

**November 2023**

# Rules of origin: Firm perspectives, lessons learned, and ways forward

ISBN:978-92-9466-485-3

## Acknowledgments

The authors would like to thank Arianna Bondi and Bernard Hoekman for assistance in producing this e-book.

doi:10.2870/144432

QM-02-23-180-EN-N



**Editor:** Stefano Inama



**Co-funded by  
the European Union**

Funded by the European Union. Views and opinions expressed are however those of the author(s) only and do not necessarily reflect those of the European Union or the European Education and Culture Executive Agency (EACEA). Neither the European Union nor EACEA can be held responsible for them.

© European University Institute, 2023  
Editorial matter and selection © Stefano Inama, 2023  
Chapters © authors individually 2023

This work is licensed under the [Creative Commons Attribution 4.0 \(CC-BY 4.0\) International license](https://creativecommons.org/licenses/by/4.0/) which governs the terms of access and reuse for this work. If cited or quoted, reference should be made to the full name of the author(s), editor(s), the title, the series and number, the year and the publisher.

Views expressed in this publication reflect the opinion of individual authors and not those of the European University Institute.

Published by  
European University Institute (EUI)  
Via dei Roccettini 9, I-50014  
San Domenico di Fiesole (FI)  
Italy

ISBN: 978-92-9466-485-3  
doi: 10.2870/144432  
QM-02-23-180-EN-N



**Co-funded by  
the European Union**

Funded by the European Union. Views and opinions expressed are however those of the author(s) only and do not necessarily reflect those of the European Union or the European Education and Culture Executive Agency (EACEA). Neither the European Union nor EACEA can be held responsible for them.

# **Rules of origin: Firm perspectives, lessons learned, and ways forward**

EDITED BY

Stefano Inama (UNCTAD)

European University Institute, Florence, Italy

Acknowledgments: The authors would like to thank Arianna Bondi and Bernard Hoekman for assistance in producing this e-book.

# Table of contents

Introduction	1
Stefano Inama (UNCTAD)	
1. How firms assess the case for using new FTAs: The Regional Comprehensive Economic Partnership (RCEP)	4
Michel Anliker	
2. The cost of rules of origin from a business perspective —How much does origin compliance cost?	26
Marius Cosnita	
3. Bicycle manufacturing in Asia: Background and a brief history	31
Jonathan William Edwards	
4. Moving towards convergence on rules of origin? The automotive industry	59
Stephan Freismuth	
5. RCEP and CPTPP: Building blocks of convergence? Or another brick in the wall for existing FTA networks	70
Kit Hickey	
6. The challenge of designing “new” rules of origin in international trade	75
Roberto Soprano	
7. The experience of applying rules of origin: a view from the private sector	99
Massimo Trabucco	

# List of Abbreviations

APAC	Asia and Pacific
ASEAN	Association of Southeast Asian Nations
B2B CoO	Back-to-back Certificate of Origin
CAPEX	Capital Expenditure
CC	Change in Chapter
CIF	Cost, Insurance & Freight
CoO	Certificate of Origin
CTC	Change in Tariff Classification
CTH	Change in Heading
CTSH	Change in Subheading
EBA	Everything But Arms
EBMA	European Bicycle Manufacturers Association
EMEA	Europe, Middle East, and Africa
ERP	Enterprise Resource Service
ESG	Environmental, Social, and Governance
EU	European Union
EXW-	ex-works price
FOB	Free on Board
FTA	Free Trade Agreement
GATT	General agreement or Tariff and Trade
GPT	General Preferential tariff
GSP	Generalized System of Preferences

LDC	Least developed Country
LED	Light Emitting Diode
LTSD	Long Term Supplier's Declarations
MaxNom	Maximum of non-originating material content
NOM	Non-originating material
PSRO	Product Specific Rules of origin
QC	Quality Control
R&D	Research and Development
RCEP	Regional Comprehensive Economic Partnership
RoO	Rules of Origin
RTA	Regional Trade Agreements
RVC	Regional Value Content
SEZ	Special Economic Zone
SME	Small and Medium Sized Enterprises
TPP	Trans Pacific Partnership (now referred to as CP-TPP)
US	United States
USP	Unique Selling Proposition
VIN	Vehicle Identification Number
VNM	Value of Non-Originating Materials
WTO	World Trade Organization

# Introduction

Stefano Inama (UNCTAD)<sup>1</sup>

This book is the result of several roundtables<sup>2</sup> and consultative meetings on rules of origin<sup>3</sup> held under the UNCTAD (United Nations Conference on Trade and EU) joint research and capacity building program. The roundtable of experts on rules of origin is an annual event and forum to discuss groundbreaking initiatives and emerging issues on rules of origin and their administration. Representatives of major firms have participated at the annual roundtable together with experts from international organizations, such as the World Customs Organization, the International Trade Center, the Asian Development Bank, and the International Chamber of Commerce, alongside European Union Commission officials and practitioners.

The origin of products and services are part of our everyday lives and range from the labelling of food or fashion products with “made-in”, to the origin of the programs we consume via Netflix. Yet, despite the comprehensive regulation of today’s society, there are no multilateral rules of origin. This leaves the consumer, firms, trade negotiators, regulators, and customs officials in no man’s land. The Agreement on Rules of Origin (ARO) was created to partially fill this gap in the 1990s. However, consensus was not reached on the adoption of harmonized non-preferential Rules of Origin at the World Trade Organisation (WTO), while hundreds of regional trade agreements (RTA) containing rules of origin provisions have been successfully concluded.

---

1 The views expressed are those of the author and do not necessarily reflect those of the United Nations

2 See for instance: Executive round table on rules of origin: towards convergence? 15-16 November 2021

3 Consultative Meeting on the Proposal of Annex K on Rules of Origin of Revised Kyoto Convention 27 November 2020

The objective of the roundtable on rules of origin is to fill a conspicuous gap that has existed for decades. In fact, not only is there no multilateral agreement on rules of origin, but, as a corollary, there is no forum, whether inter-governmental or private, to openly discuss issues related to rules of origin. The agenda items of each WTO Committee on rules of origin is still a matter of negotiation among WTO members, which limits the scope and mode of the debate in the Committee on rules of origin (CRO). The Technical Committee on rules of origin established at the World Customs Organization (WCO) has an even stricter mandate related to the failed attempt to harmonize non-preferential rules of origin.

The debates and discussions held during the annual roundtable reveal that business is moving faster than international negotiations. The selection of papers included in this e-book were drawn from contributions to the roundtables by representatives of companies. The contributions make clear that firms have managed to comply with rules of origin and associated policy uncertainty of their administration in numerous markets, but at a cost. Utilization rates of free trade agreements (FTAs) are emerging as an effective tool to measure the use made by firms of FTAs showing that compliance with rules of origin (RoO) remains a costly affair.

Business has often been ambivalent on the issue of RoO.<sup>4</sup> On the one hand they often complained about the complexity of RoO but on the other hand they have not pushed Governments to make the extra effort required to seek a multilateral solution. The focus instead has been on “easy fixes” in bilateral deals (PTAs), which have been considered as more appealing and less costly. The contributions contained in this book show that this view has evolved. Major firms are now openly advocating for clarity, predictability, and convergence toward best practice. While harmonization may be too ambitious, these firms are indicating that there are standards that could be adopted or converged upon. Most importantly the suggested recommendations are “actionable” by governments, that is, they are sufficiently precise and detailed to be addressed by trade negotiators and regulators.

Perhaps the most important message contained in the contributions of these firms is directed at politicians and researchers, two professional categories that tend to have very little in common. The message to the politicians is embedded in the unclouded analysis and approach that firms use when assess-

---

4 See Hoekman and Inama “Rules of Origin as Non-Tariff Measures: Towards Greater Regulatory Convergence” RSCAS 2017/45 Robert Schuman Centre for Advanced Studies Global Governance Programme-279



ing if an FTA is going to be used or not. Michel Anliker of Schindler and Kit Hickey of Fonterra show how firms are now scrutinizing applauded mega-regional trade agreements such as RCEP and CP-TPP to conclude that they are not going to use them despite the supposed benefits that have been trumpeted. This is also stressed by Roberto Soprano of Firmenich in his chapter '*Companies are profits driven. Therefore, any action taken is aimed at maximizing their profits*'. Thus, it is natural that firms are operating a series of internal assessments depending on their structure and culture to make informed decisions about whether to use an FTA. Soprano also explains why companies are prepared to incur the cost of buying and maintaining sophisticated IT systems and related personnel to be able to assure RoO compliance more efficiently. He provides a series of recommendations on how the RoO should be designed to consider modern techniques and business realities.

Marius Cosnita of British American Tobacco (BAT) explains how multinational companies internalize and manage their decision-making processes to make use of an FTA and its related structure and tasks among different departments of a firm. Stefan Freismuth of BMW highlights the heterogeneity of product specific rules of origin (PSRO) in EU FTAs, suggesting that there should be an effort to standardize such PSRO, and pointing out that such differences in PSROs also exist on proof of origin and ancillary requirements. Trabuco of Nestlé shares similar views on PSRO and other documentary requirements and practices such as direct consignment, third country invoice, and proof of origin. He advocates for a common framework applicable to all trade agreements notified to the WTO, based on electronic systems, reliable operator status, standard rules on cumulation, third party invoicing, and renewed direct consignment rules

The extensive and detailed contribution of Jon Edwards of A&J should be an eye opener for researchers who have been engaged in decades-long debates on the role of trade preferences and rules of origin. His contribution shows, beyond any reasonable doubt, that a sizable margin of preference with a lenient PSRO could generate trade and investment. Obviously, and as explained eloquently in his chapter, these factors are not exclusive.

The analyses and recommendations made by practitioners in this volume provide a strong basis for policymakers to move forward in developing plurilateral frameworks for rules of origin and related administrative requirements as an element of policy efforts to facilitate international trade.

# 1. How firms assess the case for using new FTAs: The Regional Comprehensive Economic Partnership (RCEP)

Michel Anliker<sup>1</sup>

## 1. Introduction

The present section is a combination of the three presentations that I have given to business associations, customs expert groups, and at the Roundtable of Experts on Rules of Origin and at the annual 2022 EUI - UNCTAD 'Roundtable of Experts on Rules of Origin.

The view expressed in this contribution focuses primarily on the perspective of the manufacturing industry, centering on industrial products of HS Chapters 84 and 85. This contribution represents and illustrates my own personal views, understandings, and interpretations of the Rules of origin provisions contained in RCEP. Every company and user of a free trade agreement (FTA) has to assess its own potential saving opportunities according to their own products, production set-up, and supply chain pattern.

---

<sup>1</sup> Attorney-at-Law, Head of Customs Import and Export Compliance, Schindler Group

In addition, local practices of customs authorities may vary, and my understanding and interpretation may not be applicable to all of the countries or customs authorities included in the Regional Comprehensive Economic Partnership (RCEP).

## 2. Thoughts when utilizing a free trade agreement

Before looking into the details of the Regional Comprehensive Economic Partnership (RCEP) and its rules, every company should work through some basic thoughts when utilizing an FTA. This can be – but does not have to be necessarily – a cumbersome task and will depend on the maturity of a company's internal procurement, sales, and production organization, as well as on the maturity of its international trade department and that department's understanding of the application of an FTA.

Some key considerations for firms to consider include:

2. *Understanding the trade flow and the invoicing flow.* Nothing is more important than having a precise overview of your supply chain pattern (sourcing, production, and deliveries) and the documentation flow.
3. *Knowing the FTAs.* The different countries involved in sourcing, production, and distribution should be matched with the possible overlapping of competing FTAs. Which FTAs can be in scope? And what FTA is more competitive in terms of duty savings and PSRO?
4. *Accessibility of information of the FTA.* How can the FTA be utilized by the company? Is it simple to obtain? Is it possible to automate?
5. *Knowing your HS Codes.* Firms need to understand the HS Codes of their final / produced product and ensure that they have collected all the HS codes of the raw materials used, and that this information is documented (for example, proof of origin such as origin statements and certificates of origin must be available).
6. *Customs duty benefits.* What are the offered customs duty benefits / tariff concessions, in short and long-term perspectives (if scheduled)? If the product is not covered by the FTA, or there is a reduced (or no) direct benefits over twenty years, or the relevant product is on an exemption list, then obviously a company can forgo using the FTA.

7. *Verifying the Rules of Origin.* What do they look like, and is the company able to satisfy those rules for its products?
8. *Comply with documentary requirements.* What are the proof of origin and documentation requirements (for example, record keeping, etc.)?
9. *Operational requirements.* Does the FTA foresee specific operational requirements or simplifications? Is the company able to use them and / or observe them?
  - Cumulation (with limitations)?
  - Direct consignment rule?
  - Back-to-Back Certificate of Origin (CoO)?
  - Approved Exporter / Registered Exporter ( REX)?
10. *Origin verification.* How to keep the savings in the long-term? Organize and manage the company's origin utilization and documentation in a proper way.

## 3. Regional comprehensive economic partnership

This section reviews the RCEP provisions concerning Rules of Origin, highlighting the practical difficulties that can arise for firms in their operations.

### 3.1 Overview

#### 3.1.1 Structure and content of the agreement

RCEP is arguably one of the largest free trade area ever created and entered into force on 1 January 2022. The member countries included in this area are the following: Australia, Brunei Darussalam, Cambodia, China, Japan, Lao PDR, New Zealand, Singapore, Thailand, and Vietnam. It marks the first time that a free trade agreement has existed between China and Japan, as well as between Japan and South Korea.



*Figure 1: RCEP members*

The agreement has 20 chapters and represents a comprehensive FTA, comprising all relevant and modern trade topics such as Trade in Services, Investment, Intellectual Property, E-Commerce, Competition, Government Procurement, etc.<sup>2</sup> The overview of the existing chapters is provided below in Figures 2 and 3.

<sup>2</sup> The structure and legal texts of the RCEP can be found on the following webpage: <https://rcepsec.org/legal-text/>. Alternatively, the Australian government has also published the text, since the official RCEP page seems to have regular server issues (<https://www.dfat.gov.au/trade/agreements/in-force/rcep/rcep-text>). Similarly, other RCEP member countries have published the RCEP legal text as well.

## Legal Text of the RCEP Agreement

- Title page, Table of Contents, and Preamble
- Chapter 1 – Initial Provisions and General Definitions
- Chapter 2 – Trade in Goods
- Chapter 3 – Rules of Origin
  - Annex 3A (Product-Specific Rules)
  - Annex 3B (Minimum Information Requirements)
- Chapter 4 – Customs Procedures and Trade Facilitation
  - Annex 4A (Period of Time to Implement the Commitments)
- Chapter 5 – Sanitary and Phytosanitary Measures
- Chapter 6 – Standards, Technical Regulations, and Conformity Assessment Procedures
- Chapter 7 – Trade Remedies
  - Annex 7A (Practices Relating to Anti-Dumping and Countervailing Duty Proceedings)
- Chapter 8 – Trade in Services
  - Annex 8A (Financial Services)
  - Annex 8B (Telecommunications Services)
  - Annex 8C (Professional Services)
- Chapter 9 – Temporary Movement of Natural Persons
- Chapter 10 – Investment
  - Annex 10A (Customary International Law)
  - Annex 10B (Expropriation)
- Chapter 11 – Intellectual Property
  - Annex 11A (Party-Specific Transition Periods)
  - Annex 11B (List of Technical Assistance Requests)
- Chapter 12 – Electronic Commerce
- Chapter 13 – Competition
  - Annex 13A (Application of Article 13.3 (Appropriate Measures against Anti-Competitive Activities) and Article 13.4 (Cooperation) to Brunei Darussalam)
  - Annex 13B (Application of Article 13.3 (Appropriate Measures against Anti-Competitive Activities) and Article 13.4 (Cooperation) to Cambodia)
  - Annex 13C (Application of Article 13.3 (Appropriate Measures against Anti-Competitive Activities) and Article 13.4 (Cooperation) to Lao PDR)
  - Annex 13D (Application of Article 13.3 (Appropriate Measures against Anti-Competitive Activities) and Article 13.4 (Cooperation) to Myanmar)
- Chapter 14 – Small and Medium Enterprises
- Chapter 15 – Economic and Technical Cooperation
- Chapter 16 – Government Procurement
  - Annex 16A (Paper or Electronic Means Utilised by Parties for the Publication of Transparency Information)
- Chapter 17 – General Provisions and Exceptions
- Chapter 18 – Institutional Provisions
  - Annex 18A (Functions of the Subsidiary Bodies of the RCEP Joint Committee)
- Chapter 19 – Dispute Settlement
- Chapter 20 – Final Provisions
- Testimonium and Signing Pages

Figure 2: RCEP legal text

Source: <https://rcepsec.org/legal-text/>

When first assessing an FTA, firms look for saving opportunities and focus on chapter 2: ‘Trade in Goods’. Obviously, there are also other topics that can be of interest for a company, as the above table of contents in Figure 2 demonstrates. Typically, firms focus on the ‘Trade in Goods’ chapter to identify the potential saving opportunities, in the form of customs duty benefits, that an FTA can offer. These are either reduced, or zero. Unfortunately, in some cases, products are not granted any benefits.

To figure out any potential benefits, a company must investigate “Annex I” named “Schedules of Tariff Commitments” (see Figure 3). From a business perspective, this can be a burdensome and time-consuming task. As opposed to a bilateral FTA, where tariff commitments are formulated in the annex of the FTA in a simple manner, the RCEP allows every country to impose its own Headnotes, Tariff Commitments and Tariff Differentials.

<b>Market Access Annexes</b>	
<b>Annex I – Schedules of Tariff Commitments</b>	
Annex I – General Headnotes	Thailand – Appendix on Tariff Differentials
Brunei Darussalam – Headnotes	Viet Nam – Headnotes
Brunei Darussalam – Schedule of Tariff Commitments	Viet Nam – Schedule of Tariff Commitments
Cambodia – Headnotes	Viet Nam – Appendix on Tariff Differentials
Cambodia – Schedule of Tariff Commitments	Australia – Headnotes
Indonesia – Headnotes	Australia – Schedule of Tariff Commitments
Indonesia – Schedule of Tariff Commitments	China – Headnotes
Indonesia – Appendix on Tariff Differentials	China – Schedule of Tariff Commitments
Lao PDR – Headnotes	China – Appendix on Tariff Differentials
Lao PDR – Schedule of Tariff Commitments	Japan – Headnotes
Malaysia – Headnotes	Japan – Schedule of Tariff Commitments
Malaysia – Schedule of Tariff Commitments	Japan – Appendix on Tariff Differentials
Myanmar – Headnotes	Korea – Headnotes
Myanmar – Schedule of Tariff Commitments	Korea – Schedule of Tariff Commitments
Philippines – Headnotes	Korea – Appendix on Tariff Differentials
Philippines – Schedule of Tariff Commitments	New Zealand – Headnotes
Philippines – Appendix on Tariff Differentials	New Zealand – Schedule of Tariff Commitments
Singapore – Headnotes	

*Figure 3: RCEP Country Schedules of Tariff Commitments*

Source: <https://rcepsec.org/legal-text/>

The example of the Vietnam Tariff schedule in Figure 4 below may further illustrate the complexity of tariff commitments under the RCEP. According to the structure of the Vietnam schedule, tariff commitments vary depending on which country the product originates from (Figure 4). Vietnam has in fact enacted different tariff schedules depending on where the product originates from, whether ASEAN, Australia, China, Japan, Korea or New Zealand. Therefore, a firm will have to go through all the country's commitments to assess whether it will be granted preferential treatment.

