used by the five jurisdictions examined in this study.

TABLE 1. Tests Used in the United States, the European Community, Australia, Canada and Japan

Type	U.S.	EC	Australia	Canada	Japan
Non-preferential	Technical test	Technical or percentage	Percentage	Percentage	CTH or technical test
Preferential	Percentage; CTH or percentage for U.S.-Canada FTA	CTH; percentage and/or technical test	Percentage	Percentage; CTH or percentage for U.S.-Canada FTA	CTH; Percentage and/or technical test

2.1. Percentage Criterion: Import Content and Domestic Content Methods; Value-of-Parts Test

The percentage criterion surfaces in three forms. In its first form, as the import content method, it imposes a ceiling on the use of imported parts and materials through a maximum allowable percentage of such parts and materials.

In its second form, as the domestic content test, it requires a minimum percentage of local value-added in the last country in which the product was processed (but see below).

The third form, the value-of-parts test, would examine whether the originating parts reach a certain percentage of the total value of parts. As the value-of-parts test is unusual, it will not be discussed further in this chapter apart from the observation that the test appears rather unfair as it focuses only on parts values and does not take into account assembly costs and overheads in the local production operation. The value-of-parts test is used in the European Community in the product specific origin

12. In UNCTAD circles, the term *process criterion* is used to describe tests that do not use the *percentage criterion*. Thus, the CTH test and the technical test would both be covered by the process criterion. *Compare* Digest of Rules of Origin, UNCTAD/TAP/133/Rev.6, at 6 (1990).

regulations for radio and television receivers and tape recorders as a subsidiary test when 45 percent value-added (the primary test) is not achieved¹³ and in Article 13 (10) of the EC basic Antidumping Regulation.¹⁴

The percentage criterion directly¹⁵ or indirectly¹⁶ specifies that a certain percentage of value-added in the last production process is necessary to confer originating status; if such a percentage cannot be reached, the last production process does not give origin and origin is given to another country in the case of nonpreferential rules or to no country at all where preferential agreements are concerned.¹⁷

The percentage criterion, in particular the domestic content variant, requires an analysis of production costs. Before further analyzing the law and practice of the jurisdictions examined in this study, it might be useful to briefly review production cost items. At this point it should be noted that there are many different methods of qualifying costs of production, and the following breakdown is designed exclusively to facilitate the understanding of the reader of this chapter.¹⁸

Production costs can be broken down in cost of manufacture and overhead costs. The cost of manufacture, in turn, can be divided into costs of materials, direct labor costs, and manufacturing overheads.

The cost of materials is the purchase price of parts, components, etc. For the application of the percentage criterion, an important distinction exists between originating materials and non-originating materials.

As explained above, the percentage criterion calculates either the maximum allowable import content or the minimum required domestic content. In either case, the question arises at what level imported, non-originating parts ought to be valued (i.e., in ascending order: ex-works, FOB, CIF or into-factory (delivered)).¹⁹ The

13. See chapter 3, sections 3.3.2.5.1.-3.3.2.5.2. The value-of-parts test is also often used by the European Community as one of the elements of mixed tests in preferential trade agreements.

14. See Vermulst and Waer, *supra* note 8.

15. "Pure" domestic content test.

16. Import content test.

17. If, for example, the last production process is performed in a GSP beneficiary country, but not enough value is added, preferential treatment will be denied without a positive determination about the "real" origin of the merchandise.

18. It does therefore not purport to be in accordance with any cost accounting standards or generally accepted accounting principles.

19. The European Community's Article 13 (10) parts test valued non-originating (and

answer to this question is consequential because each subsequent level leads to a higher price and thereby makes satisfaction of the import versus domestic content test more difficult.

The jurisdictions examined here value non-originating materials at their FOB²⁰ or CIF²¹ value. A CIF valuation base means that all costs incurred from sending the parts from the factory to the importing country border would be treated as non-originating costs and that all post-border costs, such as inland freight in the importing country, customs duties, indirect taxes, etc., would be treated as originating costs. An FOB valuation base would also treat the cost of ocean freight and insurance as originating cost items.

Originating materials are normally valued on an into-factory basis.

Costs of direct labor comprise all the costs of the direct labor that can be identified or associated with the production of the merchandise, such as basic pay, overtime pay, incentive pay, bonuses, shift differentials, employee benefits such as housing, holiday pay, retirement, social security programs, and any other employee-related expenses.

Manufacturing overheads include all expenses incidental to and necessary for the production of the product, such as indirect labor, supervision, depreciation, production royalties, rent, power, maintenance and repairs, product-related R&D,²² etc. Manufacturing overheads would normally also include the financing cost related to the production process (as opposed to the financing cost related to the sales process),²³ which typically covers the financing of raw materials and work in progress, the financing of the factory, the production line, etc.

General overhead expenses are often called selling, general, and administrative expenses or SGA. Such SGA expenses cover all other expenses incurred (typically those related to the sales process), for example, salaries of executives, telecommunication expenses, outward freight and insurance, legal and accounting fees, etc. Selling, general, and administrative expenses also cover non-operating expenses

originating) parts on an into-factory basis.

20. United States.

21. European Community, Australia, Canada, and Japan.

22. Non-product-related R&D will generally be included in the SGA expenses as general expenses.

23. The financing cost related to the sales process would normally be reported as an SGA expense.

(income) such as financing costs related to the sales process and exchange loss (gain).

The addition of all these cost items gives the fully allocated cost; the fully allocated cost plus the profit gives the sales price. The import content can easily be calculated by totalling the FOB or CIF cost of all non-originating materials.

The domestic content can be calculated either by deducting the cost of non-originating materials from the sales price²⁴ or by adding up all items of local value-added.²⁵ These two calculation methods would in theory lead to the same result. In practice, however, that is not always the case: certain sets of rules of origin, such as the Canadian and Japanese GSP rules and the European Community's preferential rules to the extent that they rely on percentage criteria, use an import content rule that sets a maximum allowable percentage of imported materials.²⁶ An import content rule of for example, 40 percent equals a 60 percent domestic content test, and the two calculation methods therefore yield the same result.

However, other sets of rules of origin, such as the U.S. preferential and Australian GSP rules and EC, Australian, and Canadian nonpreferential rules, rely on a domestic content rule under which a minimum of domestic content must be achieved. In the United States and Australia, not all domestic content is considered relevant for GSP qualification purposes and the two calculation methods will therefore yield different results. The same observation applies regarding Australian and Canadian nonpreferential rules.

TABLE 2. Import Content vs. Domestic Content Methods in the U.S., the EC, Australia, Canada and Japan

Type	U.S.	EC	Australia	Canada	Japan
Nonpreferential	NA	Technical or domestic content	Domestic content	Domestic content	NA
Preferential	Domestic content;	Import content	Domestic content	Import content for	Import content

24. This is done under the European Community's and Canada's GSP rules and also under other EC preferential arrangements. See, for example, with respect to ACP, Protocol I of Lomé IV.

25. This is done under the U.S. and Australian GSP rules.

26. *Compare* Consultations on Harmonization and Improvement of the Rules of Origin, Report by the UNCTAD Secretariat, TD/B/C.5/141, at 6 (1992).

CTH or domestic content for U.S.-Canada FTA	GSP/ LDDC; domestic content in other cases
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The sales price as such is seldom used as the denominator in percentage criterion tests. Most jurisdictions rather rely on other denominators that require certain adjustments to be made to the sales price. To give a few examples:

The EC uses an ex-works price. The ex-works price is the price of the product at the moment that it leaves the factory; it is equal to the sales price with the exception of post-factory charges if such charges are included in the price. If, for example, the conditions of a certain sale are US\$ 100, CIF thirty days, the sales price of \$ 100 includes the cost of inland freight in the exporting country, the cost of the ocean or air freight and of the insurance from the manufacturer's premises to the importing country border as well as a thirty-day credit cost borne by the manufacturer. Such costs must then be deducted from the sales price to arrive at the ex-works price.

The Japanese GSP relies in part on the FOB export price. The FOB export price is the ex-works price plus the cost of inland freight and any handling costs incurred in the exporting country.

Thus, the sales price may be, but is not always, identical to the ex-works or the FOB price; it depends on the terms and conditions of sale.

TABLE 3. Denominators Used to Calculate Percentages in the United States, the European Community, Australia, Canada, and Japan

Type	U.S.	EC	Australia	Canada	Japan
Nonpreferential	NA	Exworks price	Factory cost	Cost of production	NA
Preferential	Appraised value of merchandise as it enters the U.S.	Exworks price	Factory cost	Exfactory price for GSP/LDDC; cost of production in other cases	FOB export price

It will be clear already from the above that there are many variations between jurisdictions with respect to both the constituent elements (the numerator) and the denominator of the percentage criterion. Furthermore, the allowable import or

required domestic percentages are often different, even within each jurisdiction, where they appear to depend on the objective of the law that they are designed to support.

United States preferential *domestic content* calculations include the cost or value of originating materials²⁷ and direct costs of processing operations, defined as those costs that are either directly incurred in or can be reasonably allocated to the growth, production, manufacture, or assembly of the specific merchandise under consideration. Such costs include

1. actual labor costs, including fringe benefits, on-the-job training, and the cost of engineering, supervisory, quality control, and similar personnel;
2. costs of dies, molds, tooling, and depreciation on machinery and equipment that can be allocated to specific merchandise;
3. research, development, design, engineering, and blueprint costs to the extent allocable to the specific merchandise; and
4. the cost of inspecting and testing the specific merchandise.

The U.S. domestic content therefore does not include SGA expenses and profit.²⁸

The denominator is the appraised value of the product when it enters the United States. The appraised value is normally determined on the basis of the transaction value, which is the price actually paid or payable by the importer plus, if not included in the price, packing costs incurred by the buyer, selling commissions incurred by the buyer, the value of any assist,²⁹ any royalties or license fees that are part of the

27. With the possible benefit of the dual substantial transformation criterion, see chapter 2, section 4.2.1.1. Cost of originating materials includes (1) the manufacturer's actual cost for the materials; (2) the freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer's plant, if these are not already included in the manufacturer's actual cost for the materials; (3) the actual cost of waste or spoilage, less the value of the recoverable scrap; and (4) taxes and duties imposed on materials, provided they are not remitted on exportation. If a material is provided to the manufacturer without charge or at less than fair market price, the cost or value is determined by computing the sum of (1) all expenses incurred in the production, manufacture, or assembling of materials including general expenses; (2) an amount for profit; and (3) freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer's plant. *See Digest of Rules of Origin*, UNCTAD/TAP/133/Rev.6, at 10 (1990).

28. *See ibid.* Such overhead costs include administrative salaries, casualty and liability insurance, advertising, salesmen's salaries, commissions, and expenses.

29. Assists are items of value (e.g. tools, dies, moulds, etc.) that are provided directly or indirectly by the importer or buyer to the producer at less than full cost or value for use in the production of the imported article. *See Handbook on Major United States Trade Laws*, UNCTAD/TAP/277/Rev.1, at 3 (1989).

conditions of sale, and the proceeds to the seller of any subsequent resale, disposal, or use of the imported merchandise. Not included are CIF costs, costs or charges incurred after importation and customs duties, and other federal taxes.³⁰ The denominator therefore is essentially a species of the price at exportation³¹ which includes local SGA and profit, although these are not counted as domestic content. The appraised value is determined by the U.S. Customs Service. This means that it will not always be possible for a foreign producer or exporter to determine with certainty in advance whether or not he or she meets the domestic content percentage.