**Viet Nam**

- Headnote to Schedule of Viet Nam [[PDF 430 KB](#)]
- Schedule of Viet Nam
  - for ASEAN [[PDF 27.7 MB](#)] | [[XLSX 1.8 MB](#)]
  - for Australia [[PDF 27.4 MB](#)] | [[XLSX 1.8 MB](#)]
  - for China [[PDF 27.4 MB](#)] | [[XLSX 1.8 MB](#)]
  - for Japan [[PDF 27.6 MB](#)] | [[XLSX 1.8 MB](#)]
  - for Korea [[PDF 27.6 MB](#)] | [[XLSX 1.8 MB](#)]
  - for New Zealand [[PDF 27.4 MB](#)] | [[XLSX 1.8 MB](#)]
- Appendix of Viet Nam in relation to paragraph 3 of Article 2.6 (Tariff Differentials) [[PDF 395 KB](#)]

*Figure 4: Country specific Schedule(s)*

Source: <https://rcepsec.org/legal-text/>

### 3.1.2 Findings for industrial products

Our research suggests that savings from the RCEP are limited for industrial products that fall under Chapters 84 and 85. Many product lines under the RCEP offer benefits only after 10 to 15 years, and in some cases, after only 20 years. Existing ASEAN agreements generally offer better opportunities with direct benefits (0% customs duty).

Again, it has to be noted that the above conclusion is limited to the authors' own interpretation and does not include a detailed analysis of all product lines included in Chapters 84 and 85. Consequently, it is recommended that every company assesses the benefits of the RCEP according to their own products and HS codes.



## 3.2 Rules of origin

The RCEP uses the standard pattern of Rules of Origin (Article 3.2 of the RCEP), which are quoted as follows:

- Wholly obtained or produced.
- Produced in a Party exclusively from originating materials from one or more Parties.
- Produced in a Party using non-originating materials, provided that PSRO are met.

Product Specific Rules refer to the concept of substantial transformation, which is fulfilled when the following criteria are met:

- A Regional Value Content amounts to a certain percentage.
- Or Change in Tariff Classification (either Change in Chapter [CC], Change in Heading [CTH] or Change in Subheading [CTSH]).

The substantial transformation reflects the basic concept that a certain amount of work has to be performed to confer origin. The underlying idea of an FTA is to increase economic exchange between parties. Consequently, it makes sense that a certain level of production steps and manufacturing work is required to confer originating status, which finally leads to a reduction of customs duties.

This also means that certain production steps are not considered sufficient to confer originating status. In FTAs, this is generally referred to as “Minimal Operations and Processes”. This is a clause in the agreement that defines which “simple” operations and processes are not sufficient to confer originating status, and hence are not allowed to be considered as substantial transformation. Such operations might include simple mixing, disassembling, simple painting, simple packaging, etc. Please see Article 3.6 of the RCEP of the RCEP for more information on this topic.

Chapters 84 and 85 of the RCEP illustrate that most Product Specific Rules are as follows:

- Either a Regional Value Content (RVC) of 40% or;
- A Change in Tariff Heading (CTH) or;
- A Change in Tariff Subheading (CTSH).

Interestingly, in RCEP we have observed that there is a mix of two “FTA cultures” and approaches:

In Asian FTAs, such as the ASEAN+ 1 Free trade Agreements (FTA), the usual practice has been to establish a general Rule of Origin. In addition an Annex provides are for different Rules of Origins (often referred “Product Specific Rules” (PSR)). Western and modern FTAs do not provide for any general Rule of Origin since rules of origin are s product specific.

In addition, the perspective of the Regional Value Content (RVC) percentage indication in the Asian FTAs is a “local content” one (that is to say, the real local value-added work), based on Free On Board (FOB). Whereas Western / Central European FTAs indicate the opposite value, which is the value of all non-originating materials used and which is not allowed to exceed a certain percentage of the ex-works price of the final product. Consequently, if a RVC is set at 40%, it is likely that the corresponding “Western” rule would imply not to exceed 60% of the ex-works price of the product.

### 3.2.1 Change in tariff classification

The concept of a Change in Tariff Classification is crucial when determining origin. The classification of goods in the harmonized system is based on the so-called “production principle”, which reflects the path of a good from its “raw material” stage, to a “semi-finished product”, and finally to the “finished product”. This “production principle” is the basis of the Change in Tariff Classification, as it automatically means that if a manufactured raw material leads to a different classification of a product, the criterion of the substantial transformation is fulfilled.

*Example 1:*

US-Singapore FTA, 1511.90.00 (refined palm oil): the Rule of Origin states: “change to heading 1511 from any other chapter, except from heading 3823”.

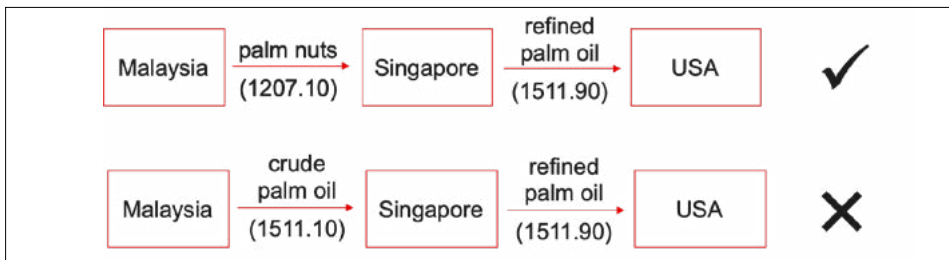


Figure 5: Change in Tariff Classification

The first 2 digits of the HS Code represent “the Chapter”, the first 4 digits of the HS Code make up the “Heading”, and the final two digits make up the “the Subheading”. In the first line of Example 1, the Heading changes from 1207 to 1511. This is a Change in Tariff Heading. Consequently, the Rule of Origin is fulfilled and the origin confirmed.

In the second example, only the Subheading (the last two digits) changes, which is not sufficient to grant the origin of a product. It simply means that such a change is not a sufficient substantial transformation.

### 3.2.2 Regional value content (RVC)

The RVC reflects the contributed local value content of a production step. In addition to the raw materials that can be added to the originating portion of the formula, profit, direct labour costs (including wages, remuneration, and other employee benefits), and direct overhead costs can also be added to the local value content.

Figure 6 shows the RVC formula as stated by RCEP (Article 3.5)<sup>3</sup>.

<p>(a) Indirect/Build-Down Formula</p> $\text{RVC} = \frac{\text{FOB} - \text{VNM}}{\text{FOB}} \times 100$ <p style="text-align: center;">or</p> <p>(b) Direct/Build-Up Formula</p> $\text{RVC} = \frac{\text{VOM} + \text{Direct Labour Cost} + \text{Direct Overhead Cost} + \text{Profit} + \text{Other Cost}}{\text{FOB}} \times 100$
--

Figure 6: RVC Formula

Source: Article 3.5 of Chapter 3, Rules of Origin, Section A of the RCEP

The simple example below (Figure 7) provides an illustration to understand the formula given above in Figure 6.

#### Example 2:

Printed Circuit Boards (HS Code: 8534). Under ACFTA, a general rule of regional value content of 40% of the FOB value is required.

<sup>3</sup> Note that sourced non-originating materials are valued based on CIF.

Rawmaterial	Origin	Value in USD	In % of the FOB price
Capacitors	China	2	20%
Transistors	China	2	20%
Tin Plating	China	1	10%
Copper Foil	Non-China third country	2	20%
Resistors	Non-China third country	1	10%
Raw material (third country)		3	30%
Raw material (China)		5	50%
Assembly, testing & profit		2	20%
<b>Final FOB price</b>		<b>10</b>	<b>100%</b>

**China origin fulfilled (70% Chinese input, 30% non originating input) → no customs duty**

Figure 7: RVC calculation

Source: Michel Anliker Presentation

When applied to the example, the formula provides for the following results:

$$\begin{aligned}
 RVC > 40\% &= \frac{FOB (= 2 + 2 + 1 + 2 + 1) - VNM (= 2 + 1)}{FOB (= 2 + 2 + 1 + 2 + 1)} \times 100 \\
 &= \frac{FOB (= 10) - VNM (= 3)}{FOB (= 10)} \times 100 = 70\%
 \end{aligned}$$

Since 70% of RVC is much higher than 40%, the contributed local value content is sufficient to fulfil the origin requirement.

### 3.3 Cumulation

Cumulation (Article 3.4 of the RCEP) is the possibility of using material or production steps of the FTA member countries to enhance economic exchange between the signatory parties, and to count such contributions toward the origin content. In other terms, if a raw material is sourced from the FTA partner country, it can be counted as originating material in local production, therefore adding origin content.

Various cumulation schemes exist in the FTA landscape, such as bilateral cumulation, full cumulation, diagonal cumulation, cross cumulation, to name a few, and all have their specific features. RCEP simply uses bilateral cumulation, although it should be re-named as “multilateral cumulation” due to

the quantity of member countries. Whenever a raw material or semi-finished product originates from a RCEP member country and is sourced for production in another RCEP member country, that product can be used to count towards origin content. However, such sourced raw or semi-finished materials always require proof of origin. This needs to be shown in the origin calculation and be substantiated with underlying documentation during an origin audit.

*Example 3:*

How does cumulation work?

- Country A and B have concluded an FTA.
- Cumulation allows country B to source originating products from country A for further processing as local content in country B. Although sourced and delivered from country A, this product is qualified as if it had originated from country B.
- The input material of country A needs to meet origin criteria and requires a certificate of origin.
- As a result, input material counts as 100% qualifying content for B, which helps to achieve the required RVC percentages.

In Section 2 of Article 3.4, the RCEP foresees the possibility of expanding the qualitative aspect of cumulation to full cumulation. With full cumulation, all stages of processing or transformation of a product between the contracting parties can be counted as qualifying operations for the production of an originating good, regardless of whether the processing or transformation is sufficient by itself to confer originating status on that same material. For businesses this is a challenging simplification in third-party transaction scenarios, as this would require sharing production specific information which is likely to be confidential. It can, however, be an add-on for larger firms that have fragmented production over various RCEP member countries.

From a practical perspective I would wonder how and what the proof of origin for such cross-border full cumulation is. The transferred material is not yet required to be an originating product, per se, and the performed production steps would need to be documented and transferred to the final production unit, in order for them to perform the final origin calculation. For a better understanding of this topic would benefit if a relevant authority or administration were to release a guideline for such cumulation.

### 3.4 De-minimis (tolerance rule)

If the *change of tariff classification* is not possible, a good can still be considered as originating if the value of that good does not exceed 10% of the FOB value of the final good (see Article 3.7 of the RCEP).

### 3.5 Direct consignment (direct transportation rule)

RCEP includes a rule on direct consignment or direct transportation (Article 3.15). This provision exists due to the “fear” of the signatory countries of an FTA that a product, manufactured and originating in an FTA country, may be altered or changed on its way to another FTA partner country. This would interfere with the entire origin calculation concept of the FTA and lead to the loss of (preferential) origin.

Given that in reality, firms rarely ship products directly from country A to country B, FTAs are required to recognize that companies may have complex supply chains with warehouses and distribution centres in different countries. Article 3.15 of the RCEP indicates what a company needs to observe in order not to lose the origin status of its goods:

‘An originating good shall retain its originating status as if the following conditions have been met:

- the good has been *transported directly* from an exporting Party to an importing Party; or
- the good has been *transported through* one or more Parties other than the exporting Party and the importing Party (hereinafter referred to as “intermediate Parties” in this Article), or non-Parties, provided that the good:
  - has not undergone any further processing in the intermediate Parties or the non-Parties, except for logistics activities such as unloading, re-loading, storing, or any other operations necessary to preserve it in good condition or to transport it to the importing Party; and
  - remains under the control of the customs authorities in the intermediate Parties or the non-Parties.

To document the above and to ensure that no authority may question the transport route that has been chosen, the agreement provides the utilizers of the FTA the following possibility to show compliance:

- Present the customs authorities of the importing Party either with customs documents of the intermediate Parties or the non-Parties, or with any other “*appropriate documentation*” [highlighted by author] on request of the customs authorities of the importing Party.
- The “*appropriate documentation*” [highlighted by author] may include commercial shipping or freight documents such as airway bills, bills of lading, multimodal or combined transport documents, a copy of the original commercial invoice in respect of the good, financial records, a non-manipulation certificate, or other relevant supporting documents, as may be requested by the customs authorities of the importing Party.’

### 3.6 Third-party invoicing

Many FTAs and Rules of Origin emphasize the physical flow of goods. In most cases, these are based on archaic business models where the seller and manufacturer are the same person, or are at least in the same country.<sup>4</sup> However, globalized business models entail fragmented production patterns and supply chains. As a result, flows of goods and invoices might not match. This led to confusions in many countries, where there were various parties involved, with a product being delivered from one country but the underlying documentation and commercial invoice provided by a different company from a different country.

Figures 8 and 9 illustrate such third-party invoicing schemes.<sup>5</sup> In Figure 8, goods from the production facility in the Philippines are directly sold and shipped to China, accompanied by a CoO from the Philippines. However, the invoicing flow goes through the HQ in Singapore, where it is significantly marked up in price, and is then sold to China for USD 300. The importing country will see a mismatch between a Certificate of Origin (CO) issued by the Philippines and an invoice issued in Singapore and might refuse to grant preferential tariff treatment. A provision on third country invoicing allows such practices, subject to certain conditions as further explained below.

---

4 This might also be the reason why the direct consignment rules had to be established.

5 Note that “third-party” in this context means “more than two”.

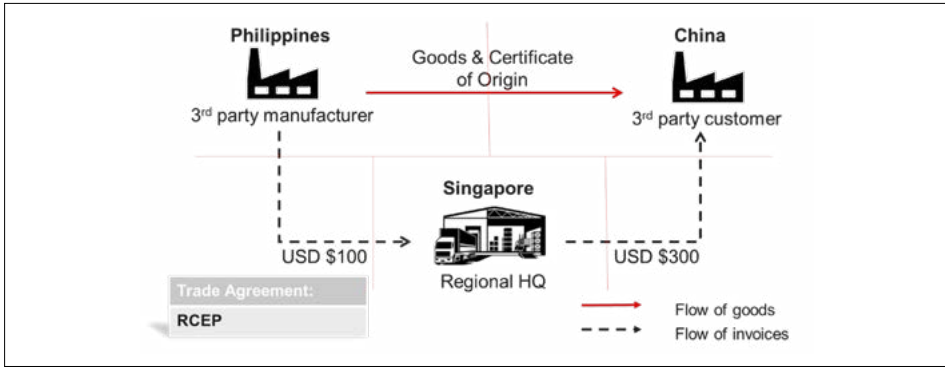


Figure 8: Third-party invoicing with 3 parties

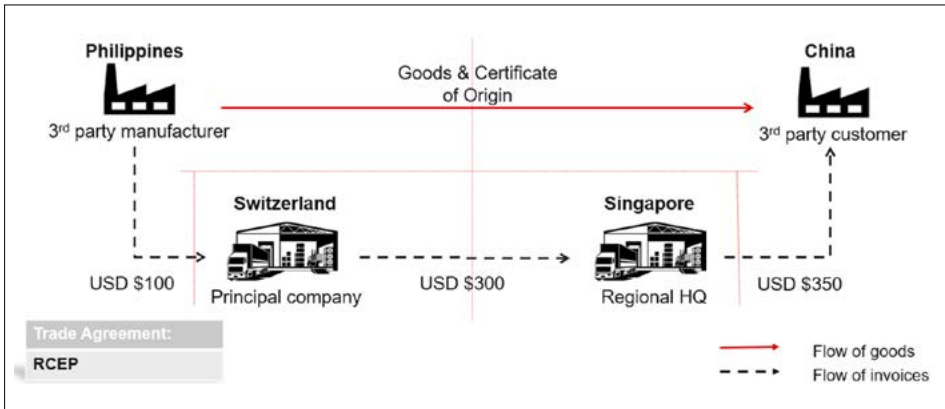


Figure 9: Third-party invoicing with 4 parties or more

Article 3.20 of the RCEP foresees that in such situations, no authority should deny the preferential origin of the goods:

An importing Party shall not deny a claim for preferential tariff treatment for the sole reason that an invoice was not issued by the exporter or producer of a good provided that the good meets the requirements in this Chapter (Article 3.20: Third-Party Invoicing of the RCEP).

However, many importing countries and customs authorities denied the preferential importation of such goods due to these mismatches. In some countries, bilateral discussions with the authority were required to allow preferential importation. Some authorities even stuck literally to the word “third”, thus not allowing preferential importation if there were more than three parties involved in the entire transaction.



## 3.7 Proof of origin

### 3.7.1 Standard proof of origin

To obtain preferential origin at importation, and with that the relief of customs duties, the importer needs to prove the (preferential) origin to importing customs authorities. Such proof of origin can take the form of a certificate of origin or a statement.

Under RCEP (see Article 3.16), proof of origin is not required for goods with a value below USD 200. A Certificate of Origin (CoO) is the relevant formal proof of origin and has a validity of one year. That would be a preferential CoO based on the FTA. Note that such CoOs must be requested from an issuing body, which in most countries is a customs authority.

In practice, there is often a misunderstanding that CoOs can be requested from a country's chamber of commerce. This is not entirely correct. Chambers of commerce are responsible for issuing CoOs for non-preferential origin. Non-preferential origin is a WTO concept, and every country has its own established national legislation and practices with respect to it. Non-preferential CoOs are not linked to tariff benefits and cannot be used for preferential importation.

As a simplification, and as a well-known concept in the Western / Central European part of the world, a Declaration of Origin (statement of origin) is possible for companies that qualify as 'Approved Exporters'. This authorization can be requested from local customs authorities. A company needs to go through an assessment to demonstrate that all its origin-related aspects are managed perfectly, and that said company can be considered trustworthy in this area.

The Approved Exporter Scheme is foreseen in RCEP but not yet implemented in all signatory countries. Countries that have not yet implemented the Approved Exporter Scheme need to meet the following deadlines to do so:

- 10 years for Australia, Brunei, China, Indonesia, Japan, Korea, Malaysia, NZ, Philippines, Singapore, Thailand, and Vietnam.
- 20 years for Cambodia, Laos, and Myanmar.

From a record-keeping perspective, certificates of proof of origin and any supporting documentation to prove the originating status of goods must be kept for 3 years.

### 3.7.2 Back-to-back certificate of origin (B2B CoO)

The back-to-back Certificate of Origin (B2B CoO) is an interesting concept which was taken over from the ASEAN FTAs.<sup>6</sup>

The best use of B2B CoOs is either for re-routing the supply chain due to business confidentiality issues, or simply to re-issue a new CoO to facilitate regional distribution.

Article 3.19 of the RCEP states the following with respect to the B2B CoO:

(d) the consignment which is to be re-exported using the back-to-back Proof of Origin does not undergo any further processing in the intermediate Party, except for repacking or logistics activities such as unloading, reloading, storing, splitting up of the consignment, or labelling only as required by the laws, regulations, procedures, administrative decisions, and policies of the importing Party, or any other operations necessary to preserve a good in good condition or to transport a good to the importing Party;

(e) for partial export shipments, the partial export quantity shall be shown instead of the full quantity of the original Proof of Origin, and the total quantity re-exported under the partial shipment shall not exceed the total quantity of the original Proof of Origin.

Thus, the RCEP allows for imported goods to be stored for a certain period of time in a country before they are re-exported, and allows companies to break up bulk shipments, and to better handle regional distribution activities. When goods are re-exported, they are eligible for a new Certificate of Origin issued by the ‘intermediary’ country, to show that the country of origin has not changed. This is an excellent provision for facilitating regional distribution and for affording businesses more flexibility in the supply chain.

The content (values, quantity, etc.) of this second certificate of origin will contain details from the intermediate country (the back-to-back certificate of origin will then contain, for example, the value of the goods ex-distribution hub (i.e., the second delivery of goods), and no longer that of the first transactional leg. The country of origin does not change. It is important to note is that there are no “substantive operations” allowed on goods in an intermediate country, as this would lead to the goods losing their status of origin from the first exporting country.

---

6 Note that in the ASEAN-China FTA the B2B CoO is known as a “Movement Certificate”.

**Example 1:**

Goods from the production facility in the Philippines are directly sold and shipped to China, accompanied by a CoO from the Philippines. However, the invoicing flow is going through the HQ in Singapore, adding a significant mark-up, and is sold to China for USD 300. The importing country will see a difference in value and might be confused, given that the products are shipped from the Philippines, but the commercial invoice with different values comes from Singapore and is used for import clearance (see Figure 10). There is a risk that the customer will see the different applied values, which is a business confidentiality issue.

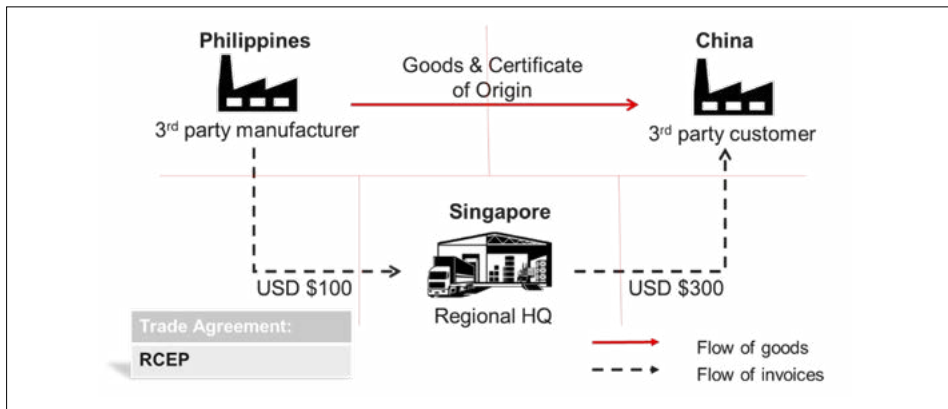


Figure 10: Normal tripartite transaction

By re-routing the supply chain and temporarily storing the goods in Singapore with the RCEP certificate of origin from the Philippines, we have the possibility of requesting a B2B CoO with the final destination being China.

The content of the B2B CoO will have to be adapted to the second delivery to China: the country of origin remains the same and the invoice value can be stated as USD 300, which is an advantage as the margin is not disclosed (Figure 11). However, other ASEAN FTAs also foresee the issuance of a B2B CoO. For example, under the ASEAN FTA, B2B CoO “Form D” will be issued. Under the ASEAN – China FTA, the Singapore customs authority will only issue B2B CoO “Form E”, since the agreement requires a “Form E” certificate of origin. These are obviously different FTAs, and the B2B CoO simplification cannot be mixed throughout the various existing FTAs that make use of B2B CoOs. Consequently, with a RCEP CoO, it is not possible to get a B2B CoO for the ASEAN China FTA.

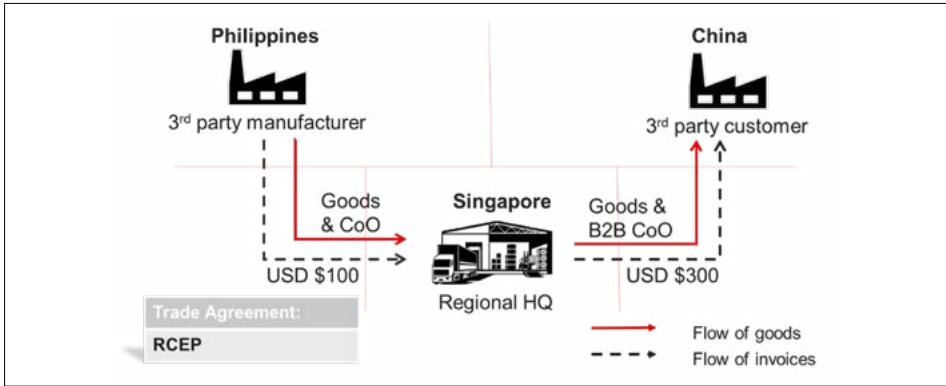


Figure 11: Re-routing supply chain to use back-to-back COO<sup>7</sup>

However, other ASEAN FTAs also foresee the issuance of a B2B CoO. For example, under the ASEAN FTA, B2B CoO “Form D” will be issued. Under the ASEAN – China FTA, the Singapore customs authority will only issue B2B CoO “Form E”, since the agreement requires a “Form E” certificate of origin. These are obviously different FTAs, and the B2B CoO simplification cannot be mixed throughout the various existing FTAs that make use of B2B CoOs. Consequently, with a RCEP CoO, it is not possible to get a B2B CoO for the ASEAN China FTA.

### 3.8 Approved exporter

Companies can obtain the special status of ‘Approved Exporter’ from the customs authority. This is subject to undergoing a specific authorization process which aims to assess if a company is qualified as specifically compliant in matters of origin of the goods. This results in the possibility of issuing declarations of origin on commercial documents. Consequently, this increases speed and efficiency, as a formal CoO is no longer required.

From a compliance perspective, the status of ‘Approved Exporter’ places emphasis on internal controls, as it always requires verification that the correct sentence is printed and assigned to the correct deliveries, and that the underlying Rule of Origin is still fulfilled. For example, a change in supplier, prices, or exchange fluctuation may have an impact on the origin calculation.

From a business perspective, the development of parallel schemes is unfortunate and does not make sense. It confuses companies in a subject matter that

7 Source: author’s own elaboration

is already complex. Countries and trade policy specialists should be consulted about the practicability of utilized schemes, otherwise long negotiated agreements or simplification will not be used.

### 3.9 Origin verification

Article 3.24 of the RCEP includes the origin verification process. Detailing all administrative processes that importing countries can employ to conduct an origin verification is beyond the purpose of this chapter. Paragraph 1 of Article 3.24 mentions the following:

For the purposes of determining whether a good imported into one Party from another Party qualifies as an originating good under this Chapter, the competent authority of the importing Party may conduct a verification process by means of:

- a written request for additional information from the importer;
- a written request for additional information from the exporter or producer;
- a written request for additional information to the issuing body or competent authority of the exporting Party;
- a verification visit to the premises of the exporter or producer in the exporting Party to observe the facilities and the production processes of the good and to review the records referring to origin, including accounting files; or
- any other procedures to which the concerned Parties may agree.

In practice, we already know that several of the above-mentioned actions are disputed and may not lead to the intended result of the trade agreement, such as the importing authority requesting origin information from the exporter.

## 4. Conclusion

The RCEP is an interesting FTA, especially considering the large amount of signatory parties it encompasses. The concepts, tools and simplification that were included into the RCEP makes this FTA a modern agreement. It is interesting to see the influence that agreements from both the Western and Asian parts of the world have had on the RCEP.

It is, however, disappointing that every country included its own tariff schedule, and that this has to be cross-checked with other countries, which makes the agreement difficult to access and utilize. The RCEP missed an opportunity to implement harmonized rules and make significant savings, especially considering the large geographic area it covers. Many companies will have to wait years before making the savings that will render their use of the FTA profitable. Overall, this means that the RCEP is not a competitor vis-à-vis existing ASEAN agreements.

Finally, the RCEP is not revolutionary, and rather constitutes an add-on to the large numbers of FTAs that exist around the world, thus further complicating the “noodle bowl” of agreements in the region. Again, this is the author’s perspective of the FTA, and does not include a comprehensive global analysis of all the potential existing benefits.

## References

- Trade Policy — Status Quo and Quo Vadis of Trade Liberalisation (Anliker Michel) – in: Singapore and Switzerland: Secrets to Small State Success, published in September 2016 by World Scientific Publishing Co. Pte. Ltd. (<http://www.worldscientific.com/worldscibooks/10.1142/9472>)
- Proof of origin: The points to consider using REX, originally published in German: Ursprungsnachweis: Darauf gilt es beim System REX zu achten, in MWST Newsletter 09, Oktober 2020, WEKA (Anliker Michel).
- Challenges when utilising Free Trade Agreements in Asia, originally published in French: Les défis posés par les accords de libre-échange en Asie, in: ZOLL REVUE / REVUE DOUANIÈRE 2 2018 (Anliker Michel).
- Tariff classification – Why the correct tariff classification is important, originally published in German: Warentarifierung – Warum die richtige Einreihung in den Zolltarif so wichtig ist – in: CH-D Wirtschaft 3/2015 (Haas-Bruni Christina / Anliker Michel).
- Free Trade Agreement in Asia Pacific – benefits and pitfalls, originally published in German: Freihandelsabkommen im Raum Asien-Pazifik: Vorteile und Tücken – in: China Compass Winter 2012/2013 (Anliker Michel / Schulte Robert).

# 2. The cost of rules of origin from a business perspective —How much does origin compliance cost?

**Marius Cosnita<sup>1</sup>**

The purpose of this chapter is to illustrate the significance of obtaining preferential origin treatment in various markets for companies with increasingly diversified portfolios. It highlights the strategic need for companies to meet rules of origin requirements. It also describes the origin management program implemented by a typical consumer industry to maximize the competitiveness of its products in specific markets.

## 1. Criticality of preferential tariff rates

Consumer goods products can face protectionist tariffs in key markets of 20% or higher. In order to meet such challenges, consumer product multinationals have long deployed programs to optimise the utilization of free trade agreements (FTAs). Developing a comparable origin management program for consumer products is central to the ability of diverse companies to compete and grow their market shares.

Rules of Origin are a determining factor in the amount of customs duty

---

<sup>1</sup> British American Tobacco



payable on imported goods. A product's origin will either fall under “non-preferential” or “preferential” origin duty rates. Non-preferential rates of duty are set via the tariff of the importing country. Preferential origin rates are typically agreed between specific countries / blocs as part of a tariff schedule of FTAs.<sup>2</sup> Products that are proven to meet the specific rules of the relevant FTA can obtain reduced or even zero percent duty.

An example of applicable non-preferential and preferential duty rates for a product range in one market is detailed in Table 1. In simple terms, utilising the FTA for the products below could give a company a 20% cost advantage over a competitor. Equally, failing to meet the requirements could mean a company's product being priced out of the market.

Product	Tariff classification heading (2022)	Trade area	Non-preferential duty rate	Preferential duty rate from EU / UK
Other nicotine products for oral application	2404.91	Southern African development community	20 % tariff	0 % tariff

*Table 1 – Example of tariffs differentials*

## 2. Challenges in realising preferential duty rates

While of clear commercial value, determining a product's preferential origin status can be complex for Small and Medium Enterprises (SMEs) and large-scale businesses. Typically, a formal program is necessary to ensure effective communication and ownership amongst internal and external stakeholders.

- Origin rules can be difficult to interpret and often require customs knowledge combined with technical expertise of the product.
- Operationalising a preferential origin program requires continuous edu-

<sup>2</sup> Preferential origin rates may also be established through non-reciprocal development agreements, such as the Generalized System of Preferences (GSP) regime.

cation of internal stakeholders involved in supply chain and product development, as well as external stakeholders such as suppliers and brokers.

- Third-party supplier information and documentation must be collated and maintained for key materials across the bill of materials (BOMs).
- Accurate and up to date BOMs detailing the validated origin of the key materials must be maintained, which requires live communication between supply chain, procurement and product teams.
- Calculations must be performed on each BOM, with rules of origin varying across products in a single agreement, amplified by rule variances across different agreements. This increases the level of complexity and administrative burden for obtaining preferential origin across product lines.

Actively managed origin management programs help resolve the challenges associated with realizing preferential duty rates by streamlining the process for gathering relevant information and managing on-going compliance with origin rules. Failure to build an actively managed origin program can result in a sub-optimal qualification process reducing businesses' abilities to gain a competitive advantage through reduced duty rates.

### **3. Consumer product origin management programs**

Two aspects of origin programs are relevant to consumer goods companies. The foundation is the operational support and maintenance of FTA claims on live flows. Upon establishing high-quality data, leading companies then build models to scenario test procurement, manufacturing and trade lane decisions to optimise landed cost outcomes.

#### **3.1 Operational origin management**

Operational management forms the foundation of any origin management program. It requires ownership of the processes for acquiring data, creating documentation, and ensuring continued compliance with FTAs. To be effective, it is necessary to deploy specific FTA technology as supported by a dedicated centralized team, which included the following functions:

- **Acquiring and maintaining high quality data** that is uploaded and stored centrally in a prescribed format to ensure all necessary elements are received. A supplier solicitation process should account for dual-sourcing and other sourcing issues affecting solicitation. This includes initial automated contact with suppliers underpinned by in-person follow-ups on missing or incomplete responses. The use of systems such as SAP GTS or MIC support the effective management of trade and vendor documentation.
- **Bill Of Material analysis / FTA qualification determination** that accurately calculates and identifies the item's origin based on applicable rules, including, for example, the calculation of EXW (Ex Works), the price of finished products, or customs tariff codes of raw materials, among other things. Supplier and BOM volume and the use of multiple FTAs means that technology with relevant FTA rule of origin content and calculation capability is critical. This stage may identify dependencies that need to be re-evaluated, including the tariff classification of a component material and additional supplier information or data.
- **Managing and retaining origin documentation** to ensure that any preferential origin claims are done so compliantly. This process, which combines people and technology, should ensure that the documentation required to support an origin claim is passed onto the customs brokers / logistics partners in a timely manner.
- **Operational decision-making ownership** that ensures origin determinations / decisions undergo the appropriate manual quality checks before being applied to any supply flows / goods movements.

The functions described above are summarized in Figure 1.

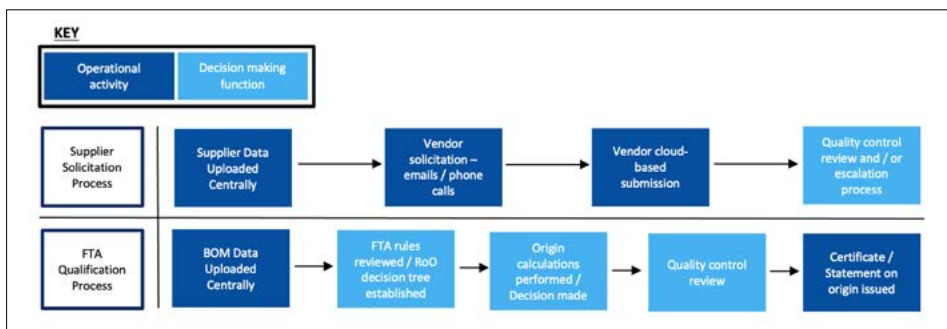


Figure 1 – Optimal FTA Management Process

## 3.2 Strategic long-term origin analysis

To identify and create opportunities to reduce costs, leading consumer goods product companies build origin management programs and utilise data analytics methods that facilitate scenario modelling to optimize longer term decision making. Strategic decision making on origin and sourcing typically includes the following:

- **Identify potential duty differentials** through total landed cost assessments that evaluate the current / future potential trade flows, including procurement expenditures, BOM, and rules of origin to understand key cost drivers.
- **Develop mitigating actions for existing duty costs** that may include switching trade lanes or shifting manufacturing bases to reduce costs.
- **Maximize savings potential and competitive advantage** through identified mitigation strategies.

# 3. Bicycle manufacturing in Asia: Background and a brief history

**Jonathan William Edwards<sup>1</sup>**

For many years, Taiwan has, and continues to be, at the centre of the bicycle business. Most of the major international bicycle brands and firms have offices with engineering and design departments there, and Taiwan is home to some of the largest bicycle manufacturers in the world. There are several hundred smaller bicycle assemblers and parts makers in Taiwan, many with Research and Development (R&D) and innovation centres.

As labour costs and overheads increased in Taiwan during the 1970s and 1980s, the country turned its focus onto manufacturing in hi-tech, mostly electronic industries. Goods produced from these industries include, for example, LED screens and computer chips. Even today, the majority of the world's laptops are assembled in Taiwan. During this transformational period, bicycle producers and bike-part makers, while keeping their head offices, financial centres, and R&D labs in Taiwan, started looking for lower cost satellite factories elsewhere in the region. China became a favourite location due to its proximity to Taiwan and the common language. As a result, many Taiwanese companies set up manufacturing plants in Shenzhen, which is a short distance from Hong Kong, making it easy to commute to and offering good access to a major shipping hub.

In 1992 EBMA (European Bicycle Makers Association) initiated a complaint of injury allegedly caused by the dumping of Chinese made bicycles

---

<sup>1</sup> A&J Europe

(HS heading 8712) into the EU. Under the World Trade Organization (WTO) Agreement, dumping is subject to anti-dumping duties if it causes, or threatens to cause, material injury to a domestic industry in the country of import. The General Agreements on Tariffs and Trade (GATT) allows countries to act against dumping. Following an investigation by the European Commission, findings of dumping and injury were confirmed. In 1993 the EU Commission published regulation 2474/93. As a result, an anti-dumping duty of 30.6% lasting five years was applied on all imports of complete bicycles from China to the EU. Although the anti-dumping duty was due to expire after a period of five years, EBMA actively sought to extend it. During a review after the second five-year period in 2005, it was noted that although the quantity of shipments had dropped in the five-year period, this drop did not meet the expected percentage. It was also noted that average bicycle prices from China had dropped significantly. This was seen as an effort by Chinese producers to mitigate part of the 30.6% duty. The conclusion of the review was that the anti-dumping duty was to be extended for a further five years and the additional duty was increased from 30.6% to 48.5%.

During this time there was no reduction for China in normal import duty under the Generalised System of Preferences (GSP) from the EU. As a result, not only did the importer have to pay the 48.5% anti-dumping duty, but also an import duty of 14%, which almost stopped entirely the export of complete bicycles from China to the EU.

Following successful applications for extensions by EBMA, the 48.5% dumping duty has been consistently re-applied every five years since then. The normal period for anti-dumping duty is a five-year period plus, in the case of an application for an extension, a 12 to 15 month 'review period', during which the duty remains in place. EBMA applied to the Commission for a further extension, which was granted in 2019, extending the dumping duty for further five years. The additional duty has been branded as a lifeline for EU producers, but it had some unfortunate side-effects and the opportunity for EU producers to pick up this dropped volume was not fully utilized.

The anti-dumping duty had three effects:

4. EU producers were duly protected as imports of complete bicycles from China almost stopped entirely. Nonetheless, EU producers did not take the opportunity to pick up this previously imported quantity for themselves. They failed to invest or modernize and simply carried on using an old model of importing frames – often already painted (ironically in

- China) and performing screwdriver assembly processes in their existing plants and other traditional locations. The ‘just carry on’ mentality of these EU producers was possibly a result of complacency brought about by the new protection they had been given.
5. Some Taiwanese assemblers moved part of the process back to Taiwan and began to tackle the island’s high labour cost by bringing manual workers into the country from lower cost areas such as Vietnam and the Philippines. This was largely successful, and Taiwan maintains a healthy quantity of exports to the EU to this day. As most of the R&D and, therefore, innovation was based in Taiwan, the average prices of the bikes produced in Taiwan increased and more high-end production became the norm.
  6. Many of the producers who specialized in lower end and mid-price point production still found Taiwan to be too expensive. Instead of moving back to Taiwan, they sought alternative manufacturing bases with low labour rates, and governments with good tax incentives to set up new facilities. Some of these locations included Thailand, Vietnam, Indonesia, and the Philippines.