The EC denominator sticks closest to the ex-works price advocated in Recommended Practice 5 of the Kyoto Convention's Annex D.1³² because it encompasses, in addition to the costs of materials, direct labor and manufacturing overheads: net SGA,³³ royalties,³⁴ packing,³⁵ and profit³⁶ of the production unit.³⁷ The European

30. See *ibid.* at 5-6 (1989).

31. Compare the commentary to Recommended Practice 5 in Annex D.1 of the Kyoto Convention providing that signatories ought to use either the exworks price or the price at exportation. The price at exportation is defined as either the appraised value at importation or the FOB value.

32. Recommended Practice 5 provides that for the calculation of domestic content percentages, imported materials shall be valued at the dutiable value at importation (normally the CIF price) and produced goods shall be valued at the ex-works price or the price at exportation. It is clear that of the countries analyzed in this study, only the United States and Japan use the price at exportation. In fact, the relevant Japanese regulation explicitly refers to a FOB export price (see chapter 6, section 4.1.2.). Although Annex D.1 does not express a preference for the ex-works price over the price at exportation, there would appear to be a certain consensus that the ex-works price is more appropriate. See, e.g., CCC, Permanent Technical Committee, Rules of Origin of Goods, Secretariat Note, 29.215E T7-3231, at 20 (2 November 1982).

33. Net SGA expenses in this chapter means SGA expenses excluding SGA costs incurred after the product left the factory, such as outward inland freight, international transportation and insurance (if the product is sold CIF), customs duties (if the product is sold on a delivered basis), etc.

34. When royalties are payable by the production operation to a parent or related company, the European Community will normally check whether the royalties are reasonable.

35. Compare the Ninth standard *jo*. Recommended Practice 10 in Annex D.1, which taken together would seem to indicate not only that the origin of the packing follows the origin of the product but also that packing should be taken into account in the calculation of domestic content where the goods concerned are ordinarily sold by retail (see chapter 3, section 3.2.2.).

Community's preferential rules of origin often rely on an import content test to supplement the CTH method.³⁸ In the non-preferential area, the domestic content is in practice often an important factor in the EC informal procedure, especially in assembly cases.³⁹ As the numerator in the European Community's domestic content test is the exact mirror image of the numerator in the European Community's import content test, both methods lead to similar results. For example, a domestic content of 60 percent is identical to an import content of 40 percent in the EC system.

Australian rules of origin predominantly rely on different domestic content percentages that are calculated as a percentage of the factory or works cost (see chapter 4, section 2.3.3.). Domestic content includes the cost of originating materials received into factory (excluding duties and taxes paid or payable in the country of manufacture of the goods in respect of such materials), manufacturing wages, factory overhead expenses, and the cost of inner containers, but excludes SGA expenses and profit.⁴⁰ The denominator is composed of the domestic content plus the CIF cost of non-originating materials (excluding duties and taxes paid or payable in the country of manufacture of the goods in respect of such materials).

36. The Kyoto Convention refers to the ex-works price, not the ex-works cost and therefore, in the view of this author, clearly establishes that it is concerned with the price, which includes profit. With respect to EC practice, it must be noted that the EC authorities routinely examine whether the profit is reasonable, especially where sales are made between related parties.

37. Compare chapter 3, section 3.2.2. in which Waer concludes on the basis of the Eleventh Standard providing that ". . . no account shall be taken of the origin of the energy, plant, machinery and tools used in the manufacturing . . . of the goods" that ". . . depreciation, lease and rental payments and royalties relating to non-originating plant, machinery and tools should be counted as local value-added."

38. Since the 1988 introduction of the single list, the percentage criterion is no longer used in parallel to the CTH. Thus, under the pre-1988 system, all working and processing in List A had to be performed in addition to the CTH. However, since 1988, CTH is only required for goods covered by an entry in this list if it is explicitly required by the entry.

39. The local domestic content is then calculated by deducting the cost of nonoriginating materials from the exworks price. There is no definition of the exworks price in the nonpreferential area, but under EC preferential rules, the ex-works price is typically defined as the price paid for the product obtained to the manufacturer in whose undertaking the last working or processing is carried out, provided that the price includes the value of the originating materials used in manufacture, minus any internal taxes which are, or may be, repaid when the product obtained is exported. *See, e.g.*, Article 3 of Protocol 1 of Lomé IV. The same definition is used in practice to determine nonpreferential origin.

40. *Ibid.*

Canadian nonpreferential and certain preferential⁴¹ rules of origin require a domestic content percentage of 50 percent of the cost of production. The denominator cost of production comprises the cost of originating and non-originating materials (exclusive of duties and taxes) and labor and factory overheads but excludes profit, export packing expenses (as opposed to the packing in which the goods are normally sold for consumption), royalties, transportation and insurance costs to the point of direct shipment to Canada, customs duties, and any other costs or charges arising after the completion of the manufacture of the goods. The domestic content consists of these same items with the exception of the cost of non-originating materials.

The Japanese GSP partly relies on an import content test that is very similar⁴² to that of the European Community's preferential origin rules.

Table 4 provides a schematic overview of the elements of domestic content in the five jurisdictions analyzed.

TABLE 4. Elements of Domestic Content (Numerator) in the United States, the European Community, Australia, Canada, and Japan

	U.S. ^a	EC ^b	Australia ^c	Canada ^d	Japan ^e
Originating materials	x	x	x	x	x
Taxes and duties paid on such materials but refunded on export ^f	x	x	x	x	x
Direct labor	x	x	x	x	x
Manufacturing overheads	x	x	x	x	x

41. See section 4.2. However, Canada's GSP and LDDC schemes effectively require a domestic content of 60 and 40 percent respectively of the ex factory price. (Technically, Canada's GSP and LDDC schemes are based on the import content rule and require that import content may not be more than 40 and 60 percent respectively.) See further section 4.2.

42. However, the denominator is the FOB export price and not the ex-works price.

Inner containers	x	x	x	x	x
Other packing expenses	x	x	—	—	x
(SGA expenses)					
Royalties ^g	x	x	—	—	x
Transportation ^h	— ⁱ	—	—	—	— ^j
Insurance	— ^k	—	—	—	— ^l
Customs duties	—	—	—	—	—
Others [net SGA expenses]	—	x	—	—	x
Profit	—	x	—	—	x

Note:

x = included

— = excluded

^a Preferential.

^b Nonpreferential (informal procedure) and preferential to supplement CTH.

^c Preferential and nonpreferential.

^d Nonpreferential and preferential (with the exception of GSP and LDDC schemes and only as a supplementary test in the U.S.-Canada FTA).

^e Technically, Japan uses an import content test as a supplementary test to the CTH in its GSP scheme. The domestic content has therefore been constructed by deducting the CIF cost of imported materials from the sales price.

^f To the extent not refunded on exportation.

^g If not included in manufacturing overheads.

^h Including outward inland transportation.

ⁱ The United States would include inland freight in the exporting country but would not include ocean freight. As inland freight in the exporting country is normally very small, it has been ignored here.

^j Japan would include inland freight in the exporting country but would not include ocean freight. As inland freight in the exporting country is normally very small, it has been ignored here.

^k The United States would include insurance in the exporting country but would not include international insurance. As insurance in the exporting country is normally very small, it has been ignored here.

^l Japan would include insurance in the exporting country but would not include international insurance. As insurance in the exporting country is normally very small, it has been ignored here.

The calculation of the percentage of domestic content then becomes a relatively simple calculation: one adds up the items mentioned above as "included" and the customs value on the importation of non-originating materials to calculate the denominator.⁴³ The cost items included in the table are then divided by the

43. In the United States, however, all items mentioned in Table 4 whether or not included

denominator and multiplied by 100 to calculate the percentage of domestic content. It might be clear from the above that the same facts will lead to different domestic content ratios in the five jurisdictions. Table 5 shows this on the basis of a concrete example:

Ceteris paribus, the EC and Japanese domestic content calculation methods are therefore more liberal than the domestic content calculation methods of the other jurisdictions. They are also the most logical in that they focus on the price of the product as it leaves the factory and therefore count local SGA expenses and profit as domestic content, provided that they are reasonable.

In turn, the Japanese system is slightly more favorable than the EC system. The Japanese denominator is the FOB price rather than the exworks price of the merchandise. Although the denominator is higher, the domestic content will also be higher because the inland freight and insurance in the exporting country are counted as local content. The drawback of using the FOB price is that it provides an unjustified, albeit slight, advantage to companies that are located further from a port. For example, if the port of shipment is Pusan, Korea, the Japanese calculation method will give a company located in Incheon a slight edge over a company located in Taegu because the transportation cost from Incheon to Pusan will be higher than the transportation cost from Taegu to Pusan.

The U.S. method effectively leads to a local cost added that is cut off at the ex-assembly line point. This cost is then divided by the price at exportation, which is jacked up by the inclusion of local SGA expenses and profit. The combination of the two methods deflates domestic content.

Australian and Canadian practice also calculates an ex-assembly line cost but at least divides it by an appropriate denominator, which is established at the same level.

in the local domestic content, will be included in the denominator with the exception of SGA expense items such as CIF costs and customs duties in the United States.

Apart from this lack of uniformity in applying the percentage criterion among jurisdictions, a disadvantage of the percentage criterion is that it penalizes low cost or efficient production operations where labor or assembly costs are lower than in high cost c.q. inefficient facilities.⁴⁴ Thus, for

TABLE 5. Domestic Content Calculation in the United States, the European Community, Australia, Canada, and Japan

	U.S.	EC ^a	Australia	Canada ^b	Japan ^c
Originating materials	80	80	80	80	80
Taxes and duties paid	5	5	5	5	5
Direct labor	20	20	20	20	20
Manufacturing overheads	20 ^d	15	15	15	20 ^e
Inner containers	2	2	2	2	2
Other packing expenses	2	2	2 ^f	2	2
(SGA expenses	30	30	30	30	30)
Royalties ^g	4	4	4	4	4
Transportation	10 ^h	10	10	10	10 ⁱ
Insurance	1 ^j	1	1	1	1 ^k
Customs duties	0	0	0	0	0
Net SGA	15	15	15	15	15
Profit	10	10	10	10	10
Nonoriginating materials	95 ^l	100 ^m	100 ^m	100 ^m	100 ^l
Denominator	253 ⁿ	253 ^o	222 ^p	222 ^q	253 ^r
Domestic content amount	133	153	122	122	153
Domestic content percentage	52.6%	60.5%	55%	55%	60.5%

Note:

^a Nonpreferential rules.

^b Not applicable to GSP or LDDC schemes.

^c Technically, Japan uses an import content test. The domestic content has therefore been constructed by deducting the cost of imported materials from the sales price.

^d This includes the CIF costs of imported materials.

^e This includes the CIF costs of imported materials.

44. See Vermulst and Waer, *supra* note 9.

- ^f "Strike out" has been used to indicate that items are not included in local domestic content.
- ^g If not included in manufacturing overheads.
- ^h The United States would include inland freight in the exporting country but would not include ocean freight. As inland freight in the exporting country is normally very small, it has been ignored here.
- ⁱ Japan would include inland freight in the exporting country but would not include ocean freight. As inland freight in the exporting country is normally very small, it has been ignored here.
- ^j The United States would include insurance in the exporting country but would not include international insurance. As insurance in the exporting country is normally very small, it has been ignored here.
- ^k Japan would include insurance in the exporting country but would not include international insurance. As insurance in the exporting country is normally very small, it has been ignored here.
- ^l FOB price.
- ^m CIF price.
- ⁿ Appraised value of the product when it enters the United States.
- ^o Ex-works price.
- ^p Factory cost.
- ^q Cost of production.
- ^r FOB export price. The FOB export price is the same as the European Community's ex works price with the addition of inland freight and insurance in the exporting country. As these tend to be rather small, they have been ignored in the calculation example.

example, it is easier for a color television producer to reach 45 percent domestic content in the European Community than in Thailand. Furthermore, domestic content and import content calculations can change constantly as a result of fluctuations in world market prices for raw materials⁴⁵ and in exchange rates. Finally, domestic content calculations provide a certain amount of discretion to administrators⁴⁶ and technically would require detailed on-the-spot visits to check the accuracy of data provided.

45. This is especially the case with respect to primary commodities whose prices tend to fluctuate widely almost as a matter of course.

46. The Honda dispute under the U.S.-Canada FTA provides good examples of this. A main bone of contention in the dispute between the United States and Canada about cars produced in Canada by Honda is the position of U.S. Customs that North American content includes the amount "paid" for North American materials and that, since Honda produces some of the materials itself in North America, it does not "pay" for them. The value of such materials was therefore not included, although the value of Japanese subparts was. See chapter 2, section 4.2.6.1.1., where Palmetier terms this the "intermediate material" issue. A second issue was whether the cost of die casting and machining qualified as processing costs or as assembling costs. U.S. Customs decided the former and therefore did not count such costs as North American value added. Palmetier's lengthy analysis of the Honda decision

In general, the import content test seems preferable over the domestic content test because it is easier to apply and leaves the importing country administrators with less discretion.

2.2. Change in Tariff Heading test

The CTH test confers origin if the manufacture results in a product that falls under a — normally four digit — HS number that is different from the numbers under which the non-originating parts or materials fall. The CTH test is the primary test for the European Community's preferential origin rules and for the U.S.-Canada FTA. Japanese nonpreferential rules of origin by and large also use the CTH test.

The advantages of the CTH test are its conceptual simplicity, its ease of application, and its lack of discretion. Furthermore, the adoption by most countries⁴⁷ of the HS system means that a similarly applied CTH test⁴⁸ normally leads to uniform determinations of origin in such countries. It is therefore convenient that it was decided early on in the Uruguay Round negotiations, at U.S. insistence,⁴⁹ that any harmonization of nonpreferential rules of origin delegated to the CCC be principally based on the HS CTH test (see section 7.3).

However, the HS system is primarily designed as a dual-purpose commodity classification and statistics system and might therefore not always be an appropriate basis for conferring originating status. Importing country administrators realized that early on and have recognized two lists of exceptions: (1) a list of products for which a CTH is not sufficient to confer origin but for which origin furthermore depends on a domestic content or import content requirement and/or a requirement that specific manufacturing operations are carried out or materials sourced (obligatory input test) in the country in which the last production process takes place and (2) a list of exceptions with processing operations sufficient to confer origin even if they do not lead to a CTH.

concludes that it is an "excellent example of the shortcomings of value added as a standard for determining origin."

47. As of 15 May 1992, the HS Code had sixty-six signatories. At least twenty-nine countries use the HS on a de facto basis.

48. This is presently not the case. For example, under the U.S.-Canada FTA, the CTH may vary from a two-digit chapter level change to an eight-digit statistical level change.

49. This is perhaps surprising as the United States "discovered" the existence of the CTH test fairly late and first adopted it only in the U.S.-Canada FTA.

Another drawback of the CTH test is that it requires indepth knowledge of the HS not only on the part of exporting country administrators (not necessarily customs experts) but also on the part of producers and exporters, for both the finished products and the raw materials.⁵⁰ This point is often made in UNCTAD discussions about the functioning of the GSP.

2.3. Technical test

The technical test prescribes certain production or sourcing processes that may (positive test) or may not (negative test) confer originating status. The technical test is used in the United States in the nonpreferential and preferential area, in the latter case in combination with a domestic content test, and by the EC in the majority of nonpreferential product specific origin regulations.

The advantage of the technical test is that of the three tests, it is best equipped to deal with the specifics of the situation at hand. However, it is also most easily abused by domestic interests as the U.S. Department of Commerce and EC determinations that the origin of integrated circuits depends on the place of diffusion show. Furthermore, it is extremely complicated to devise all kinds of technical tests for an enormous array of products. Third, it appears difficult to verify the information on specific production processes performed in third countries.⁵¹

An additional drawback of the negative technical test is that it only delineates those production or sourcing processes that do not confer origin and therefore leaves unanswered whether other production or sourcing processes do. This shortcoming causes obvious uncertainty. The EC product-specific origin regulation for photocopiers (Ricoh rule) (see section 5) is a good example. The Draft Agreement on rules of origin in principle prohibits the use of negative technical tests⁵² but immediately makes two exceptions that would still allow negative technical tests (1) as part of a clarification of a positive test or (2) in individual cases in which a positive determination of origin is not necessary. The wording of the second exception would still appear to leave importing country authorities substantial discretion to resort to negative technical tests.

50. Comment Friedl Mazal (21 May 1992).

51. Comment Wim Keizer (22 May 1992).

52. Article 2 (f), *supra* note 1.

3. Nonpreferential Rules of Origin

3.1. Procedure

In the United States, the U.S. Customs Service, an agency under the jurisdiction of the Department of the Treasury, is responsible for the application of most rules of origin (see chapter 2, sections 3.-3.1.2.). Palmeter points out that the Customs Service must make an origin determination on every import at the time of entry as part of the agency's enforcement of the marking law (see chapter 2, section 3.1.1.). Decisions of the Customs Service on protests may be appealed to the CIT.⁵³

Under U.S. law, exporters or importers may obtain a prospective ruling from the Customs Service before importation.⁵⁴ Such rulings are issued in the form of letters addressed to the parties but may be published in the Customs Bulletin as a Customs Service Decision⁵⁵ or in the Federal Register as a Treasury Decision.⁵⁶ Palmeter notes that draft Treasury Decisions are published in the Federal Register with a request for comments from interested parties before they are adopted.⁵⁷

A result of the division of powers in the European Community between the EC institutions and the Member States is that an intricate decision-making process exists in which both the EC Commission and Member States officials play an important role (see chapter 3, sections 3.1.-3.1.3.). The EC basic Origin Regulation establishes an Origin Committee consisting of representatives of the Member States with a Commission official, normally the Head of Division of Directorate-General XXI, Directorate B, Division 2, presiding.

As the complicated — and generally lengthy — administrative procedure is described in detail by Waer,⁵⁸ suffice it here to point out the distinction between the formal procedure in which, at the end of the day, the Commission plays the predominant role and the informal procedure under which the Member States make

53. Decisions of the CIT may be appealed to the CAFC; judgments of the CAFC may be appealed to the Supreme Court, which decides autonomously whether it will accept the appeal (see chapter 2, section 3.1.).

54. Ibid.

55. If the ruling has a broader interest, *ibid.*

56. If the ruling involves a significant matter of policy, *ibid.*

57. Ibid.

58. See chapter 3, section 3.1.1. See also Vermulst and Waer *supra* note 9.

decisions by consensus. While the product-specific origin rules that have ensued from the formal procedure have been published in the Official Journal, consensual decisions taken in the informal procedure have not been published.

Although the basic Origin Regulation does not foresee this, in recent years foreign exporters have started to voluntarily submit data to the EC Commission and the Origin Committee with a view to obtaining a clear-cut unanimous ruling from the Committee in the informal procedure before shipments start.⁵⁹ While time-consuming,⁶⁰ this practice has the advantages that administrative decisions on origin tend to be made on a technical depoliticized basis and that an undesirable decision may still be changed if the producer is willing to change production or sourcing strategy.

A company adversely affected by an origin determination of a Member State's administration, the Origin Committee, or the EC Commission may not directly challenge the determination in the European Court of Justice (ECJ) because, in the view of the ECJ, it will not be directly and individually concerned in the sense of Article 173 (2) of the EEC treaty. Rather, such a company must resort to legal action in the Member State(s) (see chapter 3, section 3.1.2.). The national courts may or must refer the matter to the ECJ. This means that a foreign producer who has customs cleared in several EC Member States may be engaged in simultaneous litigation in several Member States, as was the case with Yoshida in 1978 and, still ongoing, with Brother. The EC system with respect to judicial review in origin matters not only is incredibly expensive and time-consuming for affected parties but also may lead to inconsistent judgments by national courts, at least in the first instance.

In Australia, origin determinations are made by the Customs Service (chapter 4, section 3.1.1.). It would appear that in most cases Customs Service decisions on nonpreferential determinations of origin may not be appealed either to the Administrative Appeals Tribunal or to the Federal Court of Australia (chapter 4, section 3.1.2.). It is at present unclear whether an appeal to the High Court of Australia or to a state supreme court would be admissible.

As Canadian tariff law, like the tariff laws of most other jurisdictions, distinguishes between the GT and the MFN tariff (chapter 5, section 2), Gottlieb correctly classifies the MFN tariff as a preferential tariff.⁶¹ For purposes of uniformity,

59. In chapter 3, section 3.1.1. Waer appropriately terms this *producer specific investigations*.

60. Thus, for example, a submission should normally be made for each model. For advanced electronic products with frequent model changes, this implies a continuous process.

61. See chapter 5, section 2. Canada applies its MFN tariff to all countries with the exception of Albania, Libya, Oman, North Korea, and Mongolia.

however, we will classify the origin rules pertaining to the MFN tariff as nonpreferential in this comparative chapter.

Rules of origin legislation and regulations fall under the jurisdiction of the Department of Finance and are administered by the DNR in Canada. Until 1988, Canadian "investigations of origin were conducted informally and determinations were made by administrative dictate."⁶² This changed with the adoption of the U.S.-Canada FTA: the Customs Tariff was amended and a formal procedure adopted for determinations of origin.

The origin of imported goods may be determined by Canada Customs before or within thirty days after importation.⁶³ Such a determination is final unless the Minister of the DNR makes a redetermination within two years after importation at the request of the importer (a TVA decision) (see chapter 5, section 4.9.2.). The redetermination may be appealed before the federal court on points of law. Furthermore, on request, the DNR is willing to give a nonbinding origin opinion.⁶⁴

In Japan, rules of origin are adopted by the Ministry of Finance (MOF) in the form of administrative circulars (see chapter 6, section 3.1.1.2.). The rules are applied by Japanese customs. A decision by Japanese customs may be protested within two months. A negative decision on the protest may be appealed to the Minister of Finance. A decision of the latter may be appealed to the court.

A comparison of the country studies indicates that nonpreferential (and preferential) rules of origin are administered by customs authorities (but see sections 5. and 6.) and that the procedural system is most complete and transparent in the United States.⁶⁵ In particular, advance publication of draft Treasury Decisions ought to be singled out as a laudable practice that deserves adoption by other jurisdictions. Furthermore, the advance ruling procedure, which would become mandatory if the GATT Agreement on rules of origin were to be adopted, presently exists officially only in the United States. In the European Community, a ruling request is possible in practice. Finally, with the exception of the United States and Japan, satisfactory judicial review of nonpreferential origin determinations appears absent.

62. Gottlieb, chapter 5, section 4.9.

63. If no such determination is made, it is deemed to have been made thirty days after importation in accordance with the origin declared by the importer. Paraphrase of Gottlieb, Chapter 5, section 4.9.1.

64. Comment John Masswohl (13 July 1992).

65. On the other hand, U.S. practice, based largely on case law, makes it difficult to derive firm conclusions that might be applied to other similar, but not identical, cases. Comment of Friedl Mazal (21 May 1992); compare section 3.2.