While the anti-dumping duty significantly reduced imports from China, it encouraged Taiwan to find ways to become more competitive by introducing measures such as imported labour. However, the biggest effect was introducing the Chinese/Taiwanese cultures of bicycle production and export to new counties which had previously had little to no experience of manufacturing bicycles for export. As exports from these locations grew, the EBMA had no choice but to apply for dumping measures against these countries too. Whilst this action was initially successful, EBMA was unable to justify its calls for penalizing duties that matched up to the 48.5% dumping duty placed on China, and nor were its calls for extensions granted either. Thus, the duties had limited effect and expired after five years. These countries (including Thailand, Vietnam, Indonesia and the Philippines) thus became firmly established as significant bicycle exporters to the EU, the USA, and Canada.

Clearly, the huge penalty of the anti-dumping duty had a major effect on the quantity of bicycles exported to the EU, but this should be classed as an ‘exceptional duty’ which served to make a specific market correction. It was designed only to offer protection from material injury to a domestic industry, in this case the EU producers of complete bicycles. However, this contribution aims to show how regular import duty, particularly under the various GSP

schemes in the world, can influence trade from poorer countries in various ways. It is a complicated area. Nonetheless, by drawing on my direct experience of working at a start-up bicycle manufacturing company in Vietnam (which later moved to Cambodia), I hope to shed some light on the mechanisms and complications of the bicycle market (with particular relation to the efficacy of trade contingency instruments and rules of origin.

## 1. The resulting migration of production

Of the five countries in Asia to pick up major bicycle production industries from China following the imposition of the anti-dumping duty (namely, Vietnam, Indonesia, the Philippines, Thailand, and Taiwan), Vietnam emerged as a leader in lower to medium priced bicycles. By 2003, Vietnam had six active bicycle exporters in and around the southern city of Ho Chi Minh, all of whom exported the bulk of their production to the EU. When a Taiwanese company relocate a manufacturing base overseas, it can be expected that a large number of senior, middle and lower managerial staff will also relocate with it and live on the factory site in dormitories.



*Figure 1: The Ease of Relocation*

Source: Google Maps



The main reasons for Vietnam being favoured over other locations are illustrated in Table 1, ranked in order of importance.

Ranking	Selection criterion	Characteristics of Vietnam
1	Country	Vietnam has a politically stable government with a clear manufacturing and export operating system, and good tax incentives for investors. It is also a communist country, which the Taiwanese were used to in China.
2	Labor	Vietnam has low labour rates and social costs, and flexible employment conditions. There is also a large pool of highly motivated and skilled workers, many of whom speak Chinese.
3	Logistics	There are short and regular shipping times for raw materials and parts from China, Taiwan, and Japan. Ho Chi Minh developed a deep-sea port for container vessels. It also had regular feeder ships to Singapore.
4	Trade	Vietnam is part of the ASEAN group and benefits from the GSP. While import duty of bicycles into the EU from Taiwan is 14%, from GSP countries like Vietnam this duty was reduced to 10.5%.
5	Geography	Ho Chi Minh does not experience earthquakes, typhoons, or flooding. The land is fertile and local food and water is plentiful. Taiwanese management teams will be safe and should be satisfied by the quality of life offered in Vietnam.
6	Support	A good selection of local bicycle part makers (mostly of Taiwanese origin) were already established within the same area to serve the growing demand from the bicycle assembly factories.
7	Social	There is a large community of other Taiwanese manufacturers from various industries with local experience and knowledge. Locally, there are Taiwanese restaurants, tea shops, medical clinics and supermarkets.

*Table 1: Selection process*

I established the first Asian assembly factory (ABC) near Ho Chi Minh, Vietnam in 2003. At that time, due to low labour rates and very productive and efficient workers, the bicycle export business in Vietnam was thriving and growing quickly. 90% of exports were to EU importers who found prices to be more competitive than those offered by Taiwanese companies, and who were unable to buy from China due to the very high dumping-duty imposed on Chinese bicycle imports. In addition to low labor rates and a proactive workforce, there was also a system of reduced duty for exports from Vietnam under the EU GSP (i.e., item 4 in Table 1). Under the GSP, the regular import duty of 14% on a bicycle (tariff heading HS8712) was reduced to 10.5%.<sup>2</sup> However, in the case of ABC this duty benefit was not available.

To attain the reduction in duty, the importer had to make the customs entry along with certificate of origin Form A. The origin certificate was provided to the importer by the exporting factory but was issued by the ‘competent authority’ of the exporting country (i.e., the Vietnamese government in the case of ABC) and was subject to the assembly factory complying with the ‘product specific’ rule of origin (ROO) (i.e., for bicycles in this case). The rule of origin was, at that time, as follows:

Chapter 87: Vehicles other than railway or tramway rolling stock, and parts and accessories thereof;

Manufacture in which the value of all the materials used does not exceed 40 % of the ex-works price of the product.<sup>3</sup>

In a nutshell, the bicycle had to be produced under a 60/40 rule as follows:

- A Minimum of 60% of the ex-works price had to be **originating** content.
- A Maximum of 40% of the ex-works price, of imported ‘**non-originating**’ parts could be used.

‘Originating’ content included:

- A. Locally produced parts from Vietnam.
- B. Factory input such as labor, overhead, expenses and profit.
- C. As Vietnam was part of the ASEAN group under the GSP rules, cu-

2 “Council Regulation (EC) No 2501/2001, applying a multi annual scheme of generalized tariff preferences for the period 1 January 2002 to 31 December 2004”. See: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2004:0699:FIN:EN:PDF>

3 Ibid. Annex 1

mulation of parts from within that regional group of countries was also allowed (i.e., regional cumulation).

Other ASEAN countries (item C) made a big contribution to the percentage of local content and included:

- Malaysia – Shimano hubs, chainwheels, and disc brake systems
- Singapore – Shimano gears, cassettes, and gear shifters
- Indonesia – Tyres, tubes, saddles, and pedals
- Thailand – Tyres and tubes

In the case of ABC, the 60% local content required by the rule of origin could not be reached. ABC had just opened its first assembly factory. At that time, ABC was doing painting and bicycle assembly but did not produce its own bicycle frames. These were imported from experienced sub-contractors in China. As a result, ABC could not meet the rule of origin and could therefore not get Form A from the authorities. Therefore, the GSP reduction in duty was not enjoyed by the customers of ABC and the full 14% import duty had to be paid.

As can be noted from Table 1 above, when considering the location of the factory, the GSP benefit was listed fourth in order of importance. In other words, it was not seen as a huge benefit, and it was not essential to the growth of the business. This was not because we knew we could not get it. At the time of selecting Vietnam as a location, we thought we would be eligible, but the reduction was considered insufficient to make it a major part of the decision-making process. As predicted, despite the lack of GSP, the business did grow, due mainly to the competitive pricing brought about by low labor rates, and the motivated and skilled local workers. These two key points gave us a sufficient ‘competitive advantage’ over Taiwanese producers. The price of the product was 5% to 10% lower than the like-for-like product from Taiwan. The fact that the duty was not reduced under GSP was disappointing, but not essential, because the duty was still the same as that of Taiwan.

With a like-for-like duty of 14% and an (up to) 10% advantage in price, the market share in Vietnam grew. The success story was the same for all the factories there, imports from Vietnam to the EU began to climb at a steady rate and red flags were raised among EU bicycle producers. Once again, EBMA became active and launched a dumping and injury complaint to the commission about Vietnam. Having effectively stopped exports from China, EU producers who

had not developed technological advances once again came under growing pressure. Imports from Vietnam were not as cheap as they previously had been from China but were cheaper than from both Taiwan and the home-produced equivalent. In fact, they were, in most cases, also a better product, as they were produced with more up to date processes such as ‘tig’ welding, wet painting, and often with a better selection of parts, which were readily available but not fully utilized by European makers.

EBMA was once again successful in building a case, and in 2005 the European Commission imposed dumping duties, which varied from factory to factory, from 15.8% to 35% on imports of bicycles from Vietnam for a period of five years, ultimately rendering the export of complete bicycles to the EU impossible.

An article published by Bike Europe on 30 December 2010 reported that:

The anti-dumping duties on Vietnam-made bikes were instigated in 2005. They caused Vietnam exports to grind to a halt, with the number of bikes exported to the EU declining from about 1.5 million units in 2004 to less than 7,000 in 2009. It also forced a number of bike makers of Vietnam into insolvency.<sup>4</sup>

Once again, a dumping duty was imposed to protect EU manufacturers, the real effect, however, was simply to force the ‘migration’ of the main ‘manufacturing cluster’ to other places. Producers in Vietnam began to search out new locations as quickly as possible to maintain their market share, and so for ABC, the search for a new home began.

## 2. The second stage of the migration of production

China could still not be considered as a suitable alternative location due to the anti-dumping duty of 48% on bicycles, which had been in place since the 1980s, with no end in sight. Taiwan was still uncompetitive at the mid and economic level bicycles due to higher labor rates and overheads and the full import duty on bicycles to the EU of 14% (Taiwan is not a part of the GSP or a member of any regional group with similar benefits).

There were several other choices of location within the region. Thailand, Indonesia, and the Philippines all had an established bicycle export industry,

---

<sup>4</sup> See: <https://www.bike-eu.com/laws-regulations/artikel/2010/12/eu-lifts-dumping-duty-on-vietnam-made-bikes-1018943>

which indicated a level of local skill. All three countries also had similar attributes to Vietnam in terms of ease of shipping parts, low labor rates and social costs. The governments in these countries were somewhat less stable than in Vietnam, but they did provide good tax incentives for investors. The main drawback was that workforces in these countries were not quite as motivated as Vietnamese workforces, and there were no local bicycle-part makers to draw from, which increased costs. With a reasonable investment and a lot of work, most of these countries could have become an almost like for like replacement to Vietnam, and were strongly considered by ABC until another opportunity presented itself: Cambodia.

Cambodia's southern border with Vietnam was only a two-hour car journey from the company's existing factory location in Ho Chi Minh. This was an immediate attraction. However, when considering Cambodia, there were many other pros and cons to be worked through.

The *cons* included the following:

1. Cambodia, to my knowledge and experience, had no pre-existing bicycle export industry. In fact, it had never exported a single bike. This meant that there were no local part makers to draw from.
2. The government was stable in 2005, but the country had only been reformed some nine years before that, following the brutal rule of the Khmer Rouge.
3. The country had very limited finances which meant that infrastructure and internal organization was weak.
4. The population was small, at 15 million, as opposed to the 85 million population of Vietnam.
5. There were social problems such as extreme poverty, malnutrition, a lack of education, and work ethic.
6. There were language problems with very little or no English and no Chinese spoken.
7. There was not enough power to support the manufacturing process, meaning generators had to be installed, which increased costs.

There were *benefits* to offset some of the issues above:

1. Labor rates were extremely low. In 2005 the minimum wage was \$45 a month, as opposed to Vietnam which was around \$100 a month. This could have a partial balancing effect on the lack of local skills: more workers would have been needed for the same amount of output, but more workers could easily be hired at small expense.
2. The Royal Cambodian Government had formed special economic zones (SEZs) which allowed investors to import machinery and parts which could be processed and re-exported without duty. One of these SEZs was established in Bavet, a small market town close to the Vietnamese border, a two-hour drive from Ho Chi Minh. This partly overcame the issue of local parts, as it was possible to use Vietnamese factories for parts, and to use the Ho Chi Minh shipping port for export.
3. Land costs and building costs were very attractive, making investment easier to financially manage. This allowed us to dedicate more of the budget to supporting the inevitable training costs that would be incurred by an unskilled workforce.

Finally, all the challenges and opportunities presented by Cambodia, paled into insignificance compared to the *huge duty benefit* available by establishing our site in a LDC like Cambodia. LDCs are the beneficiaries of a system called Everything but Arms (EBA). This part of the GSP and reduces EU import duties to zero for all HS headings, with the obvious exception of arms (i.e., weapons or ammunition). While manufacturing bicycles is inherently complicated due to the varied parts needed and the number of different suppliers involved, the benefit of such an item is its relatively high price point, and its relatively high import duty in the EU (14%). So, where a reduced import duty of 10.5% would have been a benefit in Vietnam, this carried nowhere near the same weight of benefit as the rate of Cambodia, where duty is reduced completely to 0%.

ABC's average-priced bicycle from Vietnam was \$140. If we had received a GSP benefit there, the duty saving from GSP to the importer would have been \$4.90 (resulting from a 10.5% duty under the GSP as opposed to 14%). This was only a saving of few dollars per units, which is why this reduced duty rate was relatively low on the list of pros for Vietnam. But, if our average price from Cambodia was still \$140, then the saving to the importer from the EBA would have been \$19.60, which is significant. To put it into context, the saving was

almost the same amount that the importer would have spent per bicycle on sea freight and clearance costs to their local port. This saving is further illustrated by item 10 in Table 2.

This was the trigger that encouraged ABC to produce its own frames to ensure that there was enough local content to meet the rule of origin. This level of advantage is very important for the importer, and when taken through the retail price point to the consumer, it can actually change the goal posts in terms of market prices. A typical example of this would be as follows:

**Original Carriage Insurance and Freight (CiF)<sup>5</sup> based price from Taiwan (including freight) of a bike with a production cost of \$280.**

With 14% duty and the importers margin of 30%, the price increases to \$456

With the retailer margin at 40%, the price increases to \$760

With VAT at 20%, the consumer price is set at \$912.

**Assuming the same CiF based price from Cambodia costing \$280**

With no duty and the importers margin of 30%, the price increases to \$400

With the retailer margin at 40%, the price increases to \$667

With VAT at 20%, the consumer price is set at \$800.

If the sourcing of this bicycle was moved from Taiwan to Cambodia and duty benefit was to be passed all the way through to the consumer, there would be a \$112 reduction at the retail price point, assuming that the quality of the bicycle, and the free on board (FOB)<sup>6</sup> prices were the same. The reality is that the competitive edge gained by the importer is so significant that it is enough for a factory to *share this benefit* with the importer, so all parties can enjoy the gains.

At this point, the reader can refer to Table 2, which provides detailed information on how firms choose between production sites, and note the following points:

1. Cost of parts (lines 1-1a) will be almost identical from factory to factory (assuming similar factory sizes). Parts are ultimately chosen by the importer or brand and for each manufacturer they are essentially the same. There may be some small regional supply chain nuances for convenience or geographical reasons, but costs will be similar.

---

5 Cost of product including inland carriage, insurance and sea freight.

6 Cost of product as delivered by the seller to the shipping port

2. Freight and inland costs for incoming parts and raw materials will be different from Taiwan to Cambodia. A lot of parts come from Taiwan, so the advantage here lies with the Taiwanese bicycle maker. In addition, in the case of Cambodia, the shipping port is in Ho Chi Minh, Vietnam, which adds one more country to the travel logistics, and another national border to Cambodia to negotiate. The same applies when transferring finished bikes to port, as usually export deals are made on an FOB basis. In the case of ABC, the annual calculated cost of freight and logistics is 3.5% (line 2). It makes some sense to allocate this as a percentage rather than a fixed amount, because the more high-end the bike, the lower the volume, which leads to increased import costs as air freight is more frequently used for parts. For lower-end bikes where volumes are greater, parts can be shipped by container. By comparison, freight and logistical costs in Taiwan (lines 2-2a) were closer to 1.5%.
3. Admin costs for Form A (lines 3-3a) cover the fees applied for application and some associated costs for verification, EU customs regularly request verification that the Form A from Cambodia is real and has been obtained legitimately. This is the 'cost to comply' with Form A, which is negligible in terms of the value of the duty-free rate, but nonetheless represents another cost that is not applicable to Taiwan.
4. Painting and assembly costs do not change substantially from one bicycle to the next. The only difference is at entry level price points, where volumes are higher which, in turn, leads to less line changes in a shift. However, the paint and assembly costs for a \$400 FOB bike are exactly the same as they are for a \$1000 bike (lines 5 and 7). For example, while the rear gear on a \$400 bike may cost \$20, and the rear gear on an \$800 bike might cost \$50, there is in fact, no difference regarding the skills needed for assembly. Both rear gears would fit onto their respective bikes with the same M10 Allen key bolt, and both would be connected by one cable. As a result, assembly time and assembly cost is identical. At the lower price points of \$200 and \$100 the volumes step up and order quantities are likely to be bigger, as such, there are fewer line changes per day which does create a modest saving on the assembly cost in the region of 20-25%. The actual paint and assembly time for the \$100 bike and the \$1000 bike is the same, it is only the line 'down-time' that is influenced.



5. Total manufacturing costs in Taiwan (line 7a) are higher partly due to overheads and partly due to labor costs, although these are perhaps lower than expected. Firstly, Taiwan has been the manufacturing centre for bicycles for many years. The well-established big factories of this industry have repaid their investors time and again, whereas in Cambodia, a new factory still carries a big amortization of the investment. Secondly, there is the issue of labor. In Taiwan labor costs are high, but this is tackled partly using imported workers from the Philippines and even Vietnam. In Cambodia, the labor costs are lower but because of a lack of skilled workers, a lack of experience, and a very different 'work ethic', there is a need for more workers to do the same amount of work. For this reason, we estimated a true saving of manufacturing costs in Cambodia of around 25%.
6. As a result of an 'almost' consistent manufacturing cost across all price points, you can see that the cost of manufacturing as a percentage of the value of the bike will drop dramatically as the price point increases. This is true of both Taiwan and Cambodia (lines 7 & 7a).
7. Since the profit is computed as a percentage, the dollar profit per bike increased substantially when manufacturing more expensive bicycles (line 8).
8. Shipping costs (line 10) to the EU port of the importer is roughly the same from Taiwan as it is from Vietnam. The latest known rate for a 40' container is \$3500. Usually a 40-foot container can load 260 Bikes ( $3500 / 260 = \$13.46$ ). On top of that the importer must pay lift-on and lift-off costs, plus various clearance and document charges, in addition to an on-cost for demurrage or storage costs if this service is utilized. The estimate of \$20 per bike is the maximum cost and could be 10% less.
9. Import duty (line 11) is calculated by customs at the port of arrival and is based on the cost of goods plus the freight to the arrival port (CiF price), subsequently, (in the case of bicycles) 14% must be added to the bicycle and also to the \$20 freight. The 14% duty on the freight is around \$2.80 per bicycle. This is often overlooked by the importer who usually calculates competing factory prices simply based on the FOB + duty, rather than the correct method which is FOB + freight & insurance + duty (or CiF + duty).