3.2. Substantive law

The basic nonpreferential rule of origin in the United States is substantial transformation (chapter 2, section 3). Substantial transformation has been defined by the U.S. Supreme Court⁶⁶ as requiring the emergence from the manufacturing process of "a new and different article with a distinctive name, character or use."⁶⁷

From Palmeter's overview of case law, it would appear that the U.S. non-preferential rules of origin essentially use a technical test to determine whether substantial transformation occurs. This test is applied case by case. Palmeter notices that neither the courts nor the Customs Service have managed to come up with a consistent interpretation of the definition (chapter 2, sections 3.2.1.-3.2.2.3.).

An interesting question in the United States has been whether the policy objective of a statute should have a bearing on the degree of substantial transformation required to confer nonpreferential origin (see chapter 2, section 3.2.2.1. and section 4.2. of this chapter). In other words, should it make a difference for the degree of substantial transformation whether the origin is determined on the basis of the duty drawback provisions, the origin marking statute, MFN tariff rates, VRAs, textile quotas, etc.? In Palmeter's view, neither the administration nor the courts have been able to come up with an unequivocal answer to this question.⁶⁸

Article 5 of the EC basic non-preferential Origin Regulation provides that a product in the manufacture of which two or more countries were involved originates in the country in which

1. the last substantial process or operation,
2. that is economically justified was performed,
3. having been carried out in an undertaking equipped for the purpose and
4. resulting in the manufacture of a new product or representing an important stage of manufacture (see chapter 3, section 3.3.1.1.).

A review of product-specific origin regulations (chapter 3, sections 3.3.2.-3.3.2.11.) and judgments of the ECJ (chapter 3, sections 3.3.1.-3.3.1.7.) reveals that the EC institutions and the Origin Committee prefer the technical test for determining nonpreferential origin. Value-added percentages may be relevant, but

66. *Anheuser-Busch Brewing Association v. United States*, 207 U.S. 556 (1907), as quoted in chapter 2, section 1. *jo.* section 3.2.1.

67. *Ibid.*

68. See also section 7. While the United States in the Uruguay Round proposed uniform rules of origin for preferential and nonpreferential purposes, the European Community proposed uniform rules for all nonpreferential purposes.

only as a subsidiary factor when the technical test does not lead to a conclusive answer.⁶⁹ In the European Community, technical tests have sometimes had the effect of protecting domestic producers; the product-specific origin regulations with respect to zippers, integrated circuits, and photocopiers all resulted, advertently or not, in conferring Japanese origin on such products manufactured by Japanese companies in the European Community (zippers and integrated circuits) or in third countries (integrated circuits and photocopiers). The regulation for ball bearings might have had the same outcome, although this is not known to the author.

An informal opinion by the EC Origin Committee issued in connection with the product specific origin rule regarding radio and television receivers furthermore contains the arresting assumption that, for the purpose of applying the 45 percent value-added test, the cost of assembly, finishing and control plus profit and general costs are to be estimated as representing an aggregate of 40 percent of the ex-works invoice price of radio receivers and 35 percent of the ex-works invoice price of television receivers; that is for radios and televisions manufactured in the European Community and intended for export "given the relative homogeneity within the Community of the industry in question" (for the literal text of the opinion, see chapter 3, section 3.3.2.5.1.).

This is convenient for EC producers such as Philips, Grundig, and Thomson, that will have little trouble in reaching 45 percent value-added on the basis of the assumption that assembly costs *sensu lato* already represent 40 and 35 percent respectively. Foreign producers, on the other hand, wishing to export to the European Community free of trade restrictions such as antidumping duties and Article 115 quotas may not use this assumption but must calculate assembly and related costs on the basis of their actual situation. In low-cost countries such as South Korea, Thailand, Malaysia, Hong Kong, and China, assembly costs are in most cases far below the percentages assumed for the EC industry, and origin therefore effectively depends, at least for televisions, on the origin of the picture tube, which can easily represent 35 percent of the ex-works price.⁷⁰

Australian law stipulates as the general nonpreferential rule (for exceptions, see chapter 4, section 2.2.) that goods are the manufacture of the country where the last process of manufacture occurred, provided that not less than 75 percent of the factory or works cost of the goods is represented by the value of labor or materials

69. Chapter 3, section 3.3.1.7. Indeed, one could argue that even the product-specific origin regulations for radio and television receivers and tape recorders focus on a technical test by providing as the first test that assembly representing 45 percent value added confers origin.

70. Color picture tubes are produced in a limited number of countries only, such as Japan, Korea, the European Community, Malaysia, and China.

or of labor and materials of Australia and that country (see chapter 4, section 3.2.1. and section 2.2.). The 75 percent requirement may be reduced to 25 percent for goods of a kind not produced in Australia (see chapter 4, section 2.2.).

The Australian rule is interesting for several reasons. First, Australia is one of the few jurisdictions examined in this book that primarily relies on a domestic content test for determining nonpreferential origin, and a very high one at that. The manner in which the ACS calculates domestic content (see Table 3) is more restrictive than that of the European Community and as restrictive as the Canadian rule so that the Australian nonpreferential rules of origin are probably the most trade-restrictive of those examined here.

Second, the possible cumulation of third-country and Australian originating materials or the donor country concept,⁷¹ to borrow a GSP phrase, at first sight might appear to alleviate the high domestic content requirement, but it is also a blatant local content notion. And while the donor country concept does not necessarily violate GATT in the context of the GSP,⁷² it would certainly appear to run afoul of GATT's national treatment principle on the application of nonpreferential rules of origin.⁷³ The reason is that the concept stimulates Australian rather than third-country sourcing; it therefore puts Australian industry in a relatively advantageous position.

Finally, the possibility for Australian authorities to decrease the domestic content percentage from 75 to 25 percent in cases in which Australian industry does not produce the merchandise in question is commendable although probably devoid of meaning in practice: when certain products are not manufactured in the importing country, the origin of the imports is unlikely to become a significant issue.

Canada's MFN rules of origin (compare section 3.1.) also rely on a domestic content test but one appreciably lower than its Australian counterpart: at least 50 percent of the cost of producing (as defined in section 2.1.) the imported goods must be incurred in the country or countries that benefit from the MFN tariff or in Canada (see chapter 5, section 4.1.1.1.). The donor country concept therefore also surfaces in Canadian nonpreferential origin rules. However, as Canadian law allows unlimited cumulation between MFN countries, the national treatment problem would not appear to arise here.

71. Under the donor country rule, materials sourced in the preference-giving country may be counted as originating materials.

72. The legal basis for the GSP is a 1971 GATT waiver to the MFN obligation of Article I of GATT.

73. While at present rules of origin do not fall within the jurisdiction of GATT, the adoption of the Draft Agreement would necessitate changes in Australian law in this respect.

Japanese nonpreferential rules of origin are based on the CTH test with modifications in the form of a positive list⁷⁴ and a negative list of minimal processing operations.⁷⁵ Komuro points out (in chapter 6, section 3.1.3.1.) that nonpreferential rules of origin have not given rise to controversy in Japan, presumably because Japan has few discriminatory trade regimes, the enforcement of which depends on rules of origin.

4. Preferential Rules of Origin

The best-known preferential trading regime is the GSP. However, this book shows that all jurisdictions examined here, with the exception of Japan, have concluded a variety of preferential trading agreements, with the European Community leading the pack. In all instances, the preferential trade agreements contain their own sets of origin rules.

Preferential rules of origin are relevant only for determining whether products manufactured in the preference-receiving country qualify for preferential treatment. In other words, they are completely immaterial for determining whether the same products fall within the scope of trade-restrictive measures such as quotas, antidumping duties, etc.

For example, a determination whether compact disc players manufactured in Malaysia qualify for the GSP is made on the basis of the GSP preferential origin rules under which ASEAN-produced materials (for the United States, the European Community, or Japan) or all beneficiary countries' materials (for Australia or Canada) could be cumulated. A determination whether the Malaysian production of the same compact disc players by a Japanese producer constitutes third-country circumvention of antidumping duties imposed on compact disc players originating in Japan, on the other hand, will be made in the European Community and the United States on the basis of the nonpreferential origin rules (in which cumulation is not possible) or in the United States on the basis of the specially enacted third country circumvention provisions.

4.1. Procedure

United States procedure for nonpreferential and preferential rules of origin is the same (see chapter 2, section 4.1.).

74. Processing operations that confer origin even if they do not result in a CTH.

75. Processing operations that do not confer origin even if they do result in a CTH.

In the European Community, a distinction must be made between reciprocal or contractual preferential trade agreements, such as EFTA, and unilateral or autonomous preferential trade agreements, such as the GSP (see chapter 3, section 4.1.1.). For the former, origin-related decisions are made in joint committees in which all signatories participate; origin decisions concerning the latter are made by the Commission and the Origin Committee autonomously. With respect to judicial review, the system is the same as that set out in section 3.1. of this chapter.

In Australia (and Canada), an importer may request informal advice from the Customs Service to know in advance whether a certain importation could benefit from preferential treatment (see chapter 6, section 4.1.1.). However, the Customs Service would not consider itself bound by the advice.

A decision by the Customs Service not to accept a claim for preferential treatment may be appealed in three ways, assuming that the duty has been paid under protest. The first avenue is an appeal to the Administrative Appeals Tribunal, a quasi-judicial body (see chapter 6, section 3.1.1.). The scope of review covers manifest errors of fact or patent misconceptions of the law (see chapter 6, section 4.1.1.). Decisions of the Administrative Appeals Tribunal may be appealed to the federal court on points of law. Second, the owner of the goods may bring a direct appeal before the commonwealth or state courts, in which case such courts' review will cover the law and the facts. Third, prerogative writs may be brought in the High Court of Australia or one of the state supreme courts on errors of law.

Canadian law distinguishes between origin disputes arising from the U.S.-Canada FTA and disputes about other preferential origin rules. For the latter, the system is the same as the system described in section 3.1. for nonpreferential origin rules. For U.S.-Canada FTA origin issues, the situation is more complicated. At a first level, the importer may appeal to the Tariff and Values Administrator (TVA) within ninety days of the determination of the Customs Service or within two years if certain criteria are fulfilled. At a second level, the importer may request a further redetermination from the deputy minister of the DNR within ninety days of the TVA's redetermination or within two years under certain conditions. At the third level, the importer may go to the CITT (see chapter 5, section 4.9.4.). Decisions of the CITT may be appealed to the Federal Court of Appeal on questions of law.

In Japan, the institutional framework for the GSP, the only Japanese preferential regime, is similar to that of nonpreferential rules. However, Japanese customs has an advance ruling procedure under which responses given by customs remain valid for one year.

4.2. Substantive Law

Rather than going into detail about the myriad types of preferential origin rules, Tables 6-10 summarize such rules jurisdiction by jurisdiction.

A fundamental question for the operation of the GSP would appear to be whether GSP rules of origin ought to be stricter than nonpreferential rules of origin⁷⁶ (and stricter than those of other preferential trade regimes) (see section 7.1.).

For the United States, the European Community, and Japan, the answer appears to be positive. While U.S. nonpreferential origin rules only require a substantial transformation, the GSP rules require substantial transformation plus a — relatively low — 35 percent domestic content requirement;⁷⁷ cumulation possibilities are limited. In Japan, the nonpreferential CTH test is less austere than its preferential equivalents (i.e., double processing, value-added, and mixed tests).⁷⁸

In the European Community, GSP rules of origin are also clearly more stringent than nonpreferential rules of origin, and the ECJ has upheld this difference on the ground that stricter GSP rules

. . . may . . . be necessary to attain the objective of the generalized tariff preferences of ensuring that the preferences benefit only industries which are established in developing countries and which carry out the main manufacturing processes in those countries.⁷⁹

The European Community's 'concern' for the indigenous development of developing countries is somewhat contradicted by its reluctance to accept

76. Compare Palmeter's discussion in chapter 2, section 3.2.2.1., *supra*, about the possible linkage between the policy objective of a statute and the degree of substantial transformation required.

77. Of the appraised value.

78. Comment of Norio Komuro (26 May 1992).

79. Case 385/85, *S.R. Industries v. Administration des Douanes*, (1986) ECR 2929, as quoted in chapter 3, section 4.3.1.

cumulation among developing countries. In many cases, this implies the denial of GSP benefits for products that comprise materials of two or more developing countries.

TABLE 6. United States Preferential Origin Rules

Trade Regime	Origin Rule Elements
GSP	<ul style="list-style-type: none"> -Substantial transformation and local direct cost added of 35% of the appraised value -Dual substantial transformation possible^a -Full and regional cumulation possible among members of free trade associations^b -Direct consignment rule
CBI ^c	<ul style="list-style-type: none"> -Substantial transformation and local direct cost-added of 35% of the appraised value -Dual substantial transformation possible -Unlimited cumulation possible among all CBI beneficiaries -Limited donor country benefit^d -Direct shipment from any CBI beneficiary possible
Insular possessions ^e	<ul style="list-style-type: none"> -Local direct cost added of 30% of the appraised value for articles eligible for CBI preferences -Local direct cost added of 50% of the appraised value for other articles -Unlimited donor country benefit
Freely associated states ^f	<ul style="list-style-type: none"> -Local direct cost added of 35% of the appraised value -Direct shipment rule
U.S.-Israel FTA	<ul style="list-style-type: none"> -Local direct cost added of 35% of the appraised value -Dual substantial transformation possible -Limited donor country benefit^g -Direct shipment rule
U.S.-Canada FTA	<ul style="list-style-type: none"> -CTH rule^h and/or 50% domestic content test -Donor country benefit in case of domestic content test

Source: Chapter 2, sections 4.2.1.1.-4.2.1.6.; Digest of the Rules of Origin, UNCTAD/TAP/133/Rev. 6 (1990).

Note:

^a If an imported raw material is itself substantially transformed in the developing country into an intermediate article that is itself a new and different article, that intermediate article

has 100 percent developing country origin. Paraphrase of chapter 2, § 4.2.1.1. This dual transformation possibility is quite logical and would appear to be followed by the other jurisdictions too (see, e.g., chapter 3, § 4.2.1.2. and Consultations on Harmonization and Improvement of the Rules of Origin, Report by the UNCTAD Secretariat, TD/B/C.5/141, at 5 (1992)).

^b The United States accepts cumulation from the following free trade associations: ANDEAN (Cartagena Agreement — Bolivia, Colombia, Ecuador, Peru, Venezuela), ASEAN (Indonesia, Malaysia, Thailand Philippines) with the exception of Brunei Darussalam and Singapore, and CARICOM (Caribbean Common Market — Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guiana, Jamaica, Montserrat, Saint Christopher-Nevis, Saint Lucia, Saint Vincent and the Grenadines, and Trinidad and Tobago).

^c Twenty-seven Central American and Caribbean Nations.

^d Up to 15 percent of the value of U.S. raw materials imported and substantially transformed in a CBI country may be included in the 35 percent domestic content (see chapter 2, § 4.2.1.2.).

^e Guam, Wake Island, Midway Islands, Kingman Reef, Johnston Island, American Samoa, and Commonwealth of the Northern Mariana Islands.

^f Marshall Islands, Federated States of Micronesia.

^g Up to 15 percent of the value of U.S. raw materials imported and substantially transformed in Israel may be included in the 35 percent domestic content (see chapter 2, § 4.2.1.2.).

^h Palmeto, in chapter 2, § 4.2.1.6. points out that the change may vary from a two-digit chapter level change to an eight-digit national tariff line change.

Another interesting example of the restricted character of the European Community's GSP origin rules is the requirement for many electronic products such as microphones, and audio and video equipment that all transistors be originating products.⁸⁰ Ostensibly designed to prevent the use of too many Japanese transistors, the rule in practice often results in denial of GSP benefits because many transistors are made only in Japan. Nor does the rule help the EC transistor industry because the European Community does not presently recognize the donor country concept and does therefore not stimulate the use of European Community-originating transistors. It can be noted that the transistor rule has disappeared from most of the European Community's other preferential sets of rules of origin (see also section 7).

80. See Commission Regulation (EEC) No. 693/88 of 4 March 1988 on the definition of the concept of originating products for purposes of the application of tariff preferences granted by the European Economic Community in respect of certain products from developing countries, O.J. (1988) L 77/1.

In view of the strict requirements and the complexity of the EC scheme, it is hardly surprising that the utilization rate of the European Community's GSP is apparently as low as 21 percent!⁸¹

81. As noted by Waer, in chapter 3, section 4.4. with footnote reference. Komuro, in chapter 6, Annex 3.2., observes that the Japanese GSP utilization ratio was 57.4 percent in 1986 and 48.3 percent in 1990. Keizer (letter of 22 May 1992) states that the European Community's GSP utilization rate is actually closer to 50 percent and mentions as possible reasons for the discrepancy between the figures (1) the ACP treatment and (2) the quota system for sensitive products.

TABLE 7. European Community Preferential Origin Rules

Trade Regime	Origin Rule Elements
GSP	-Sufficient working or processing, expressed as CTH test, ^a technical test or import content test ^b -Partial and regional cumulation among certain regional groupings ^c -No donor country benefit -Direct consignment rule
EFTA ^d	Same except -Donor country benefit -Cumulation among EFTA countries under certain conditions
ACP countries ^e	Same except -Donor country benefit -Regional cumulation possible -Direct shipment from ACP countries
Mashreq ^f	Same except -Donor country benefit -No cumulation
Maghreb ^g	Same except -Donor country benefit -Regional cumulation possible
Cyprus	Same except -Donor country benefit
Israel	Same except -Donor country benefit
Malta	Same except -Donor country benefit
Slovenia, Croatia, Bosnia-Herzegovina, Macedonia (and Montenegro) ^h	Same except -Donor country benefit
OCTs ⁱ	Same except -Donor country benefit -Regional cumulation possible
Faroe Islands	Same except -Donor country benefit
Ceuta, Melilla, and Canary Islands ^l	Same except -Donor country benefit -Regional cumulation possible
Territories occupied by Israel	Same except -Donor country benefit
Hungary, Poland, and Czechoslovakia	Same except -Donor country benefit -Regional cumulation possible

Source: Chapter 3, sections 4.1. - 4.4.; Digest of the Rules of Origin, UNCTAD/TAP/133/Rev. 6 (1990).

Note:

^a Imported materials, parts, or components are considered to have undergone sufficient working or processing when the product obtained is classified in an HS heading at the four-digit level that is different from those in which all nonoriginating materials, parts or components used in the process are classified *see* Digest of the Rules of Origin, at 6.

^b See chapter 3, § 4.2.1., where Waer also observes that value-added percentages may differ depending on the product and may sometimes be combined with, for example, a value-of-parts test, the obligatory use of certain inputs, or both. The EC value-added tests in the GSP context use the maximum import content method.

^c The European Community in theory accepts cumulation from the following free trade associations: ANDEAN (Cartagena Agreement — Bolivia, Colombia, Ecuador, Peru, Venezuela), *see* O.J. (1983) L 372/63; ASEAN (Brunei, Indonesia, Malaysia, Thailand, Philippines, Singapore), *see* O.J. (1983) L 372/57; and CACM (Central American Common Market — Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua), *see* O.J. (1983) L 372/60. However, in practice, only ASEAN and ANDEAN cumulation is accepted, and this only since 1989 and 1992, respectively. The reason why cumulation among the CACM members is not accepted is that this bloc apparently has not yet complied with the administrative cooperation requirements laid down in Articles 6, 7, and 8 of the relevant Commission Regulation.

^d Austria, Sweden, Switzerland, Iceland, Norway, Finland, and Liechtenstein.

^e For more detail, see Inama, Handbook on Lomé IV Convention, UNCTAD/ITP/61 (1991).

^f Syria, Jordan, Lebanon, and Egypt.

^g Tunisia, Morocco, and Algeria.

^h Montenegro's position at the moment of writing was still under consideration.

ⁱ For more detail, see Inama, *supra* note e.

^j The Canary Islands are presently part of the customs territory of the European Community. The preferential treatment applies only with respect to agricultural products.

TABLE 8. Australian Preferential Origin Rules

Trade Regime	Origin Rule Elements
GSP	-Last process -50% factory or works cost -Full and global cumulation among GSP beneficiaries -Donor country benefit -No direct shipment rule
CANATA	-75% factory or works cost -Direct shipment rule
Australia-Papua New Guinea	-Last process -50% factory or works cost -Donor country benefit
SPARTECA	-Last process -50% factory or works cost -Donor country benefit
ANZCERTA	-Last process -50% factory or works cost -Donor country benefit -Direct shipment rule

Source: Chapter 4, sections 2.1.-2.1.6.; Digest of the Rules of Origin, UNCTAD/TAP/133/Rev. 6 (1990).

Although Australian and Canadian GSP rules of origin require domestic content ratios of 50⁸² and 60⁸³ percent respectively, the unlimited cumulation and donor country content possibilities in both schemes would appear to make up for this. The liberal Australian and Canadian rules should serve as an example for U.S., EC, and Japanese practice as there does not appear to be any logical basis for restrictive cumulation rules and, indeed, the latter arguably frustrate GSP objectives.⁸⁴

82. Of the factory cost.

83. Of the ex-factory price.

84. *Compare* Consultations on Harmonization and Improvement of the Rules of Origin, Report by the UNCTAD Secretariat, TD/B/C.5/141, at 21, 22 (1992).

TABLE 9. Canadian Preferential Origin Rules

Trade Regime	Origin Rule Elements
GPT ^a	Value of imported parts and materials from nonbeneficiary countries may not exceed 40% of the exfactory price ^b Full and global cumulation among GPT beneficiaries Donor country benefit Finishing in beneficiary Direct shipment rule
LDDC ^c	Same except Value of imported parts and materials from non-LDDC countries may not exceed 60% of the exfactory price ^d Unlimited cumulation among LDDC beneficiaries
CARIBCAN ^e	Same except Cumulation among CARIBCAN countries
BPT	50% cost of production Cumulation among beneficiaries Finishing in beneficiary Direct shipment rule (transshipment through nonCommonwealth port is not allowed)
A & NZ	50% cost of production Donor country benefit Finishing in beneficiary Direct shipment rule Cumulation is not possible
U.S.-Canada FTA	CTH rule, ^f 50% domestic content test, or both Donor country benefit in case of domestic content test

Source: Chapter 5, sections 4.3.-4.8.; Digest of the Rules of Origin, UNCTAD/TAP/133/Rev. 6 (1990).

Note:

^a General Preferential Tariff (= GSP).

^b The exfactory price may include overhead expenses, royalties and profit to the extent that they are reasonable. This is therefore different from the cost-of-production test used under the other Canadian preferential rules.

^c LDDC Tariff.

^d Digest of Rules of Origin, at 9.

^e CARIBCAN Tariff

^f Palmeto, in chapter 2, § 4.2.1.6. points out that the change may vary from a two-digit chapter level change to an eight-digit statistical level change.

TABLE 10. Japanese Preferential Origin Rules

Trade Regime	Origin Rule Elements
GSP	Value of imported parts and materials may not exceed 40% or 45% of the FOB price; CTH test; double processing test or mixed test Partial and regional cumulation for ASEAN countries Donor country benefit Direct shipment rule

Source: chapter 6, section 4.1.2.