*Table 2 - Manufacturing cost and duty analysis - Cambodia vs Taiwan*

<b>Examples based on CAMBODIA at FOB selling prices:</b>		<b>\$100</b>	<b>\$200</b>	<b>\$400</b>	<b>\$600</b>	<b>\$800</b>	<b>\$1000</b>
1	Cost of parts purchased	66	148	314	488	662	836
2	Freight and inland costs of parts in and Bikes out	2.39	5.37	11.39	17.70	24.01	30.32
3	Admin cost form A - application and verification	1.00	1.00	1.00	1.00	1.00	1.00
4	Sub total	69.39	154.37	326.39	506.70	687.01	867.32
5	Painting and Assembly cost	12	16	20	20	20	20
6	Overhead allocated	8	10	14	14	14	14
7	Total manufacturing cost	20	26	34	34	34	34
	Manufacturing costs as a % of the FOB price	20.14%	12.97%	8.49%	5.66%	4.24%	3.40%
8	Profit = 10%	9.93	20.04	40.04	60.08	80.11	100.15
9	FOB export price	99.33	200.41	400.43	600.78	801.12	1001.47
10	Shipping cost from FOB to importers local Port	20	20	20	20	20	20

Taiwan FOB based on the same cost of parts		\$98	\$195	\$385	\$572	\$760	\$948
1a	Total cost of parts purchased	66	148	314	488	662	836
2a	Freight and inland costs of parts in and Bikes out	1.01	2.25	4.78	7.43	10.08	12.73
3a	Admin cost form A - application and verification	0.00	0.00	0.00	0.00	0.00	0.00
4a	Sub total	67.01	150.25	318.78	495.43	672.08	848.73
5a	Painting and Assembly cost	15	20	25	25	25	25
6a	Overhead allocated	10	12.5	17.5	17.5	17.5	17.5
7a	Total manufacturing cost	25	32.5	42.5	42.5	42.5	42.5
	Manufacturing costs as a % of the FOB price	25.54%	16.72%	11.06%	7.43%	5.59%	4.48%
8a	Profit = 6%	5.87	11.67	23.06	34.34	45.61	56.89
9a	FOB Export Price	97.88	194.42	384.34	572.27	760.19	948.12
10a	Shipping from FOB to importers local Port	20	20	20	20	20	20

### Comparative summary

11	Import duty from TAIWAN (14%)	\$16.50	\$30.02	\$56.61	\$82.92	\$109.23	\$135.54
	Landed cost when shipped from Taiwan	134.38	244.44	460.95	675.18	889.42	1103.65
12	Import Duty from Cambodia - LDC Country (0%)	0.00	0.00	0.00	0.00	0.00	0.00
	Landed cost when shipped from Cambodia - LDC Country	119.33	220.41	420.43	620.78	821.12	1021.47
13	Potential saving from Cambodia vs Taiwan	\$15.05	\$24.03	\$40.52	\$54.41	\$68.30	\$82.19

When referring to Table 2 along with Figures 1 and 2, some key points are clear:

- The cost of manufacturing becomes significantly less (as a %) as the price of the bike increases (Figure 1).
- The duty saving in dollar terms becomes much greater as the price of the bike increases (Figure 2).
- The additional costs of freight, Form A and assembling in Cambodia can easily be absorbed by the duty saving.
- Not only can those costs be absorbed but an additional profit can be added by the factory. Note that the model used in Table 2 includes a 10% profit for the factory as opposed to a 6% profit which we experienced in Vietnam and would be normal in Taiwan.

Even after adding on the additional costs involved with being located in Cambodia, and a higher profit for the factory, the importer can still make a saving of around 7-10%. Of course, the importer will try to get as close to the total duty saving of 14% as they can and will try to negotiate the same FOB that is obtainable from Taiwan. As such, this additional profit often becomes a question of negotiation over quantity and number of models awarded to the factory, both of which can be used to build the business more quickly. The fact remains that the duty-free advantage is significant enough for all parties to enjoy real benefits, whether extra profits, a way to gain more volume and quicker growth for the factory, or greater market shares for the importer by competitive consumer pricing.

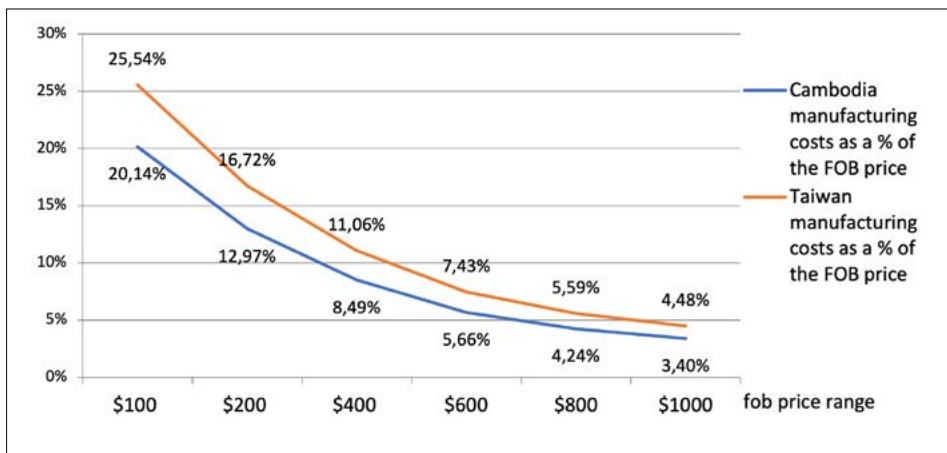


Figure 1: Manufacturing cost as a % of the FOB price



Figure 2: Potential saving (each bike) on landed cost vs buying from Taiwan

### 3. Using the advantage for growth

In the case of ABC, the strategy was to balance the financial benefit partly for additional profit, and partly targeting more rapid growth. There is no doubt that the duty saving brought the rapid growth that we sought, and this came in two phases.

#### 3.1 Growth phase 1

During this period the factory experienced year on year growth at a steady rate from 2007 through to 2010, climbing roughly 30% in terms of bicycles exported in those three years from 111,000 pieces shipped to Europe in 2007, to 143,000 in 2010 (Figure 3). As we approached customers with our business plan for Cambodian-made bikes, there was skepticism at first that a factory in a LDC country like Cambodia could really produce bikes of the same quality level as Taiwan. The key sales pitch was to show customers that ours was not really a ‘Cambodian bike factory’. Our Unique Selling Proposition (USP) was that we are a Taiwanese bike factory that happens to be located in Cambodia. Customers saw that we had the same type of layout, machinery, quality control (QC) procedure and management that they would regularly see in any Taiwanese bike factory.

During this period, once customers were convinced about the level of bike we could produce, demand started to lean toward more expensive bikes. In those same three years, our average FOB price also increased from \$185 to \$225

(see Figure 3). This was a huge change from 5 years previously when we were in Vietnam, with an average FOB price of \$140. The fact is that the amount of dollars saved would drive up the price points, and customers would put low-end bicycle orders into other factories and start to put more of the mid to higher-end bicycle orders into ABC.

It is a universal truth that no buyer likes to put ‘too many eggs in the same basket’. If ABC was to get only a share of the business, it made more sense for us to get the share of the bikes with the biggest dollar saving to the importer. The correlation between duty benefit and both the increased sales, and the increased average price is clearly demonstrated in Figure 3.

Here I refer to the rule of origin as shown previously:

Chapter 87: Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof;

Manufacture in which the value of all the materials used does not exceed 40 % of the ex-works price of the product.

In a nutshell, the bicycle had to be produced under a 60/40 rule as follows:

- A Minimum of 60% of the ex-works price had to be originating content.
- A Maximum of 40% of the ex-works price, of imported ‘non-originating’ parts could be used.

CORRELA-TION	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Average FOB value	\$185	\$190	\$195	\$225	\$275	\$275	\$275	\$250	\$250	\$270
EU sales ('000s)	111	119	121	143	265	387	508	501	479	579

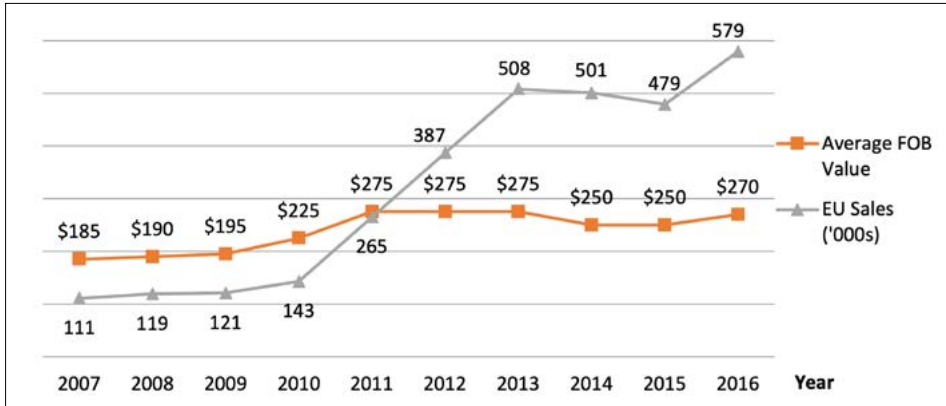


Figure 3: 2007 - 2016 Correlation Chart (unit sales vs average price)

In our move into more up-market products, we began to run into problems reaching the required percentage of local content. As Table 2 and Figures 1 clearly show, the value of the local input in terms of total manufacturing cost becomes smaller (as a percentage) as the price increases. While this is a benefit to the customer, it created a situation where we found it harder to reach the required amount of 60% local content. Thus, we found that we had a natural limit or ceiling on the FOB price of around \$400 FOB. An example from Cambodia shows this as follows:

#### Example 1 - \$400 Bike:

Manufacturing cost including overhead \$34.

Profit \$40.

Freight, logistics and Form A costs (a local factory cost) \$12.39.

Local parts including those with regional cumulation \$170.

Total local content \$256.39 or 64%. Conclusion: Rule of Origin passed.

#### Example 2 - \$500 Bike:

Manufacturing cost including overhead \$34.

Profit \$50.

Freight, logistics and Form A costs (a local factory cost) \$15.55.

Local parts including those with regional cumulation \$170 (2).

Total local content \$269.55 or 54%. Conclusion: Rule of origin failed.

The “ceiling” created the following problems:

1. As the bike price increased, manufacturing costs remained the same, only the profit and freight costs generated a small increase.

2. The value of cumulated parts became ‘frozen’ because the parts available from the countries in the ASEAN group and allowed for cumulation were limited, and these parts also had their own ceiling. Once a bike reached a certain price point (\$400 plus) it became equipped with more parts from Taiwan and Japan and even some parts from the USA – none of which were included in regional cumulation.

This became a fact of life, and despite this situation, ABC continued to grow at a steady rate, and we increased our ‘average’ FOB as much as we could or as much as the rule of origin would allow us to. Business was still good for ABC in Cambodia.

### 3.2 Growth phase 2

It became apparent during 2010 that the GSP rules were about to undergo a major change in favor of LDC countries. A new regulation became effective as of 1 January 2011, and the rule of origin changed as follows:

ex Chapter 87: Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof; except for:

- (a) LDCs Manufacture in which the value of all the materials used does not exceed 70 % of the ex-works price of the product
- (b) Other beneficiary countries Manufacture in which the value of all the materials used does not exceed 50 % of the ex-works price of the product.<sup>1</sup>

The new regulation split the rule of origin into 2 parts:

- Under rule A, for LDC countries, bicycles now had to be produced under a 30/70 rule as follows:
  - A minimum of 30% of the ex-works price had to be originating content.
  - A maximum of 70% of the ex-works price, and of imported ‘non-originating’ parts could be used.

---

1 COMMISSION REGULATION (EU) No 1063/2010 of 18 November 2010. Amending Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code. See: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R1063#:~:text=Commission%20Regulation%20%28EU%29%20No%201063%2F2010%20of%2018%20November.%28EEC%29%20No%202913%2F92%20establishing%20the%20Community%20Customs%20Code.>



- Under rule B, there was a small change for GSP countries like Vietnam and Thailand who now only had to find 50% local content as opposed to the 60% previously (this would have helped us a lot when we were in Vietnam), but the big change came to LDCs who now got their own separate and much lower target of local content, which was half of the present percentage - from 60% down to 30%.

This led to a new situation on mid to high-end bikes that effectively lifted the 'duty free' ceiling to levels we and our customers had never experienced before:

#### **Previous Example - \$500 Bike:**

Manufacturing cost including overhead \$34.

Profit \$50.

Freight, logistics, and Form A costs (a local factory cost) \$15.55.

Local parts including those with regional cumulation \$170 (2).

Total local content \$269.55 or 54% = Rule of origin passed.

#### **New Example - \$1000 Bike:**

Manufacturing cost including overhead \$34.

Profit \$100.15.

Freight and logistics costs (a local factory cost) \$30.32.

Local parts including those with regional cumulation \$170.

Total local content \$334.47 or 33.34% = Rule of origin passed.

This new proposition gave us a whole new impetus in our approach. Customers immediately recognized the bigger savings which were now on offer. Having enjoyed two to three years of (mostly) successful business together, and with healthy improvements to clients' bottom lines already showing, the next wave of increased business was quick to follow.

The sales pattern in Figure 4 clearly shows the three years (2007 – 2010) of steady growth under the previous GSP rules of origin and the great effect the new rule had. In a very short time, from 2010 to 2013, sales climbed by over 180%. In addition, the correlation chart (Figure 3) shows that the average price grew at the same period from \$225 to \$275 FOB. There can be no doubt that this significant growth was due entirely to the change in rules brought about by regulation No. 1063/2010 and the halving of the local requirement percentage.

Further evidence presented itself (in negative ways) in 2014 and 2015. During 2014, the European Commission launched an investigation into a possible circumvention of the anti-dumping duty from China. It was alleged

by EBMA that certain assembly factories in Indonesia, the Philippines, and Cambodia were either:

1. Importing complete or almost complete bikes from China, re-packaging them with a new origin mark on the packaging and exporting them to the EU.
2. Assembling bikes with a majority of Chinese parts – ‘majority’ meaning more than 60% of the value of the parts used were of Chinese origin.

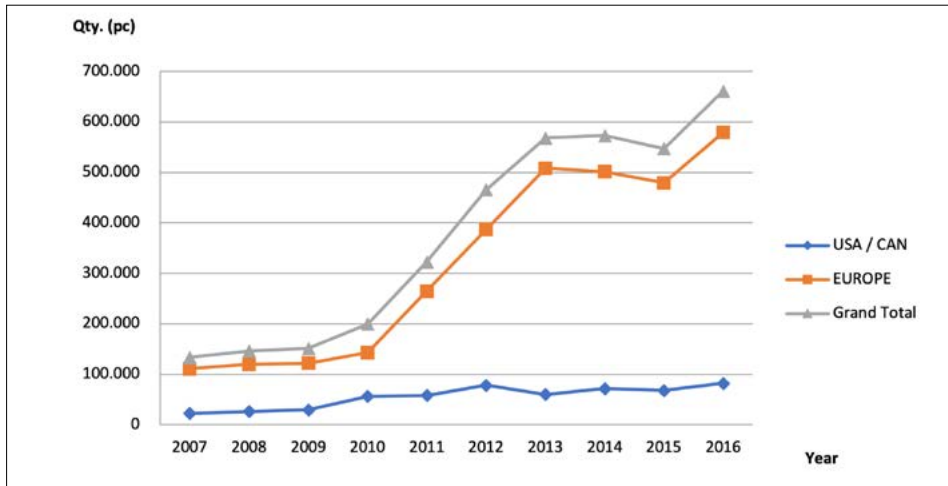


Figure 4: 2007 ~ 2016 Regional Sales Comparison Chart

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
USA / CAN	22,500	26,440	29,630	56,560	58,182	78,409	60,088	71,922	67,940	82,020
EUROPE	111,200	119,650	121,952	143,179	264,860	387,207	508,106	501,065	479,091	578,920
Grand total	133,700	146,090	151,582	199,739	323,042	465,616	568,194	572,987	547,031	660,940

The investigation began into ‘non-preferential’ rules of origin. The target was not so much anyone claiming GSP benefit with the incorrect use of Form A (which may or may not have occurred), but the possible evasion of the 48.5% anti-dumping duty on Chinese bicycles. This was based on the anti-circumvention legislation.

The investigation covered all known producers in the three countries and took nine months to complete. When the turn of ABC came, we were able to

demonstrate that our assembly process was limited to just 30% of parts from China (around half of the allowed limit). This was due to two main factors:

1. During the rapid growth period of 2007 – 2012, we had gradually increased our own frame production in Cambodia. Initially, this was to increase our level of local content and at the same time to allow us to control both the delivery and the quality of the frames we used in production. By the time of the investigation, almost all of our frames were of Cambodian origin rather than Chinese.
2. As the average price of our bikes climbed higher, the level of the componentry changed and moved away from lower-level parts from China to more mid and high-end parts from Taiwan and Japan.

We proved our innocence in this case and the result was announced in 2015, but the disruption to our sales pattern is obvious (*Figure 4*). Even though we offered firm guarantees and even financial support in the event of a negative outcome, the thought of potentially losing their duty-free source was too much to contemplate for many of our customers, and they started to move a percentage of their orders back to the safety of Taiwan. This is further evidence of how fragile a business can be when it relies heavily on a duty-influenced environment.

Future rule changes that could end up not going in our favor have to be considered. In fact, there are several factors which could dramatically change our situation:

1. Changes to the GSP rule of origin which may re-introduce a ceiling.
2. Changes to the list of countries eligible for cumulation as various countries either graduate out of GSP or enter into free trade agreements with the EU.
3. Change to Cambodia's LDC status.
4. Initiation of the TPP partnership, which would give Vietnam duty free status to several of our export countries, including the USA and Canada.
5. Free trade agreements currently under negotiation between the EU and Vietnam (already concluded) and Thailand and Indonesia (in negotiation). These are described as the 'building blocks' to an eventual FTA with the ASEAN group, but not until the group FTA is made. There is great potential for damage to Cambodia from: (A) the further loss of countries it can cumulate from (i.e., countries concluding FTAs with

Europe are automatically ‘graduated’ out of GSP); and (B) the added competition from these agreements eventually bringing duty free access to Europe.

## 4. The derogation case

In addition to the anti-circumvention investigation, which had a remarkable effect on business during 2014 and 2015, we also faced another new rule change in January 2014 which led to the loss of some ASEAN countries from which we could cumulate parts. These included Thailand, which was a useful source for tires and inner tubes, and more importantly Singapore and Malaysia, from where very valuable and widely used Shimano parts originated.

(3) It is necessary to provide that regional cumulation applies amongst countries in the same regional group only where they are, at the time of exportation of the product to the Union, beneficiaries of the scheme.<sup>2</sup>

Under the new rule of origin - item 3, countries which had graduated out of the GSP regime could no longer be included in regional cumulation despite the fact that they remained within the ASEAN group. Shimano parts are highly desirable on medium to high end bicycles, and a lot of different Shimano parts come from Malaysia and Singapore. This event was to put pressure on all Cambodian factories which relied heavily on this part of the global value chain. As a result, the Royal Government of Cambodia applied to the EU for a derogation of the new rule, which (if granted) would allow the temporary continued use of Malaysian and Singaporean parts for cumulation. After the application was made, it was followed by a period of discussion. On 31 July 2014, some 6 months after the new rule had taken effect, a derogation of the rule was finally granted and cumulation from Malaysia was to be re-included for a period of three years. This was specific to Malaysia and not Singapore, as requested.

The derogation was designed to be of maximum use from the start and offered a declining use over years 2 and 3. This was to give the Cambodian bicycle industry some time to encourage supporting companies (bicycle part makers) to the area, which would build up our local content and alleviate the

---

2 COMMISSION IMPLEMENTING REGULATION (EU) No 530/2013 of 10 June 2013 amending Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code. See: <https://op.europa.eu/en/publication-detail/-/publication/2d3495fd-d27a-11e2-9b1a-01aa75ed71a1/language-en>.

need for Malaysian parts. The derogation was linked to an annual quantity as follows<sup>3</sup>:

Calendar year 2014 – 400,000 bicycles could include Malaysian parts in cumulation.

Calendar year 2015 – 300,000 Bicycles could include Malaysian parts in cumulation.

Calendar year 2016 – 150,000 Bicycles could include Malaysian parts in cumulation.