5. Rules of Origin in the Context of Antidumping Proceedings

Practically all the authors in this volume note that the increased use of antidumping measures has had repercussions for the formulation c.q. the application of rules of origin and — directly or indirectly — has largely been responsible for the present controversy about the use of origin rules as commercial policy instruments.⁸⁵ This is perhaps not surprising with the emergence of the antidumping law as the single most important trade policy instrument of the 1980s and 1990s.⁸⁶

The reason is first of all that antidumping proceedings are normally initiated against and antidumping duties imposed on products originating in a certain country, although the GATT-basis for this practice is uncertain.⁸⁷ This practice requires the importing country authorities in charge of the administration of the antidumping law to make judgments about the origin of the products that are under investigation or that are subject to antidumping duties.

Second, antidumping complaints must be brought by the importing country industry producing the like product. In an increasing number of antidumping proceedings, foreign producers and their importers question whether the production processes carried out by the domestic industry in the importing country actually are sufficient to confer origin on the merchandise produced.

Third, a number of circumvention problems are solved through the use of rules of origin.

Most countries investigated in this study use a double, if not triple, standard: on the one hand, most administrators of the antidumping law take the position that

85. See also Vermulst and Waer, *supra* note 8, and Vermulst and Waer, *supra* note 9.

86. See John H. Jackson and Edwin A. Vermulst, eds., *ANTIDUMPING LAW AND PRACTICE: A COMPARATIVE STUDY*, (ANN ARBOR: THE UNIVERSITY OF MICHIGAN PRESS, 1989).

87. For a detailed analysis of the GATT framework, see Vermulst and Waer, *supra* note 8 and Vermulst, Waer, *supra* note 9.

antidumping duties ought to be imposed on products originating in a foreign country. On the other hand, these same administrators are reluctant to use rules of origin in order to determine whether importing country complainant producers actually qualify as a domestic industry. (Yet another, third, test is used to determine whether importing country producers related to the foreign producers with respect to whom antidumping duties were imposed are circumventing the antidumping duties.)

This two-headed snake approach is condoned by the draft GATT Agreement on rules of origin which provides in Article 1:2 that the agreement applies to antidumping proceedings but then immediately makes an exception in footnote 2 stipulating that the article is without prejudice to determinations made for the purpose of defining the domestic industry.⁸⁸ In the United States, as in the European Community, cases are brought against and residual duties imposed on products originating in a specified country. The Department of Commerce is in charge of the enforcement of antidumping duties and U.S. Courts have held that Commerce — for antidumping law enforcement issues — has the authority to make origin determinations that may differ from those issued by the Customs Service and the Treasury Department. Thus, while for Department of Treasury purposes the origin of semiconductors depends on the locus of assembly and testing, for Commerce Department antidumping purposes the origin depends on the diffusion process.⁸⁹ To make matters more complicated, to determine whether importing country or third country circumvention occurs, the Commerce Department would examine whether the difference between the value of the completed product and the components or materials from the country subject to the duty is small. Palmeto appropriately terms this the "heads-we-win, tails-you-lose" factor (see chapter 2, section 5.).

As far as the definition of the domestic industry is concerned, it may be noted that the Commerce Department has dismissed a small number of antidumping petitions, including the controversial *Brother* case, on the ground that they were filed not by producers, but by assemblers.⁹⁰

88. Draft Agreement *supra* note 1. Compare chapter 8 section 2.

89. Surprisingly, when the European Community was in the process of adopting a product specific rule for semiconductors that focused on diffusion, it encountered vociferous opposition from the United States, although the U.S. Commerce Department had previously adopted the same rule for antidumping purposes: at least the EC rule was consistent for all trade policy purposes.

90. See also, e.g., Latchet Hook Kits from the United Kingdom, 45 Fed. Reg. 81,241 (1980) (dismissal petition).

In the European Community, third-country circumvention is judged on the basis of the nonpreferential origin rules (for more detail, see chapter 3, section 5.1.2.). In 1986, for example, the Commission terminated an antidumping proceeding initiated against the Taiwanese production operations of the Japanese producer Brother on the ground that the typewriters produced in Taiwan had not acquired Taiwanese origin;⁹¹ as a result, the EC Member States applied antidumping duties (retroactively). At the moment of this writing, six years later, Brother is still involved in litigation in at least two EC Member States.⁹² More recently, in a case involving compact disc players from Malaysia and Singapore, the Commission is again suggesting that anti-dumping duties be applied retroactively on the basis that locally produced CDPs did not obtain local origin, but rather had Japanese origin.

Importing country circumvention, on the other hand, was appraised in the European Community on the basis of a 60/40 percent value-of-parts test from 1987 to 1989 until a GATT panel ruled in 1990 that the application of the EC test was GATT illegal. More or less simultaneously, the EC Commission in a number of cases, notably *Photocopiers*,⁹³ decided to include EC producers in the definition of the domestic industry not on the basis of origin rules or the parts test but rather on vague grounds such as the producers' intentions to increase local value-added or their long-term commitment to investment and employment in the Community.

The Photocopiers proceeding offers a good illustration of the confusing EC tests: in the course of the administrative proceeding, serious questions were raised about the (lack of) local sourcing of the main EC complainant Rank Xerox. However, Rank Xerox promised to increase local sourcing and was therefore included in the definition of the EC industry. After the conclusion of the proceeding, a parts investigation was opened against the Japanese producers' manufacturing operations in the European Community in which the existence of circumvention was determined on the basis of the 60/40 percent value-of-parts test; Rank Xerox, which had links with the Japanese producer Fuji Xerox, was excluded from the investigation. Mita's and Ricoh's production operations in Hong Kong and California respectively were also investigated, but this time by Directorate-General XXI of the EC Commission, which used the nonpreferential origin rules to effectively determine whether Mita and Ricoh were circumventing the antidumping duties imposed with respect to Japan. In the case of Ricoh, the Commission issued

91. Typewriters from Taiwan, O.J. (1986) L 140/52 (termination).

92. The Netherlands and Germany. It would appear that litigation in the United Kingdom was recently stopped with Brother agreeing to pay a certain amount of antidumping duties. Comment of Wim Keizer (22 May 1992).

93. Photocopiers from Japan, O.J. (1987) L 54/22.

a regulation that held that assembly accompanied by the manufacture of the harness, drum, rollers, side plates, roller bearings, screws, and nuts (i.e., the production processes performed by Ricoh in California at that time) in any event did not confer origin.⁹⁴ This regulation was the main reason for the United States⁹⁵ and Japan to insist in the Uruguay Round negotiations that negative origin rules should not be allowed under the Draft Agreement.

The EC antidumping proceeding concerning SCTVs from Hong Kong (see chapter 3, section 5.1.1.) offers a good illustration of the type of problems that can arise as a result of antidumping duties being imposed on countries of origin and would seem to have perplexed even the EC Commission: the Commission admitted in so many words that its investigation revealed that the SCTVs produced in Hong Kong did not have Hong Kong origin, but then proceeded to impose antidumping duties on the Hong Kong producers with the caveat that Member States' "customs authorities . . . may determine an origin which differs from that which is declared" (read, may impose the residual antidumping duty applicable to South Korea if the SCTVs are in fact of Korean origin or may impose no duty at all if, for example, the SCTVs have Japanese, Malaysian, or EC⁹⁶ origin). Waer (in chapter 3, section 5.1.1.) correctly points out that the case "effectively is a story of certain Hong Kong producers cooperating in the wrong procedure." One might add, and of the Commission imposing nonsensical antidumping duties.

In Australia, rules of origin thus far do not appear to have given rise to great controversy in connection with antidumping measures. This seems the result of the following factors:

- Importing country circumvention is unlikely because of the small market, isolated position, and labor conditions of Australia (see chapter 4, section 5.1.).
- The starting point for dumping margin calculations is the country of export as opposed to the country of origin.⁹⁷

94. Commission Regulation (EEC) No. 2071/89 of 11 July 1989 on determining the origin of photocopying apparatus, incorporating an optical system or of the contact type, O.J. (1989) L 196/24.

95. The United States presumably saw further Japanese investment in the United States jeopardized.

96. If the Hong Kong producers were to use EC-originating color picture tubes, the SCTVs would arguably have EC origin on the basis of the subsidiary 35 percent value-of-parts test.

97. See chapter 4, section 5.3. Where the country of export and the country of origin differ, it may be decided by the Minister to base normal value on prices or costs in the country of origin. This happened only once (see chapter 4, footnote 79). In Xlpe cable, the ACS

-Australia has imposed company-based antidumping duties⁹⁸ when industrial products were concerned.⁹⁹

The second and third factor combined would seem to indicate that duties are typically imposed on merchandise exported from country X by producer x. If producer x then sets up a joint venture plant x/y in and starts exporting from country Y, presumably the ACS would require a new complaint against the merchandise exported by company x/y from country Y.

In contrast, the Canadian authorities have been confronted with globalization problems in a multitude of cases, perhaps because of Canada's proximity to the United States, and Gottlieb gives a very comprehensive overview of the problems faced and solutions found by the Canadian authorities in chapter 5, section 5.1.-5.3.7.

With respect to the definition of the domestic industry, the Canadian authorities would appear to adopt the most elastic attitude of the jurisdictions examined here by holding repeatedly that mere assembly is sufficient for a producer to qualify as (part of) the domestic industry (see the examples in chapter 5, section 5.3.3.1.).

Importing country circumvention does not appear to have been a major problem in Canada, presumably because of the widespread practice of Canadian industry to file cases not only against finished products, but also against parts and components.¹⁰⁰

With respect to third-country circumvention, Gottlieb (in chapter 5, section 5.3.2.1.) cites one instance of the DNR attempting to assess antidumping duties on third country production on the ground that the value-added in the third country (the United States) was insufficient and the products therefore continued to have Japanese origin.

Finally, it appears that Canadian antidumping law provides the Canadian industry with substantial discretion to sculpt the targets of the proceeding and that cases may be initiated against products originating in, exported from, originating in or exported

terminated an antidumping proceeding initiated against Xlpe cable allegedly exported from Singapore on the ground that the product was not exported from Singapore but from Korea.

98. Country-based duties are imposed in Australia essentially where the products under investigation are commodities or where the goods are exported from nonmarket economies (see chapter 4, section 5.4).

99. See chapter 4, section 5.4. Multicountry sourcing is more likely in the case of industrial products.

100. This raises certain unique problems with respect to the injury determination (see chapter 5, sections 5.3.3.3.-5.3.6.).

from, produced by or on behalf of company x, imported from, supplied by or otherwise introduced into the commerce of Canada by or on behalf of company y, etc. While this possibility to focus on specific companies at first sight may seem bizarre and certainly subject to abuse, Gottlieb pointedly draws our attention to the other side of the coin: "[c]ountries do not dump; individuals do." (see chapter 5, section 5.3.7.). This elementary truth has indeed been almost forgotten under the residual duty practice of the United States and the European Community.

Japan has adopted antidumping measures only once thus far, but rules of origin did not play a role of importance in that case (see Komuro, chapter 6, section 5.1.1.)

6. Rules of Origin in Other Contexts

Rules of origin also play a role in the application of marking, labelling, and false or misleading advertising laws; duty drawback provisions; government procurement; process patents; countervailing duty and safeguard proceedings; quantitative restrictions; prohibited imports; trade embargoes; and services.

In all these areas, they can stir controversy and have on occasion done so (see chapter 2, section 6., chapter 3, sections 5.2.-5.4., chapter 4, section 6., Chapter 5, sections 6.-7., and chapter 6, section 6.). One need only think of the Nissan Bluebird dispute in the European Community which is discussed in detail in other parts of this book (see chapter 3, section 6. and chapter 8, section 1.).