The derogation was granted at the *end of July 2014* which was not very fair. As seven-twelfths of the first year had already passed, in reality, for the whole of the first year the derogation could not be used at all. In the bicycle business we work to a four-month lead time. Even if we had been able to secure additional orders immediately after having received the news of the derogation (which was unlikely), it would have been the end of the year before any additional bikes could be exported using the derogation. In reality, it was even worse than that, because the Form A required for the inclusion of the parts was not as quickly forthcoming as we had hoped for from the Malaysian government. It seems they had no prior warning that the derogation had been applied for and was ‘potentially’ approaching, and apparently, they had no procedure in place for administering this.

Enquiries had to be made to the European Commission about execution and logistics, which took some time to complete. As the Malaysian government began to build a plan of procedure, they started to request verification from Shimano of which parts met the ‘rule of origin’ in the form of a cost breakdown. For Shimano, this was also a new procedure which was detailed and complicated, it would take them some months to complete this for all of the parts they produced. Then, after each part was duly broken down, permission to include that part had to be applied for from the Malaysian government. Shimano could not confirm in advance which parts would be eligible and the whole process was very slow. By December 2014, we still had no idea which parts (if any) would be eligible for inclusion as local content under the derogation: this was disastrous in terms of timing.

Therefore, the derogation, which had been granted at the end of July 2014, went unused for the whole of the first calendar year, and the first half of the second year due to the four-month lead time from order to production. E.g. it was a whole fourteen months before Shimano parts from Malaysia could be used, and... the duty-free benefits were felt once again.

---

3 The quantities were divided among the 3 exporting factories on a ‘pro-rata’ basis.

Gradually, once re-armed with the duty free USP, we started to win back models again and to turn the business around. By mid-2015, we were back to full strength and the business was once again growing which is clearly shown in Figure 4.

## 5. Conclusion

From the above chain of events, it is possible to conclude that the duty-free benefits offered in the case of bicycles from Cambodia were a major benefit to both the exporter and importer. The country of Cambodia has also benefited, as the factory went on to employ over 2200 local Cambodian workers, and still does today. Those workers originally arrived for work in trucks or on foot from local villages and towns. Now, a large percentage arrive by their own motorcycle, so much so that we have had to install a two-story motorcycle parking facility to cope with the parking.

It is also clear from the experience in Vietnam, that the *level of support* offered by the scheme is crucial. For a GSP country, the duty reduction scheme (in the case of bicycles) saved 3.5% import duty, this was an insufficient benefit to have a major bearing on the business, and furthermore the rule of origin was also too difficult to reach. Had the new (January 2014) rule applied when we were in Vietnam, and the local content percentage dropped from 60% to 50%, it would have made a difference to our business as more of our models would have been eligible for Form A at that time. 3.5% would still have been an insufficient saving to warrant the extra investment needed to begin frame production.

It is even conceivable to imagine that by scouring the books of various import duties to the EU for all products, a shortlist of high value, and high duty items (as in the example of bicycles) could be drawn up for possible manufacture in Cambodia and a successful business could be built on the back of the EBA scheme, attracting new investors. Yet, this possibility requires an in-depth analysis and experience that unfortunately has not yet been carried out. With favourable conditions built on the back of the EBA scheme, Cambodia could truly turn into a significant manufacturing hub even for parts of bicycles.

The EBA duty reduction scheme for LDCS is not without its dangers. The rule changes which can, and do, occur could be fatal to businesses. While the rule change in 2014 (i.e., graduated countries no longer included in cumulation) could have been seen as a minor change, in the case of ABC it had a major effect due to the importance of those particular suppliers in the global supply chain. The GSP could be significantly improved if changes were planned with

much more notice, and were more open, so that affected governments and factories would be kept more informed and would, therefore, be able to take evasive action.

The derogation system in the case of Cambodia was also flawed:

1. It took too long for the EU to initiate the derogation, which finally occurred 6 months *after* the change in rules, when much of the damage had already been done.
2. Granting a derogation for 2014, with only five months left was short-sighted. The three years should have started from the effective date of the rule, not retrospectively through a period where no one was brave enough to 'assume' the derogation would be granted. This was the result of careless assumptions, and a lack of consultation with the interested parties.
3. An overzealous demand for forms and applications and difficult to initiate systems created another long delay from Malaysia. As a result, of the three years granted by the derogation, the first 18 months were almost totally unusable.

*The EU could learn from both the Canadian and USA GSP systems.* Some benefits in brief:

Customs in the USA have no demand of Form A for eligible parts, which are used for cumulated inputs by an LDC exporter, nor do they require a certificate of origin for the exported item (Form A) issued by a competent authority. The exporter simply has to make a signed 'statement of declaration' for which they are responsible, and liable for inspection. This makes the scheme much easier to administer. Canada also has no need for a certificate of origin (Form A) of any kind. For incoming parts used for cumulation, or for exports to Canada, like in the USA, a simple signed declaration from the factory is sufficient.

In the case of Canada, cumulation is allowed from what they class as General Preferential Tariff (GPT) countries (a similar meaning to GSP beneficiaries). In 2013, a rule which pushed several countries out of the GPT by graduation was also passed. It took a simple exchange of letters from the Cambodian ministry of commerce to its counterparts in Canada before the understanding that this rule change would inadvertently cause material damage to the industrial progress being made by Cambodia. The Canadian system was simply changed. First, a list of countries that LDCs could cumulate from was issued. The list



included all of the countries which were previously GPT countries. Then the wording in the rule of origin was changed from 'LDCs can cumulate from GPT countries' to 'LDCs can cumulate from the countries listed', a simple solution which was easily explained and quickly applied by our firms.

Finally - there needs to be a realization that whilst it may be correct to update the rules from time to time, and even to graduate to the status of more economically developed countries like Singapore and Malaysia there is often damage of a 'collateral nature' when these things are done, as in 2014. One can imagine that this was not only limited to Cambodia.



# 4. Moving towards convergence on rules of origin?

## The automotive industry

Stephan Freismuth<sup>1</sup>

### 1. Introduction

BMW prioritizes and strongly commits to three goals with different sets of targets and different accomplishments:

5. Electromobility:

Targets:

2023: 13 fully electric models (BEVs). At least one BEV model in all key segments.

2030: at least 50% of our global sales are BEVs.

6. Sustainability:

Accomplishment:

We are the first German car manufacturer to join the "Business Ambition for 1.5°C".

We are committed to the goal of climate neutrality via the value chain by 2050.

---

<sup>1</sup> BMW

## 7. Digitalization:

## Targets:

We are on the way to fully connect and digitalize our vehicles and the whole mobility ecosystem.

Our iX is the first ever 5G ready vehicle, using customer centric shy tech.

The attainment of electromobility, sustainability and digitalization goals is influenced by tension in the global field of car manufacturing. In particular:

- **Europe:**  
Fit for 55: The German industry is gearing up for its next lobbying battle: the internal combustion engine.  
Germany's Corporate Due Diligence Law regulating human rights and sustainability standards.
- **Transatlantic relations:**  
Biden has set the goals for clean cars to make up half of 2030 sales in the USA.
- **South Africa:**  
The government links Automotive Support Policy to Black Economic Empowerment with aggressive timelines.
- **Asia:**  
Decoupling: A wake-up call for European companies.  
Malaysia, Vietnam: Chip shortages has deepened supply problems for global carmakers.

Global cooperation and open trade channels are key to achieving our goals. However, global trade is more *complex* than ever and is characterized by challenging relationships. This suggests that we are at a *crossroads*: either to *find common ways* in international cooperation or to *give in to protectionist tendencies*. The latter is not an appropriate option for the globally acting automotive industry. We believe that we all should *focus on common goals*, find solutions to our different ways of thinking, and find ways to intensify cooperation.

*Figure 1* and *Figure 2* illustrate BMW EU exports of vehicles. [In the European Union the BMW Group produces cars for the global market. The most important markets from an export perspective are Asia/Oceania, North America, and Eastern Europe (including the EFTA countries). Thus, free and frictionless trade with these markets is of utmost importance for the BMW Group. Some countries of these markets are already covered by an EU free trade agreement (for example, South Korea, Great Britain, Canada, etc.).

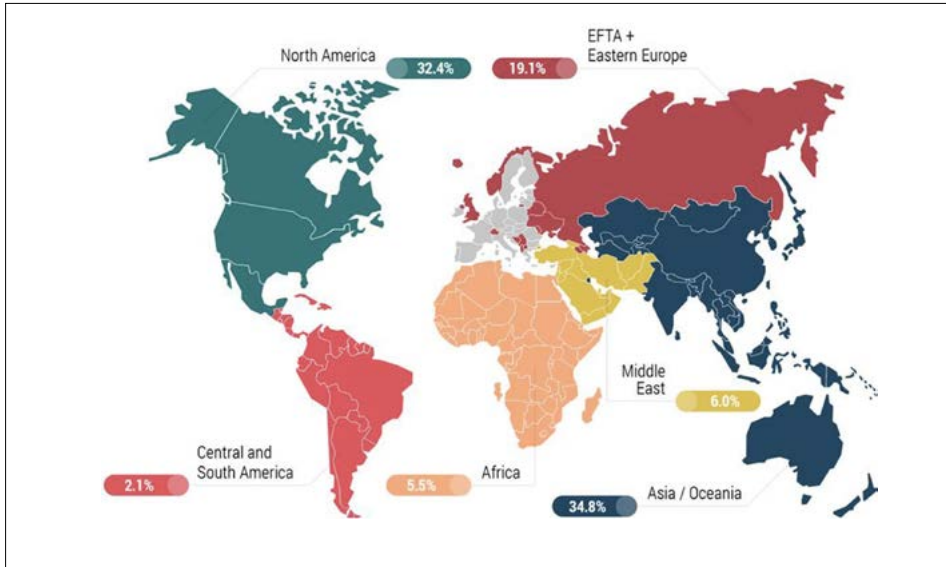


Figure 1: Units market share regions 2019.

Source: BMW internal export figures

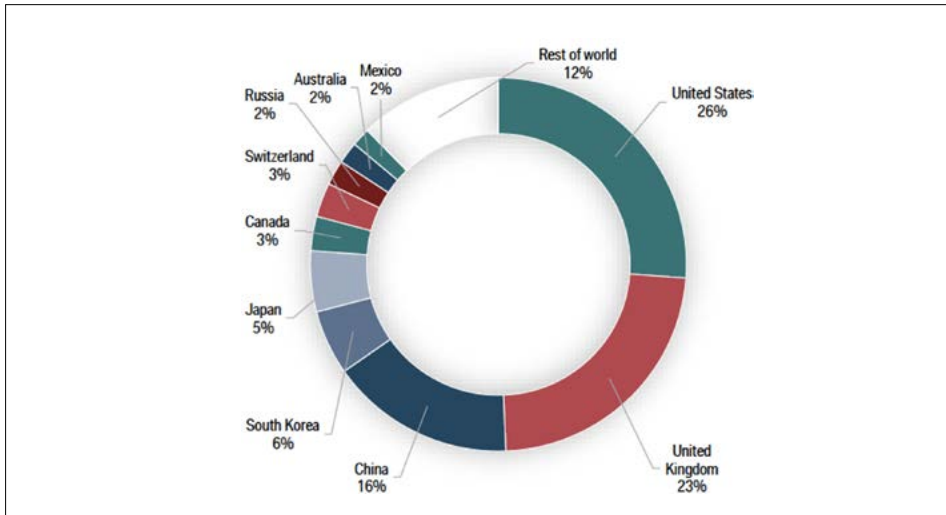


Figure 2: Units market share countries 2019

Source: BMW internal export figures

To promote global free trade, establish fair rules around the world, and create a global level playing field, the EU must:

1. live and promote an Open Trade Policy.
2. actively engage with key trading partners around the world.
3. negotiate/update and implement free trade agreements.

Are we truly on the way toward convergence regarding product specific rules of origin in EU free trade agreements? The next sections will address this issue from an automaker perspective such as BMW.

## 2. Product specific rules of origin (PSRO) in EU FTAs—divergence or convergence?

Diverging product specific rules of origin (PSRO) exacerbate compliance costs. This finding, as shown in tables 1 to 4 below, indicates that a standard PSRO would be welcomed to facilitate trade.

### Turbochargers

EU FTA	Product specific rule
PEM	CTH and MaxNOM 40%
PEM (revised)	CTH or MaxNOM 50%
CETA	CTH or CTSH and NOM without CTH MaxNOM 50%
KR	CTH or MaxNOM 50%
JP	CTH or MaxNOM 50% (EXW) or RVC 55% (FOB)
MX	CTH and MaxNOM 40% or MaxNOM 30%
VN	CTH or MaxNOM 70%
UK	CTSH or MaxNOM 50%

*Table 1: Turbocharger (HS-8414)*

Source: Respective EU Trade agreements

**Li-NMC preparation**

EU FTA	Product specific rule
PEM	MaxNOM 50%
PEM (revised)	CTH or NOM without CTH MaxNOM 20% or MaxNOM 50%
CETA	CTSH
KR	CTH or NOM without CTH MaxNOM20% or MaxNOM 50%
JP	CTSH or MaxNOM 50% or RVC 55% or chemical reaction, cleaning, manufacture of precursor, isomer separation, biotechnological process
MX	MaxNOM 50%
VN	CTH or NOM without CTH MaxNOM 20% or MaxNOM 50%
UK	CTSH or MaxNom 50% or chemical reaction, cleaning, blending, manufacture of precursor, change of the particle size, isomer separation, biotechnological process

*Table 2: Lithium-Nickel-Manganese-Cobalt-Oxide (HS 3824)*

Source: Respective EU Trade agreements

**Lithium cell**

EU FTA	Product specific rule
PEM	CTH and MaxNOM 40% or MaxNOM 30%
PEM (revised)	CTH or MaxNOM 50%
CETA	CTH or CTSH and NOM without CTH MaxNOM50%
KR	CTH or MaxNOM 45%

EU FTA	Product specific rule
JP	CTH or MaxNOM 50% or RVC 55%
MX	CTH and MaxNOM 40% or MaxNOM 30%
VN	CTH or MaxNOM 70%
UK	CTH reactive cathode material excluded or MaxNOM 35%

*Table 3: Lithium-Cell (HS 8507 60)*

Source: Respective EU Trade agreements

### Floor mat

EU FTA	HS-POS 8708 KN	HS-POS 3926 KN
PEM	MaxNOM 40%	MaxNOM 50%
PEM (revised)	CTH or MaxNOM 50%	CTH or NOM without CTSH MaxNOM 20% or MaxNOM 50%
CETA	CTH or CTSH and NOM without CTH MaxNOM 50%	CTH
KR	CTH or MaxNOM 50%	MaxNOM 50%
JP	CTH or MaxNOM 50% or RVC 55% (material use)	CTH or MaxNOM 50% or RVC 55% (material use)
MX	MaxNOM 40%	MaxNOM 50%
VN	MaxNOM 45%	CTH or NOM without CTH MaxNOM 20% or MaxNOM 50%
UK	CTH or MaxNOM 50%	CTH or MaxNOM 50%

*Table 4: Floor Mat (HS 8708 and HS-Pos. 3926)*

Source: Respective EU Trade agreements

### 3. How has the administrative effort increased as a result of the UK-withdrawal from the European Union?

The withdrawal of the United Kingdom (UK) from the EU resulted in a massive increase in administrative effort. Noticeable examples are: i) the increase of calculation efforts (Vehicle Identification Number (VIN) based calculations); ii) the increase of customs audits; iii) the increase of maintenance efforts (process and system; and iv) doubling of supplier communications. Figure 3 below shows an increase of 143 % of preference calculations of cars as a consequence of Brexit.

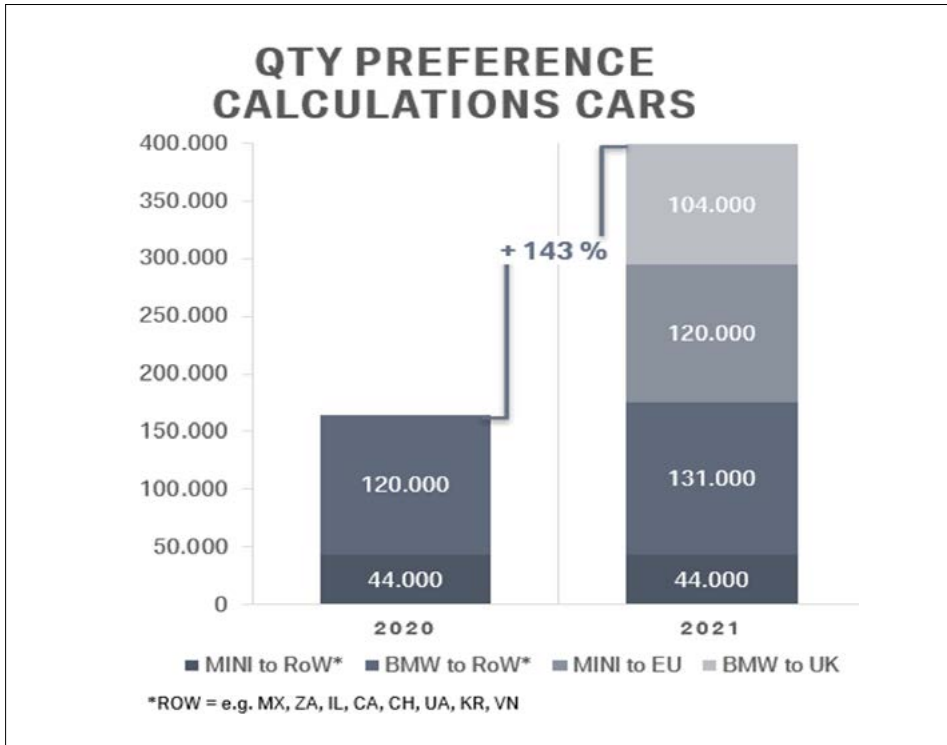


Figure 3: QTY Preference Calculations Cars

Source: BMW internal figures

## 4. Administration of proof of origin and related procedures in EU-free trade agreements—divergence or convergence?

Table 5 below shows that there is a conspicuous divergence among EU FTAs on proof of origin.

PEM	PEM (Revised)	CETA	KR	MX	VN	JP	UK
<ul style="list-style-type: none"> <li>• EUR.1 and EUR-MED</li> <li>• Origin declaration (max. 6.000 € / unlimited approved exporter)</li> </ul>	Origin declaration (registered exporter)	Origin declaration (max. 6.000 € / unlimited approved exporter)	<ul style="list-style-type: none"> <li>• EUR.1</li> <li>• Origin declaration (max. 6.000 € / unlimited approved exporter)</li> </ul>	<ul style="list-style-type: none"> <li>• EUR.1</li> <li>• Origin declaration (max. 6.000 € / unlimited registered exporter)</li> </ul>	<ul style="list-style-type: none"> <li>• Importers knowledge</li> <li>• Origin declaration (registered exporter)</li> </ul>	<ul style="list-style-type: none"> <li>• EUR.1 and EUR-MED</li> <li>• Origin declaration (max. 6.000 € / unlimited approved exporter)</li> </ul>	Origin declaration (registered exporter)
For single consignment						For multiple consignments	

Table 5: Overview of proof of origin in different EU FTAs

Source: Respective EU Trade agreements

In addition, recent legislation in the Union Customs Code – Implementing Act (EU) 2015/2447, contain contrasting time periods for the supplier declaration for multiple consignments. The single declaration reproduced below does not foresee any limitation for retrospective issuing.