The French position in the Nissan dispute and initial dubious interpretations by the EC Commission of Article 13 (10) of the basic Antidumping Regulation¹⁰¹ have created the misunderstanding that a certain amount of local content¹⁰² is needed for EC plants to export to other parts of the EC *c.q.* to avoid importing country circumvention. Suffice it here that the French position was utterly illegal under EC law, first because the French quota on Japanese cars was illegal and second because once products are in free circulation in the EC, as was the case with the Nissan cars produced in the United Kingdom, Community origin is irrelevant.

Komuro pays extensive attention (chapter 6, section 6.) to the Japanese FTC's application of rules of origin in the context of origin marking laws and raises the interesting question whether Japanese and U.S. Federal Trade Commission origin marking requirements fall under the purview of the Draft Agreement on rules of origin. He tentatively concludes that the answer depends on whether such requirements constitute origin marking requirements within the meaning of Article IX of GATT.

101. With respect to the conditions for the acceptance of "parts" undertakings.

102. The French argued for 80 percent in the case of Nissan.

7. Conclusions and Recommendations in the Light of the Draft Agreement

Until a few years ago, rules of origin were an obscure area of law in which legal processes were by and large absent and government officials agreed in *in camera* sessions on both policy formulation and policy implementation. Discussions about rules of origin were felt to be a government affair in which private companies, let alone foreign companies, had no standing. The lack of interest was fuelled by the widespread perception of rules of origin as technical rules applied by technicians on the basis of technical considerations. This conceivably explains why the GATT drafters did not deem it worthwhile to include provisions on rules of origin and rather leave it

. . . within the province of each importing member country to determine, in accordance with the provisions of its law, for the purpose of applying the most-favoured-nation provision [and for other GATT purposes, EAV], whether goods do in fact originate in a particular country.¹⁰³

While some lackadaisical efforts were made in a variety of fora¹⁰⁴ to agree on certain common principles in the period from 1947 to 1989,¹⁰⁵ none of these were particularly successful. For a variety of reasons,¹⁰⁶ not least of all the realization that certain recent formulations and interpretations of origin rules by the European Community¹⁰⁷ and the United States were politically motivated and had trade-restrictive or -distortive ramifications, a number of countries agreed fairly late in the Uruguay Round that an agreement on rules of origin would be worthwhile and consensus on a concept Agreement¹⁰⁸ was reached surprisingly fast. The Draft

103. JACKSON, *WORLD TRADE AND THE LAW OF GATT* 468 (1969).

104. Such as UNCTAD, the OECD, the CCC and GATT. For more detail, see *The Impact of Rules of Origin on U.S. Imports and Exports*, Report to the President on Investigation No. 332-192 Under Section 332 of the Tariff Act of 1930, USITC, at 70-72 (1985).

105. In fact, in 1922 the League of Nations had already adopted a convention on the simplification of customs procedures that contained provisions on rules of origin.

106. See Vermulst and Waer, *supra* note 8, at 55-57.

107. Compare Hindley, *Foreign Direct Investment: The Effects of Rules of Origin* (1990).

108. *Supra* note 2.

Agreement provisions are analyzed in chapter 7, section 2. The remainder of this chapter therefore focuses on some of the salient issues raised by authors in this book and reviews to what extent the Draft Agreement satisfactorily addresses such points.

7.1. The Policies of Rules of Origin

Should rules of origin be different depending on the policy objective of the law that they support? This is a fundamental issue that touches the core of the discussion whether rules of origin merely support other trade discriminatory measures or in fact qualify as discriminatory measures themselves and therefore can be used as trade policy instruments. Palmetier discusses this issue in detail with respect to nonpreferential U.S. rules of origin (see chapter 2, section 3.2.2.1.), although it is relevant to all jurisdictions and to the administration of both nonpreferential and preferential rules of origin.

To analyze this issue, it might be useful to distinguish between policy formulation and policy implementation of rules of origin.

At the policy formulation level, all jurisdictions examined here substantively distinguish between preferential and nonpreferential origin determinations and, with the exception of Japan, also differentiate among preferential trading regimes. Regarding the latter, the rationale appears to be that more relaxed rules of origin might be appropriate for those preference-receiving countries with respect to whom the preference-giving jurisdiction has closer economic or political ties. Thus, for example, the EC rules of origin that apply to ACP countries and OCTs allow donor country benefit and full global cumulation possibilities among preference-receiving countries while under the European Community's GSP rules of origin only partial regional cumulation is possible. Clearly, the result is that the same origin rule is easier to satisfy for an ACP country or an OCT than for a GSP beneficiary. This type of differential treatment could be classified as methodological discrimination.

Another example, this time of what one might call discriminatory severity of the rules themselves: under the EC GSP rule of origin for televisions, (1) the value of all the materials used may not exceed 40 percent of the ex-works price of the television (import content test), (2) materials classified within heading No. 8529 may be used only up to a value of 5 percent of the ex-works price of the television (obligatory input test), (3) the value of non-originating materials used may not exceed the value of the originating materials used (value-of-parts test), and (4) all transistors of heading No. 8541 must be originating products (obligatory input test). In contrast, the ACP rule of origin for televisions only requires (1) that the value of the materials used does not exceed 40 percent of the ex-works price of the television and (2) that the value of all the non-originating materials used does not exceed the value of the originating materials used. Thus, a Zaire producer may use as many Japanese or

EC¹⁰⁹ transistors as it wants, but if a Bangladesh producer uses even one, it loses any possibility to claim GSP benefits: *quod licet ACP, non licet GSP*.

Such methodological discriminations and disparities in the stringency of the rules at the policy formulation level amount to an implicit recognition by administering authorities that rules of origin may and in fact do have trade-distortive effects.

They also show the hypocrisy behind policy statements in some jurisdictions that (certain types of) preferential origin rules are designed to help genuine local development: a foreign investor would have to source more local materials in Bangladesh than in Zaire and, *mutatis mutandis*, would therefore chose Zaire over Bangladesh to set up a plant. If anything, the rules are an expression of nepotism fashioned to foster foreign investment in certain countries rather than others.

The nonneutrality of nonpreferential rules of origin at the policy implementation level is most clear in the United States, where administrative determinations and a number of court judgments indicate that the degree of substantial transformation may differ depending on the policy purpose of the underlying statute.¹¹⁰ While nonpreferential origin rules in the European Community are the same for all policy purposes, it cannot be denied that certain product-specific origin regulations such as the ones on zippers, integrated circuits, and photocopiers, benefitted EC industry and worked to the disadvantage of Japanese producers. In both the United States and the European Community, the potential for trade-restrictive interpretations of nonpreferential rules of origin seems closely connected to the blurry "substantial transformation" respectively "last substantial process" criterion.

The Draft Agreement on rules of origin provides that, at least at the end of the three year transitional period, signatories should use the same rules of origin for all purposes and therefore provides a conclusive answer to the still ongoing U.S. discussion in the nonpreferential area.¹¹¹ The successful harmonization of nonpreferential origin rules in the CCC (see sections 7.2.-7.3) will furthermore presumably lead to the abolition of the opaque U.S. and EC standards and replace them with the CTH test, at least as the general rule.

109. Donor country benefit!

110. With respect to origin for antidumping purposes, see the separate discussion in sections 7.7. and 7.8.

111. Article 3 (a), *supra* note 1. This provision would appear to target the United States and arguably would prohibit the U.S. Customs Service and the Commerce Department from adopting differing rules of origin. Although, with regard to Japan's rules of origin, a discrepancy between Custom's rules and MITI's rules for import control of *silk woven fabrics* from China exists, this has not given rise to any controversy at international levels. See chapter 6, section 3.2.2.1.2.

Unfortunately, the Draft Agreement itself starts from the fallacious perception that the drafting of rules of origin is a technical matter.¹¹² This is likely to give rise to profound problems in the CCC negotiations on harmonization.

Furthermore, the Agreement will not be applied to preferential rules of origin. While opinions differ regarding the desirability and, indeed, the possibility of bringing preferential rules of origin within the ambit of the Draft Agreement,¹¹³ it cannot be contested that the epidemic and expanding establishment of preferential trading blocs creates a major loophole in the applicability of the relevant Draft Agreement provision. The Common Declaration¹¹⁴ clearly will not close this gap.

In the view of this author, it is regrettable that the chance has been missed to bring some uniformity in the formulation of preferential origin rules (see sections 7.5.-7.6. for more detail). Such rules are effectively used at the policy formulation level to pursue trade, investment, and sourcing policies, particularly in the European Community and the United States, in manners that distort an efficient globalization.

In summary, at the policy formulation level, all jurisdictions examined in this book use rules of origin to pursue policy purposes, and the Draft Agreement is unlikely to solve this. At the policy implementation level, the vague definitions in U.S. and EC non-preferential origin rules have led to trade-restrictive or -distortive interpretations. However, the adoption of the Draft Agreement and subsequent successful CCC harmonization can prevent this from occurring in the future.

7.2. Harmonization of Nonpreferential Origin Rules in the Customs Cooperation Council

It has been agreed in the Draft Agreement that nonpreferential rules of origin will be harmonized in the CCC in Brussels. Fully harmonized rules of origin present an enormous benefit for transnational enterprises, which typically would set up low-end production facilities in low-cost developing countries and high-end production facilities in high-cost developed countries and export from such production bases to the rest of the world (globalized production philosophy). Rational advance sourcing and production planning would allow such transnationals to simultaneously comply with different countries' nonpreferential rules of origin.

112. Comment Friedl Mazal (21 May 1992).

113. Navarro, see chapter 7, section 2.1., for example, argues that "a harmonization of preferential rules of origin seems rather difficult, given the individuality intrinsic to the preferential rules of origin."

114. Annex II to the Draft Agreement, *supra* note 1.

It should be noted, however, that the present time schedule, which foresees completion of the harmonization efforts at the end of a three-year period seems highly unrealistic and is unlikely to be met, not in the least because of the diminutive staff and meagre resources of the CCC.

7.3. Change in Tariff Heading as the Basis for Harmonization

The Draft Agreement stipulates that harmonization negotiations in the CCC will use the HS CTH test to the extent possible.¹¹⁵ However, experience with the U.S.-Canada FTA origin rules, Japanese nonpreferential origin rules and the EC's preferential origin rules, all three of which also predominantly use the CTH test, makes exclusive reliance on the CTH approach unlikely. Combination with a technical test, a percentage criterion, or both, in many instances will be unavoidable.

It is important for developing/low-cost countries to realize before the negotiations in the CCC start that both tests have a great potential for protectionist applications and that major trading units such as the United States, the European Community and Japan¹¹⁶ are in the process of preparing for the negotiations; they have, for example, already asked domestic industries for their recommendations on the contents of possible harmonization rules. Developing/low-cost countries should prepare for the harmonization negotiations well in advance not to be presented with *faits accomplis* in the negotiating process.

115. Article 9 (2) (ii), *supra* note 2.

116. See the extensive discussion in chapter 6, section 7. about efforts currently being undertaken in Japan.

7.4. Harmonization of Percentage Criterion Calculation Methods

This study has shown enormous differences between jurisdictions with respect to (1) the numerator and (2) the denominator to be used in calculating percentage criteria and (3) the maximum allowable percentage of nonoriginating parts and materials (import content test) or the minimum percentage of domestic content (domestic content test).¹¹⁷ Clearly, any CCC attempts at harmonization that partly rely on the use of percentage criteria will be undermined by a failure to harmonize underlying calculation methods. The CCC negotiations ought to take this into account.¹¹⁸

In section 2.1., I argued that EC and Japanese domestic content and import content calculation methods seem most logical and appear to follow Kyoto Convention recommendations most closely; EC and Japanese rules might therefore serve as a basis for harmonization.

7.5. Harmonization of the General System of Preferences?

Preference-receiving countries have been pointing out since 1970, i.e. almost since the inception of the GSP, that the lack of GSP harmonization is a "major (and also inadvertent) barrier to GSP trade."¹¹⁹ However, while such countries have been pressing for increased harmonization of GSP origin rules for more than two decades now, the present study¹²⁰ shows that, as of 1993, marked differences exist between donor countries' implementation of the GSP system.

Fundamental issues such as broad (Australia, Canada) or narrow (United States, European Community, Japan) cumulation, (non)acceptance of the donor country principle and more (United States, European Community, Japan) or less (Australia, Canada) strict origin requirements for GSP qualification would appear to have a direct bearing on the possible utilization rates by beneficiary countries. With respect

117. In 1982, the CCC already made a proposal to use a uniform 50 percent maximum. See CCC, Permanent Technical Committee, Rules of Origin of Goods, Secretariat Note, 29.215E T7-3231 (2 November 1982). However, this proposal was never acted on.

118. Article 9 (2) (iii) of the Draft Agreement, *supra* note 1 merely provides that if the ad valorem criterion is prescribed, the method of calculating this percentage shall also be indicated in the rules of origin.

119. Consultations on Harmonization and Improvement of the Rules of Origin, Report by the UNCTAD Secretariat, TD/B/C.5/141, at 1 (1992).

120. *See also* Consultations on Harmonization and Improvement of the Rules of Origin, Report by the UNCTAD Secretariat, TD/B/C.5/141 (1992).

to the GSP, the devil lies in the details, and methodological and substantive details are arguably used by donor countries to covertly protect sensitive products by means of unrealistically high origin requirements. With respect to methodology, the United States, the European Community, and Japan ought to rethink their limited cumulation possibilities, which clearly affect inter-developing country integration.¹²¹

An obvious forum for the harmonization of GSP rules is the UNCTAD, the force behind the establishment of the GSP and the institution where discussions about the efficacy of and improvements in GSP schemes take place almost continuously.

A recent UNCTAD Secretariat Report,¹²² distinguishes between limited harmonization (i.e., harmonization of existing differences within and between the various versions of the process criterion and the percentage criterion, and full harmonization (i.e., an additional choice for either the process criterion or the percentage criterion by all preference-giving countries).

The report tentatively concludes that a percentage criterion based upon import content is preferable because of "its simplicity and straightforwardness"¹²³ and might therefore form the best foundation for full harmonization.

One might wonder whether this conclusion is sufficiently thought through. First of all, the import content percentage criterion will necessarily leave importing country administrators discretion on how to value imported parts' prices where such parts are sourced from related suppliers. Second, at least at present, there is no uniformity among preference-giving jurisdictions with regard to the appropriate valuation level of imported parts (FOB or CIF) and the denominator to be used in calculating the percentage. Effective harmonization would require consensus on these points also. Third, as the European Community is unlikely to ever give up its CTH test and the United States might not be as reluctant as it was a few years ago to accept a process criterion, from a realistic point of view, harmonization might be achieved more quickly if a choice was made for the process criterion.

Finally, and perhaps most importantly, in view of the choice for the harmonization of nonpreferential origin rules on the basis of the CTH test and the adoption by most countries now of the Harmonized System, it might be better to have any GSP harmonization take place on the basis of the same method; UNCTAD

121. Compare the 1990 UNCTAD Report, Report of the Special Committee on Preferences, on its Seventeenth Session, UNCTAD, TD/B/1263, at para 26 (1990), which recommends that the United States and the European Community accept the donor country concept and unlimited cumulation among GSP beneficiaries.

122. *Supra* note 199, at 1.

123. *Ibid.*

could then not only profit from the work undertaken in the CCC but also from the different balance of power in the CCC under which conflicting interests between the United States, the European Community, and Japan perhaps form a better guarantee for fair rules than GSP rules of origin unilaterally decided on by preference-giving countries.

Indeed, if donor countries could be persuaded to use the same CTH test for nonpreferential and GSP purposes, it would appear to be a significant victory for preference-receiving countries as it would mean an implied reversal of present U.S., EC and Japanese policy that GSP rules of origin ought to be more exacting than nonpreferential rules.

7.6. Different Rules of Origin for Free Trade Areas?

Contrary to the autonomous character of the GSP, free trade areas are contractual.

This nature implies that the specifics of the contract, including applicable rules of origin, are negotiated among the members.¹²⁴ Because of differing economic interests, it seems almost unavoidable that the relevant rules of origin are highly individualistic and patterned after the economic interests of the members and of the bloc as such.

Article XXIV:4 of GATT recognizes as a matter of principle the "desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements." Other parts of Article XXIV impose various obligations that customs unions and free trade areas need to comply with.¹²⁵ In particular, duties and other regulations of commerce of the regional bloc should not be higher or more restrictive vis-à-vis third countries than those previously existing at the various countries' levels. The philosophy of Article XXIV is therefore to create trade yet to avoid the diversion of trade.¹²⁶

With respect to preferential rules of origin negotiated as part of an FTA or customs union package, the question therefore is whether such rules divert trade to the disadvantage of nonmembers. Arguably, very stringent rules of origin lead to trade deflection (see the example in the foreword) because members of the bloc need to use more domestic content to qualify for preferential treatment and therefore will use less parts and materials imported from third countries.¹²⁷ The donor country

124. For an illustration, see the citation at the beginning of this chapter.

125. For a detailed description, see JACKSON, *supra* note 102, at 575-625.

126. JACKSON, *THE WORLD TRADING SYSTEM* 141 (1989).

127. This assumes that the benefits of the preferential agreement are worthwhile enough

concept will yield a similar result because bloc members have an incentive to use parts and materials originating in the bloc. Lax rules of origin, on the other hand, while probably leading to less trade diversion, raise major free rider problems.

In the view of the author, the simplest and least internationally-controversial solution would be to use identical nonpreferential and preferential rules. However, vehement EC opposition to this idea in the Uruguay Round negotiations would appear to preclude this for the decade to come.

7.7. Rules of Origin to Assess the Circumvention of Antidumping Duties?

A controversial question is whether rules of origin ought to have a place in determining whether the circumvention of antidumping duties takes place. Theoretically at least, one could argue that if importing country or third-country manufacturing is carried out under such conditions that the locally-produced merchandise obtains originating status, it should not be subjected to antidumping duties, unless a full investigation shows that either the parts or the third country exports are dumped and have thereby caused injury to the relevant importing country industry.

Palmer takes this position (in chapter 2, section 7) by arguing that rules of origin and not specially adopted anticircumvention rules ought to be the basis for determining whether circumvention takes place.

This author has previously¹²⁸ argued the opposite on the ground that anticircumvention duties are such an extreme measure (because they violate the basic Article VI GATT rule that antidumping duties may be imposed only following findings of dumping and resulting injury)¹²⁹ that origin rules, drafted for other purposes, are not an appropriate yardstick. The draft GATT Anti-Dumping Code of 20 December 1991 takes a cryptic approach.¹³⁰ It contains a specific importing country anticircumvention provision that clearly would provide the exclusive avenue for determining whether importing country circumvention occurs.¹³¹ With respect

to comply with the qualification rules. The relatively low level of customs duties these days casts some doubts on this assumption.

128. Vermulst and Waer *supra* note 8.

129. Article VI, in turn, is an exception to the tariff bindings and MFN principles, so it must be interpreted narrowly.

130. The draft code is part of the Dunkel package, *supra* note 2.

131. Quere whether importing country industries can still bring complaints against parts.

to third-country circumvention, however, the draft only contains a mechanism for imposing antidumping duties retroactively once third country circumvention has been determined to exist and findings of dumping and resulting injury have been reached. Already this formulation is giving rise to controversy in Geneva with the European Community taking the position that the draft code would allow the continuation of the EC practice of judging third-country circumvention on the basis of the application of nonpreferential origin rules and other countries making a *lex specialis* argument that retroactivity would be the only resort available to importing country authorities.

7.8. Rules of Origin to Define the Domestic Industry in Antidumping Proceedings?

The European Community and other main users of antidumping laws have been reluctant to subject the domestic industry to rules of origin tests,¹³² a glaring incongruity that is now unfortunately condoned by the Draft Origin Agreement (see section 5.). The domestic industry is therefore likely to continue to be defined on the basis of soft criteria that offer more openings for political rather than technical input.

7.9. Procedural Improvements

One of the most interesting innovations of the Draft Agreement and the Common Declaration is the advance ruling procedure (see chapter 7, section 2.3.1.1.3.). At present, all five jurisdictions examined in this book are to varying degrees willing to provide advance information on origin if so requested. However, the process is time-consuming (European Community), not binding (Australia, Canada), and murky (all five jurisdictions). The fairly detailed requirements of the Draft Agreement, including a 150-day time limit for the administering authorities and a publication requirement,¹³³ will compel the establishment of a ruling procedure in all jurisdictions examined in this book with respect to both nonpreferential and preferential¹³⁴ rules of origin.

132. Vermulst, "The Antidumping Systems of Australia, Canada, the EEC and the USA: Have Antidumping Laws Become a Problem in International Trade?" 425-467, at 455, in John H. Jackson and Edwin A. Vermulst, eds., *ANTIDUMPING LAW AND PRACTICE: A COMPARATIVE STUDY*, (ANN ARBOR: THE UNIVERSITY OF MICHIGAN PRESS, 1989).

133. Technically, the draft Agreement would only require the authorities to make rulings publicly available. However, effective implementation of this requirement would appear to necessitate publication in the jurisdictions' official gazettes.

134. See the Common Declaration, *supra* note 2.

Such a procedure should, in the view of this author, be a layered one, with a possibility for interested parties to make their views known before a final decision is made, as is the case in the United States with draft Treasury Decisions (see section 3.1.). Clearly, interested parties should also have procedural rights, notably rights of confidential treatment of business proprietary information submitted¹³⁵ and of access to the nonconfidential file, and rights to be heard and to obtain an explanation of the essential facts and considerations underlying a proposed ruling as well as the opportunity to comment on them before the adoption. It furthermore ought to be possible for interested parties to directly appeal to the appropriate court from adverse administrative determinations.

On the basis of the above observations, the procedure could become as shown in Figure 1 (page 470).

A special problem in the European Community might be whether administrative and judicial remedies ought to be available at the Member State or the EC level. In the view of this author, the centralization of both at the EC level would be preferable to avoid inconsistencies and save time.

7.10. Power-Oriented or Rule-Oriented Framework?¹³⁶

The establishment of an adversarial legal process to decide on origin with procedural safeguards for interested parties amounts to a long-due recognition of the fundamental character of determinations on rules of origin as decisions on conflicting interests.

Such decisions will always affect investment and sourcing strategies and international trade flows, and it is therefore important that they are harmonized and imperative that they are transparent, depoliticized, and predictable.

135. Compare Article 2 (k) and 3 (i) of the Draft Agreement, *supra* note 2.

136. The distinction comes from Jackson, *The Crumbling Institutions of the Liberal Trade System*, 12:2 *Journal of World Trade Law*, 93-106 (1978).

With respect to nonpreferential rules of origin, the international community has taken the first step on the road to a rule-oriented system with respect to policy formulation¹³⁷ and implementation.

Preferential rules of origin, on the other hand, will continue to generate stumbling blocks to rational allocations of resources as long as harmonization within each jurisdiction and among jurisdictions is not achieved and importing country administrators are free to continue to mete out justice à la carte, at least at the policy formulation level.

137. However, the exclusion of preferential origin rules from the harmonization process leaves jurisdictions significant elbow room to continue to pursue policy objectives.

FIGURE 1. Flow Chart of a Possible Ruling Procedure