<p><i>Article 61</i></p> <p><b>Supplier's declarations and their use</b></p> <p>(Article 64(1) of the Code)</p> <p>1. Where a supplier provides the exporter or the trader with the information necessary to determine the originating status of goods for the purposes of the provisions governing preferential trade between the Union and certain countries or territories (preferential originating status), the supplier shall do so by means of a supplier's declaration.</p> <p>A separate supplier's declaration shall be established for each consignment of goods, except in the cases provided for in Article 62 of this Regulation.</p> <p>2. The supplier shall include the declaration on the commercial invoice relating to that consignment, on a delivery note or on any other commercial document which describes the goods concerned in sufficient detail to enable them to be identified.</p> <p>3. The supplier may provide the declaration at any time, even after the goods have been delivered.</p>
---

In contrast, in the long-term supplier declaration reproduced below, retrospective issuing is limited to one year.

<p><i>Article 62</i></p> <p><b>Long-term supplier's declaration</b></p> <p>(Article 64(1) of the Code)</p> <p>1. Where a supplier regularly supplies an exporter or trader with consignments of goods, and the originating status of the goods of all those consignments is expected to be the same, the supplier may provide a single declaration covering subsequent consignments of those goods (long-term supplier's declaration). A long-term supplier's declaration may be made out for a validity period of up to 2 years from the date on which it is made out.</p> <p>2. A long-term supplier's declaration may be made out with retroactive effect for goods delivered before the making out of the declaration. Such a long-term supplier's declaration may be made out for a validity period of up to 1 year prior to the date on which the declaration was made out. The validity period shall end on the date on which the long term supplier's declaration was made out.</p> <p>3. The supplier shall inform the exporter or trader concerned immediately where the long-term supplier's declaration is not valid in relation to some or all consignments of goods supplied and to be supplied.</p>
--

Thus, reconciliation of these different provisions is required to decrease administrative burden on the business side.

There is also lack of clarity in the definition of ex-works price as shown in figures 4 and 5. Let us assume a car is manufactured in the EU under the framework established in figure 4. If the origin is calculated as the ex-works price in factory B, that same car will not gain origin status, as the amount of non-originating materials (NOM) price exceeds 45%. i.e. ex works price 20.000 euros and value of non-originating materials of 10.000 euros= 50 of non-originating materials.

### 4.1 What is the right price for the threshold comparison?

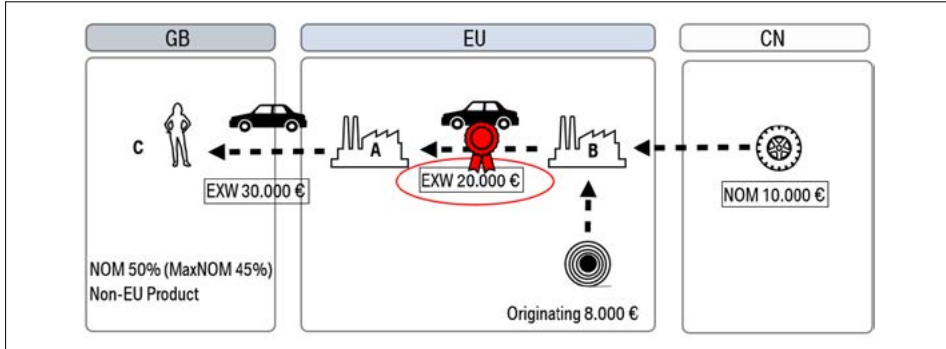


Figure 4: Illustration ex-works price contractor to contracting entity

Source: BMW internal figures

In relation to the example given in figure 4, however, if the same car is sold by exporter A with a mark-up of 10,000 euros, the car could be considered as originating. i.e. 30,000 euros with 10,000 euros of non originating materials equal to 33 % of non-originating materials.

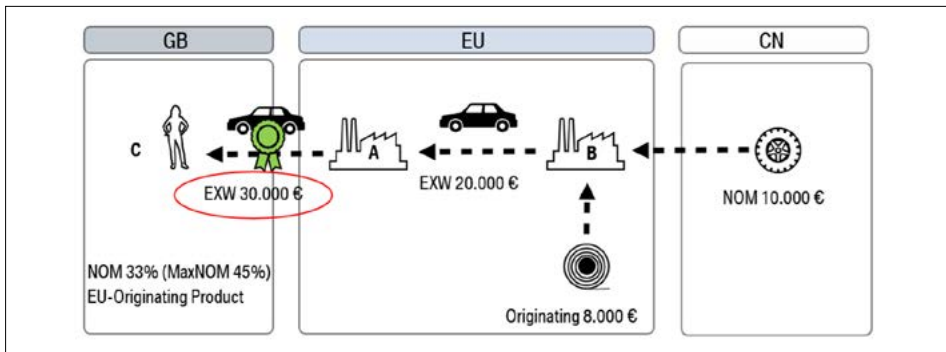


Figure 5: Illustration ex-works price exporter to customer

Source: BMW internal figures

The lack of an ex-works price (EXW) definition in most EU treaties causes issues in the application of rules of origin. In this area, a clear and harmonized definition of the EXW-price is required as it has been the case in the EU-UK Trade Cooperation Agreement (TCA). The text of note 4 of the EU-UK TCA is reproduced below providing the required clarity.

## Introductory notes to product specific rules of origin (Annex 2 EU-UK TCA)

### NOTE 4

#### Calculation of a maximum value of non-originating materials

For the purposes of the product-specific rules of origin, the following definitions apply:

- (a) "customs value" means the value as determined in accordance with the Agreement on Implementation of Article VII of GATT 1994;
- (b) "EXW" or "ex-works price" means:
  - (i) the price of the product paid or payable to the producer in whose undertaking the last working or processing is carried out, provided that the price includes the value of all the materials used and all other costs incurred in the production of the product, minus any internal taxes which are, or may be, repaid when the product obtained is exported; or
  - (ii) if there is no price paid or payable or if the actual price paid does not reflect all costs related to the production of the product which are actually incurred in the production of the product, the value of all the materials used and all other costs incurred in the production of the product in the exporting Party:
    - (A) including selling, general and administrative expenses, as well as profit, that can reasonably be allocated to the product; and
    - (B) excluding the cost of freight, insurance, all other costs incurred in transporting the product and any internal taxes of the exporting Party which are, or may be, repaid when the product obtained is exported;
  - (iii) for the purposes of point (i), where the last production has been contracted to a producer, the term "producer" in point (i) refers to the person who has employed the subcontractor.

The above comments are just examples of the loopholes that need to be addressed in future legislation.

# 5. RCEP and CPTPP: Building blocks of convergence? Or another brick in the wall for existing FTA networks

**Kit Hickey<sup>1</sup>**

To answer the questions posed in the title of this article, *are RCEP and CPTPP the building blocks of convergence, or just another brick in the wall for existing network of FTAs?*, we must consider the historical context of the two agreements..

Firstly, a brief comment. As trade people, we judge the success of a trade agreement by the quality of the ‘trade in goods’ deal, and in terms of our own industry sector. We sometimes forget that there are other people in other sectors who have done well out of an agreement, or whose measure of success is more to do with ‘trade in services’. A mediocre deal in goods for one trader, therefore, does not necessarily make for an overall bad agreement.

In terms of goods, no one would disagree that an agreement intended to liberalize trade and establish a harmonized set of rules can only be fully realized if the outcome of that agreement reflects the stated intent.

---

<sup>1</sup> Fonterra

The scale of a mega-regional agreement such as the CPTPP has the potential to create such an environment. However, it is a numbers game, and by increasing the number of parties there is a corresponding increase in competing interests which results in more compromise. It is the nature of such compromise that influences behaviors in terms of FTA utilization.

Pre-negotiation studies carried out to identify each Party's offensive and defensive interests and to manage the expectations for outcomes based on this criterion, while relatively simple with a bi-lateral, are less so when the number of parties increases.

The inclusion of Canada, Japan, and the US into the negotiations brought an imbalance of economic clout to the table, in addition to entrenched policies and practices that would distort what had been a relatively simple trade environment. By introducing, for example, embedded and unfriendly quota systems of trade that hark back to an earlier time with their burdensome and uncertain administrative processes.

However, the flip side to this coin is that these kind of economies (or at least some of them) tend to have a more liberal view of risk assessment and documentary requirements, and while the measure of success for a trade agreement is largely based on how far it is used, the determiner of that success is how easy it is to use.

Bearing in mind CPTPP covers a region that is already awash with trade agreements, many of which provide comparatively advantageous choices including some that have been in effect for lengthy periods of time and are fully liberalized, CPTPP's place in this landscape is as much about politics as it is about trade. Indeed, the domestic trade sector and politics of this region signal support for broader trade liberalization at a time when... the international rules-based trading system is under considerable strain.

To be sure, there are advantages on offer for the parties that do not have an existing agreement with some of the other parties, but the question here is whether these concessions (although welcome) set a low bar for a future trade deal between these countries outside of the CPTPP.

Comparing CPTPP with an existing plurilateral agreement such as the AANZFTA highlights how market access outcomes continue to be impeded by a lack of political will in some countries, most notably developed countries, to genuinely open their markets.

There has been a gradual trend across the Asia-Pacific region to move away from prescribed documents such as certificates of origin and to accept certifications/declarations that include transfers of data from the producer/exporter

and/or importer. This is in part due to exposure from other negotiations, but also stems from an appreciation that if you want a deal with a ‘mega-economy’ such as the EU or the US, either immediately or in the future, you will have to play by their rules at some point in time.

Certificates of origin are a source of many problems, but it appears that the intent of ‘non-prescription’ has not been communicated well as it has enabled some of the customs agencies involved to interpret their own intent. For example:

6. Certain customs agencies have taken advantage of importer certifications to demand ‘ruling’ level data at a stock keeping unit (SKU) level from importers, in effect bullying importers for information that should only be requested for risk assessment & verification purposes.

Rulings are designed for situations where an uncertainty exists and providing this level of data irrespective of certainty, and for all imports, is highly resource intensive and contra to the risk management provisions of the agreement, as well as being against broader customs policies related to risk assessment.

7. The agreement’s lack of a prescribed format for certification was deliberate and negotiators wanted to provide flexibility to cater for different business models and systems, and to (quite correctly) focus on the data and not on the format.

Unfortunately, some parties have interpreted this to mean that they can prescribe their own formats, which adds complexity for traders who must now understand destination country specific requirements.

8. Blanket statements are not well understood, and clearance status for goods is often delayed while customs agencies ponder over what such statements signify. The issue here appears to be that customs offences are associated with individual entries and a blanket certificate covering multiple entries does not fit well with this business model.

After reviewing the pros and cons of this agreement, Fonterra (and our customers), with a few exceptions, have chosen to trade under other existing agreements where available. These agreements have better market access provisions, simpler rules of origin and/or prescribed operational procedures which at least provide, for the most part, consistency, which is very important for a business.

As a general rule, business will follow the greatest benefits, whether in terms of financial advantages, cost reductions, or limits to business risk. In other words, if a tariff advantage offered by an agreement is outweighed by the resources or costs required to obtain that advantage, businesses will avoid that agreement. Likewise, if a tariff advantage is outweighed by the risks of applying for it, businesses will be unlikely to apply.

Our experience is that the main source of business risk when using trade agreements comes from customs post entry audit programmes. While no-one denies the advantages of these programmes, they do change the quantum of the risk by making it cumulative over an extended period resulting in significant assessments.

In recent times there has been a definite increase in post entry audits focused on origin and preference with assessments issued on administrative detail rather than the substance of rules of origin and goods. These experiences indicate the importance of consultation with businesses during the negotiation phase of an agreement, in order to understand how the text of that agreement may impact business systems and methodologies. Moreover, we cannot overstate the importance of pre- and post-implementation outreach programmes to educate parties as to how a trade agreement is to be interpreted and implemented.

Outreach needs to be government-to-government and government-to-business and should be ongoing to ensure that every party understands the rules, and so that knowledge is not lost over time. This would also flush out any inconsistencies between an agreement and relevant local regulations.

Looking at how the CPTPP came about, from the perspective of a business that has had first-hand experience of P3 and P4, permits us to say that each expansion to the agreement has made it more. Perhaps this was inevitable, as the tariff rates of the P3/P4 Parties was, in the main, zero, or close to it. Certainly, the involvement of Canada, Japan, and the US fundamentally changed the tone of the agreement, and not all for the better from my perspective.

ASEAN (the world's fifth largest economy) is a significant 'economy' in its own right and is well positioned to drive its agenda and counter a mega-economy negotiating partner if it so chooses. This is the essence of the RCEP. Of course, the agreement is not without its complexities, but the possibility to negotiate as a single unit gives ASEAN the potential to drive more balanced outcomes, certainly much more so than if the members of ASEAN negotiate as individual, smaller economies.

As it stands, CPTPP is, in all but words, an APEC agreement. Due to ongoing engagement over many years, the current parties of the CPTPP know

each other very well, with many having existing trade agreements and regular contact with each other. It will be interesting to see how the next evolution of the CPTPP unfolds, when less familiar faces appear at the table. What will their expectations be? How much ‘baggage’ will they try to bring with them? And are they willing to adapt to the Asia-Pacific landscape, or will they try to reform the landscape further?



# 6. The challenge of designing “new” rules of origin in international trade

**Roberto Soprano<sup>1</sup>**

The extreme complexity of Rules of Origin (RoO) is demonstrated by the lack of an agreement on the harmonization work program on non-preferential RoO and the absence of a model to draft preferential rules of origin. While the multilateral and plurilateral negotiating machinery has been unable to regulate RoO, businesses have had to adapt in different ways. Firms may be complying with RoO when they confer an advantage to them, by filling existing gaps on regulation and by paying the costs of such gaps.

The fragmentation of production in value chains has not only exacerbated the technical complexities in determining the origin of the final good, but it has also created a wide gap in the distribution of the costs in producing a finished good. Labeling and origin marking are also closely intertwined with RoO and may generate misleading signals to consumers depending on the product. The behavior of firms also varies depending on the nature of their goods.

In the midst of these developments, it is necessary for this research to correctly identify and depict company behaviors during their interaction with different sets of RoO and related trade policy instruments. The behavior of

---

1 Firmenich

The views expressed and all information contained in the paper cannot be attributed to any of the companies I have worked for. I am responsible for all opinions expressed, and any error made herein.

selected firms can provide us with information and insights to help us identify new ways of designing RoO that take into consideration the pricing structure of a finished good. Moreover, this approach will allow us to better understand how planning/investment strategies have been affected by more or less stringent RoO; and also identify avenues for possible convergence at multilateral or plurilateral level on rules of origin.

## 1. Rules of origin and their influence on strategic decision-making

Companies are profit driven. Therefore, any action they take is aimed at maximizing profits. Their employees are led by objectives set by upper management and receive bonuses for achieving of their targets.

These statements may appear obvious, but they are of foremost importance if we are to understand why and how customs duty avoidance strategies, including those related to preferential origin, are taken into consideration by companies. Customs duties not only represent losses for businesses, but also have an additional impact on cash-flow. This is an important statement. Cash-flow is taken into deep consideration by entrepreneurs, as it affects their financial performance and their costs of raising money on the market. For publicly traded companies, this is also a key performance indicator evaluated by analysts, and therefore by investors.

Knowledge of preferential origin regimes in companies has increased over the years. Information about Regional Trade Agreements (RTAs) and duty avoidance mechanisms have reached a larger audience and employees working on customs matters are more competent than before, as they are trained and informed about such matters. Chambers of Commerce, national authorities and International Organizations, as well as customs brokers, external consultants and counsels have increasingly promoted training on RoO and their benefits. The creation of specialized masters on trade and customs matters and the inclusion of such topics in MBAs and supply chain courses also contributed to divulgate knowledge on RoO. The use of social media has increased exponentially the awareness on the topic.

Duty optimization strategies perfectly match the constant desire of companies to reduce costs like the costs of goods sold (COGS) in order to increase their margins and EBITDA (i.e Earnings Before Interest, Taxes, Depreciation, and Amortization), be more competitive in the marketplace, and have a better

“Profit and Losses” financial statement. Therefore, companies tend to pay more attention to RoO as they have an impact on both selling and purchasing strategies. Their weight depends on the benefit that a company could draw from the use of preferential regimes. In fact, in a 0% MFN world, there would be no need for RoO and RTAs (at least the trade in goods aspect of RTAs), as there would be no duty to be avoided.

## 1.1 Selling strategies

Sales department performances are evaluated on the basis of different key performance indicators, including the contribution to growth and margins achieved. Therefore, the preferential treatment accorded to goods sold in preferential markets can help them to achieve their targets as they may make their products more attractive.

When companies design marketing strategies, they have to analyze many factors: the targeted market, the number, size and prices of competitors, the needs and behavior of potential customers, internal and external resources/costs to dedicate to the projects, marketing strategies, sales channels, and so on. If the products have to be sold in a third country market, other elements have a high(er) influence on the decision: freight and insurance costs, exchange rates, taxes as well as tariffs and non-tariffs barriers to be faced in the targeted market. Generally speaking, once the potential customer/s or country/area has been chosen, a floor price including fixed and variable costs as well as a margin of profit is calculated. The floor price will be used for quotes by the sales associate in charge of finding customers and of making offers. While the floor price usually does not include landing costs such as freight and duties, the final price set for the quote may include such costs depending on the INCOTERMS® chosen.<sup>2</sup>

The amount of the tariff faced by the importers is a key factor to be taken into consideration when setting a price for the quote. In fact, duties are borne, directly or indirectly, by the buyer, and this affects and this affects the buyer’s purchasing decision .. Prohibitive tariffs may discourage buyers to source goods internationally, while high but not prohibitive tariffs may make a foreign product non price competitive. Therefore, before sending a quote, the seller should calculate the tariff faced by the importers as it needs to assess the impact of this on the total price and on the choice of the buyer.

---

2 Duties are included in the final quotation if the INCOTERMS® chosen is DDP. If any other INCOTERMS® are chosen, the buyer will bear the burden of paying them and these will not be included in the quote.

Duty avoidance mechanisms thus play a considerable role in marketing strategies as they can reduce the price quoted to the buyer. Sometimes, they are necessary for the success of a strategy, in particular for products facing high tariffs. Accordingly, the preferential status of products may become part of a company’s marketing strategy. Many importers request information about the preferential origin of the goods before making any order, and sales representatives can mention this during their negotiations with potential clients.

In that respect, it should be stressed that the predictability of the preferential origin of the goods is fundamental to marketing strategies. Certain rules of origin, such as those based on ad valorem percentage criterion, reduce the possibility of predicting whether a product can obtain preferential status. In fact, those RoO are very sensitive to the fluctuation of the values of the raw materials and the finished product. In contrast, prescribed manufacturing processes or changes of tariff classification criteria increase the predictability of the outcome of the preferential calculation.

In sum, market access and duty avoidance mechanisms can play an important role in market strategies. Their importance increases depending on the level of the duty that is faced by the importer. The higher the duty, the higher the importance of the preferential status in selling strategies.<sup>3</sup> For example, in the US steel market, sales strategies do not need to involve preferential origin talks as the market is fully liberalized (from a tariff point of view). Conversely, in the textile sector, where tariffs are much higher, duty avoidance mechanisms play a major role in sales strategies.

It should be pointed out that in reality, duty avoidance mechanisms are not always well known to sales representatives and the intervention of customs compliance specialists can be extremely helpful to support sales operations. Customs compliance specialists should make sales representatives aware of marketing benefits generated by the preferential origin regimes by, for example, providing specific training. In addition, they can conduct internal analyses and explore new options to increase the utilization rates of RoO.

## 1.2 Purchasing strategy

In companies, purchasing activities are dealt with by a purchasing department or dedicated employees. In large corporations, their targets and bonuses are usually based on the amount of savings that can be obtained on the purchase

---

3 Low tariffs may also attract companies’ attention depending on the volume/value of the materials/goods subject to the tariff and the cost reduction that could be generated.

of raw materials and other indirect purchases (such as machinery, equipment, and so on). Key elements in purchasing strategies include quality, prices, and the reliability of the supplier, which is based on the availability of the material and its rating assessed in terms of timely deliveries and customer service as well as its environmental, social and governance (ESG) rating.

The cost of the good purchased is a key factor to consider before purchasing materials. Buyers usually request quotes to calculate the whole cost of purchasing, delivery, and importing the material to the factory where the goods will be processed or to the warehouse where they will be stored. When products are sourced from foreign suppliers, an assessment on the duty to be paid must be made.

In such circumstances, duty avoidance mechanisms, including preferential origin regimes, are taken into consideration by buyers as they reduce the final price. Imports from preferential countries become a more profitable option for buyers. As mentioned above, reducing costs for companies is part and parcel of their strategies. The lower the duty paid, the higher the possibility of achieving company cost reduction targets. It is very common for buyers to include requests for preferential origin certificates in their purchase orders.

Similarly to the sales strategies, the importance of the duty saving mechanism depends on the amount of the “avoidable” duty. The higher the duty avoided, the higher the benefit drawn from preferential treatment. Import duties vary extensively across countries and industries. For example, certain countries agreed on the elimination of all import duties in certain sectors (steel or most recently IT) or to have a tariff ceiling for certain goods (chemicals 6.5%).<sup>4</sup> Therefore, importers of goods in liberalized sectors/countries might receive lower benefits from importing goods from preferential countries, while importers in protected sectors may benefit more from using preferential origin regimes. For example, producers of welded tubes in the European Union and in Mexico might adopt completely different approaches towards preferential origin schemes when deciding their purchasing strategies, as the “avoidable” duties differ significantly.

### **Example 1**

#### Impact of Preferential Origin in Purchasing Decision Making

---

4 Since the average tariff charged on imports to the EU is only 1% (World Bank, 2015).

	Producer of tubes in the EU (HTS 7303)	Producer of tubes in Mexico (HTS 7303)
Main raw material (coils)	7208	7208
Applicable tariff in manufacturing country (7208)	0%	15%
Preferential tariff rate (7208)	0%	0%
Relevance of preferential origin in purchasing strategy	<b>NONE</b>	<b>HIGH</b>

### 1.3 Linking purchasing decisions to selling strategies

While buyers may take preferential origin into consideration when sourcing from preferential countries as this reduces the final cost, they only rarely assess the impact of purchasing preferential origin raw materials on the preferential status of finished products. In other words, very few companies try to coordinate purchasing and selling from a preferential strategy point of view. As described above, the two teams have different objectives and, despite being part of the same company, they may not have the same approach towards preferential origin.

Purchasing teams are generally not aware of the impact of the choice of preferential origin materials on the preferential status of the finished products. When their targets are merely based on purchase savings, they may choose to source materials from foreign suppliers without analyzing the impact on the preferential status of the finished products. Instead, purchasing teams should be made aware of, and align their activities to, sales team strategies toward preferential destinations. At company level, the savings made by avoiding the duties on raw materials may be much lower than the savings made by avoiding duties on finished products.

For example, an EU company may decide to shift its source of supply of a material from a domestic to a foreign vendor as the prices of the latter are cheaper. Despite the savings made, this decision may affect the marketing of the finished products that contain such material, as they may become non-preferential. This is particularly true for companies producing goods subject to *ad valorem* RoO as the non-preferential status of the raw materials have a negative impact on the preferential status of the finished products. In-house customs

compliance specialists should promote internal projects aimed at assessing the potential impact of shifting source of supply from preferential to non-preferential materials and *vice versa*.

### Example 2

Impact analysis of the change of a main raw material preferential origin on finished products.<sup>5</sup>

Finished product impacted	HTS - Comm. Code	Preferential destinations (country)	Applicable duty	Value (€) of sales (Last 12 months)	Impact in Euros (Duty to be paid)
X	29332900	Switzerland	6.5%	10 000	650
Y	29109000	Switzerland	5.5%	100 000	5500
Z	29336900	Morocco	2.5%	200 000	5000

## 1.4 RoO lobbying

To open strategic markets and enhance benefits from RTAs, companies may lobby domestic authorities for the conclusion of new agreements. For example, a company would lobby to start RTA negotiations with countries whose markets are protected by duties. Usually, companies perform an impact assessment on the amount of savings that could be generated by eliminating tariffs in trade between RTA partner countries. For example, the Transatlantic Business Dialogue played an extremely important role for the Transatlantic Trade and Investment Partnership (TTIP).

At the time of negotiating free trade agreements, industries would also lobby for RoOs depending on their needs and interests. The TTIP was an example of such activities. The Federation of German Industries (BDI), for

<sup>5</sup> For example: the purchasing team of an EU company wants to source raw material 1 from a foreign supplier and stop sourcing it from a more expensive EU supplier. As the difference in the preferential origin of raw material 1 may have an impact on the preferential origin of the finished products containing raw material 1, the purchasing team contacts the trade compliance specialist to assess the impact of the decision. A trade compliance specialist then checks which finished products are affected, the change in preferential origin and the potential impact on the duty to be paid in the market of destination as described in example 2.

example, called for a uniform cross-industry value added rule in the TTIP as their main concern was the simplification of RoO. They considered that the complexity of RoO may discourage companies from making use of the RTA. Euratex on the other hand, lobbied for the use of specific RoO tailored to the industry and requested the EU not to adopt value added rules to the textile sector.<sup>6</sup> Meanwhile, Orgalime supported a coherent approach to RoO to eliminate any difference in the Rules of Origin in respective trade negotiations.<sup>7</sup> Similarly, Eurometaux called for a coherent approach to RoO.<sup>8</sup> Businesseurope requested flexible and simple rules of origin to ‘boost the benefits of the agreement by enhancing preference utilization’.<sup>9</sup> Simplicity was also a key point raised by Eurocommerce.<sup>10</sup>

Internal lobbying strategies should start (if data are available) from a utilization rate analysis of existing RTAs and their relevant RoO by companies. In fact, the utilization rate of an RTA would give important information on whether a product would (or would not) qualify for a new RTA based on the current supply chain and production methods. Data obtained need to be used to determine the preferred RoO for the specific product and the company position. Said position should then be communicated directly or indirectly through producer associations, to the negotiators.

- 
- 6 According to BDI, ‘the key feature of the T&C value chain is its high fragmentation both with regard to its markets and its production structure. This means *inter alia* that a company could sell a product range constituted of several different products with different characteristics and performances falling under the same harmonized system (HS) or combined nomenclature code (CN). Those products could be an infinite number of mixtures of originating and non-originating material with a wide spectrum of values. The variability of the value of originating/non-originating products (fibres, yarns or fabrics) used in spinning or weaving or making-up means that, under a same CN classification, customs officers will find a wide variety of products having extremely different value added which will impede the definition of a single value added threshold of any significance. Moreover, in the opinion of Euratex members, recourse to the value added principle is uncontrollable as the added value can be influenced by many factors such as raw materials price, financing, exchange rate manipulations etc.’ Full text available at: [http://euratex.eu/fileadmin/user\\_upload/images/position\\_papers/position\\_papers\\_2015/Euratex\\_position\\_RoO\\_TTIP\\_June15\\_.pdf](http://euratex.eu/fileadmin/user_upload/images/position_papers/position_papers_2015/Euratex_position_RoO_TTIP_June15_.pdf) [last accessed 29/06/2016].
- 7 [http://www.orgalime.org/sites/default/files/position-papers/PP\\_TTIP\\_May14.pdf](http://www.orgalime.org/sites/default/files/position-papers/PP_TTIP_May14.pdf) [last accessed 29/06/2016].
- 8 Eurometaux position paper available at: [http://www.eurometaux.be/DesktopModules/Bring-2mind/DMX/Download.aspx?Command=Core\\_Download&EntryId=6836&PortalId=0&TabId=57](http://www.eurometaux.be/DesktopModules/Bring-2mind/DMX/Download.aspx?Command=Core_Download&EntryId=6836&PortalId=0&TabId=57) [last accessed 29/06/2016].
- 9 Businesseurope position paper available at: [https://www.businesseurope.eu/sites/buseur/files/media/reports\\_and\\_studies/why\\_ttip\\_matters\\_to\\_european\\_business.pdf](https://www.businesseurope.eu/sites/buseur/files/media/reports_and_studies/why_ttip_matters_to_european_business.pdf) [last accessed 29/06/2016].
- 10 The relevant EU-US rules of origin should be as simple, predictable and legally certain as possible. Eurocommerce position paper available at: [http://trade.ec.europa.eu/doclib/docs/2012/july/tradoc\\_149722.pdf](http://trade.ec.europa.eu/doclib/docs/2012/july/tradoc_149722.pdf) [last accessed 29/06/2016].



In conclusion, preferential origin regimes are taken into serious consideration by companies as they contribute to improving their performances by boosting exports and decreasing the price of purchased products. Their importance is definitely linked to the amount of savings drawn from their use. Customs specialists should contribute to maximizing the use of preferential regimes by disseminating information about their benefits and supporting the departments involved.

## 2. The costs of complying with RoO

Compliance with RoO may involve both fixed and variable costs, but also creates benefits for companies. Whether companies should make use of RTAs depends on the costs and benefit analysis.

Companies making use of preferential origin regimes bear the costs of the employees working on RoO related matters. Such costs are variable and depend on the hours of work required per person and the work hours needed to carry out the activities necessary to comply with the RoO. Most of those persons are not fully employed for RoO requirements but deal with such matters as part of their daily activities. They are usually part of supply chain, purchasing, legal, and customer service departments. The cost of compliance for the company definitely varies with output, namely the calculations performed by the employees per product.

In companies using software, compliance with preferential origin requirements also involves fixed costs. These are linked to the price paid for the license fees for software, in addition to those borne for its implementation, maintenance, and upgrading. The cost of the licenses may be expensive. In addition to license fees, the budget needs to include implementation costs that vary depending on the sites, products, users, and regions involved. Incurring the fixed costs due to the use of software drastically reduces the variable costs described above. In fact, automatization of RoO significantly limits manual activities.

However, the use of preferential regimes also generates advantages for companies. For any enterprise, but in particular for large or export-oriented corporations, both fixed and variables costs need to be compared to the benefits that can be drawn in terms of duty savings. Depending on the value and volume of goods exported and the tariff faced, directly or indirectly by the importer, a company should assess whether preferential origin benefits prevail over their costs before deciding whether to adopt an internal policy on preferential origin.

As mentioned, the higher the duty faced, the higher the (direct or indirect)

benefit for the exporter. Depending on their size, companies that make use of preferential regimes may, directly or indirectly, save millions of dollars. Some studies consider that the benefit of ‘complying with rules of origin in their current form does not pay off for companies when the margin between the MFN tariff and the preferential tariff is only two to six percent of the value of a good’.<sup>11</sup> This statement is true, but the margin needs to be multiplied by the volume/value of the exported goods. In fact, many chemical companies make use of preferential origin regimes despite facing, in their main markets of destinations, a maximum tariff rate of 6.5%.<sup>12</sup>

In conclusion, companies should build a business case and assess whether they should make use of preferential origin regimes by calculating the benefits that can be drawn in terms of duty savings and comparing these to relevant fixed and variable costs. The amount of savings would depend on the duty faced by a company’s products in preferential markets and its export volume/values. Costs will vary depending on the use of software and the number of hours of work dedicated to RoO activities.

### 3. The use of software in RoO calculations

Savings attributed to the use of software to perform RoO related calculations can be estimated by comparing the cost of the software costs to the variable costs of using employees to carry out RoO related tasks. The significance of the cost / saving depends on the number of certificates of proof of origin issued by the company and the complexity of the RoO applicable to its products.

11 BDI position on RoO citing the World Bank, World Bank Evaluation of the EU-Turkey Customs Union, 2014, S. 22, <http://www.worldbank.org/content/dam/Worldbank/document/eca/turkey/tr-eu-customs-union-eng.pdf>> See also Joseph Francois, Bernard Hoekman and Miriam Manchin, *Preference Erosion and Multilateral Trade Liberalization*, World Bank Economic Review, Vol. 20, No. 2. May 2006., available at [http://bdi.eu/media/user\\_upload/20150420\\_BDI-Papier\\_Ursprungsregeln-in-TTIP\\_Englisch.pdf](http://bdi.eu/media/user_upload/20150420_BDI-Papier_Ursprungsregeln-in-TTIP_Englisch.pdf)

12 Parties to the Chemical Tariff Harmonization Agreement (CTHA) from the World Trade Organization's Uruguay Round, certain states apply duties ranging from 0 to 6.5 percent on most chemicals. The original participants in the CTHA are: Canada, European Union, Japan, Korea, Norway, Singapore, Switzerland, and United States. Since the Uruguay Round, the following countries have applied most or all of the CTHA as part of their accession to the WTO: Albania, Armenia, China, Chinese Taipei, Croatia, Estonia, Former Yugoslav Republic of Macedonia, Georgia, Jordan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Oman, Saudi Arabia, Ukraine, and Vietnam. <https://ustr.gov/issue-areas/industry-manufacturing/industry-initiatives/chemicals>.

If a company decides to make use of preferential origin, it has to comply with a complex set of rules and requirements. It needs to collect evidence of the preferential origin of raw materials, perform a calculation, issue or request an issue of proof of origin from the relevant authorities, and archive information. Companies need a person (or more persons) to perform the following activities:

7. Request suppliers to provide them with preferential proof of origin of the materials purchased.
8. Report information collected into the “bill of materials” (the recipe) of the finished product and maintain the preferential status of the raw materials, their value and HS classification.
9. Calculate, based on the RoOs applicable to the specific product, the preferential status for a specific RTA or all of the RTAs applicable to the manufacturing country.
10. Issue a proof of origin, or request one from the competent authorities.
11. Send the mentioned proof of origin to the customer.
12. Archive any evidence proving the status declared in the proof of origin. This includes invoices of raw materials purchased, as well as the certificates of proof of origin of such raw materials.

In general, these actions will be performed before any domestic sale or export toward a preferential destination of any product is made. At the very least, they should be performed every time that any preferential element of the raw materials or the finished product changes. For example, for goods whose preferential status should be assessed on the basis of value-added RoO, a new calculation should be performed every time that the price or the preferential status of the raw materials changes and/or the EXW price of the finished products change. In addition, certain products can be made in different manners or by using different raw materials. Accordingly, for goods whose preferential status should be assessed on the basis of tariff alternation RoO, the competent person shall recalculate the preferential origin, if the classification of the raw materials used changes.

These are very time-consuming and daunting tasks when done manually. The cost of complying with preferential origin requirements depends on the work-hour costs per person involved, multiplied by the hours dedicated to such activities. The time dedicated to these tasks would depend on the company

product portfolio, the number of raw materials purchased, and the number of products sold. In addition, it depends on the RoO applicable to its products as some RoO are more complex than others.

The size of the company matters too. Large corporations may have millions of transactions that require calculation of preferential origin around the world and the creation of specific certificates of proof of origin. In addition, they need to request thousands of preferential declarations to vendors depending on the different applicable RTAs and maintain such information for RoO calculation.

Compliance software can automate all the steps in the calculation. They can prepare and send requests to obtain certificates of proof of origin from suppliers, perform calculation by sourcing information from the Enterprise Resource (ERP) system about the value, specific production processes and HS of raw materials and finished products, and issue preferential documents (e.g., invoice declarations or supplier’s declarations). Therefore, they can significantly reduce the variable costs of complying with preferential origin requirements.

Furthermore, they can be used for archiving certificates of proof of origin obtained, calculation information, and documents printed. The return on investment of such software also depends on the export orientation of the company. The higher the number of exports to preferential destinations, the higher the benefit drawn from the use of preferential regimes in terms of duty avoided. More importantly, these kinds of software store precious data for duty optimization strategies.

The importance that customs authorities give to software can be counted as a further benefit for companies. Authorities generally appreciate the efforts made by enterprises that invest in compliance tools. This is particularly true when they need to decide on granting customs certificates such as, for example, AEO-C, C-TPAT or approved exporter authorizations, as software is considered as a reliable tool for preferential calculation and the archiving of data and documents.

Despite the recent expansion of the compliance software market and competition driving prices down, given today’s recession companies are reluctant to spend money on such tools unless they do see an immediate return on their investments. Costs of licenses and implementation, or issues related to compatibility with internal ERP systems, may also discourage companies from installing customs compliance software.

Customs compliance specialists must build solid arguments to convince upper managements to invest in such tools. Those arguments should be based

on the amount of savings generated using preferential origin regimes and the reduction of variable costs of work hours dedicated to such activities. As stated before, savings depend on the volume/value of exports made and the duty faced in preferential markets. In large corporations, savings can be much higher than the cost of compliance.

In conclusion, software drastically reduces the variable costs of the time/personnel spent on RoO related activities, ensures an up-to-date calculation in the case of change (e.g., raw material changes), reduces the risk of non-compliance, and facilitates recordkeeping. On top of this, the decision by companies to build automation into their structure or operation is seen as a positive behavior by authorities.

## 4. RoO planning and sourcing strategy

At the time of concluding RTAs, economists and politicians usually discuss their potential effects on domestic economies. It may be argued that RTAs attract the investments of companies that would take advantage of preferential rates in the markets of destination. On the other hand, it can also be stated that RTAs create the risk of production shifts to other (neighboring) RTA partners.

The assessment of the economic effect of RTAs should include an evaluation of factors other than the level of duties, such as the type of industry and production costs and processes, as well the costs of logistics. In fact, companies producing goods that require huge capital expenditure (CAPEX) investments in terms of manufacturing sites and equipment cannot easily shift from one country to another just to benefit from preferential origin regimes. For example, petrochemical production plants or blast furnaces in steel mills cannot be easily moved from one country to another. In contrast, assemblers of bicycles or lighters can more easily transfer their factories to new sites to benefit from preferential regimes (or avoid restrictive measures such as antidumping and countervailing duties).

Leaving aside the possibility of shifting manufacturing sites, large companies can decide to assign markets to a specific production site to benefit from preferential regimes. They develop supply chain strategies to take advantage of preferential duty rates. Some large corporations may produce the same product in different countries. In some cases, there is at least one production facility per region (EMEA, APAC and Americas).

**Example 3**

Supply chain/logistics in choice of the best supplying/manufacturing location

Production site	X APAC	Y EMEA	Z Americas
Freight cost	...	...	...
Insurance cost	....	....	....
Tariff	% or X\$ Kg	% or X\$ Kg	% or X\$ Lbs.
Preferential tariff	Y/N %	Y/N %	Y/N %
Floor price			
Final price			

Once a client has been found in a foreign country, the supply chain department may choose the best (most profitable) production site to supply a product to the customer. In practice, the supply chain/logistic department must analyze, *inter alia*, the applicable duty in the country of destination, which may vary depending on the preferential agreements/scheme in force with the country of destination. Accordingly, a simulation can be put in place to calculate the cost of supplying goods from different locations.

The logistic/supply chain department, usually with the support of the customs compliance team, has to check whether:

1. Alternative options exist to supply the requested product from different sites to a certain country.
2. If applicable, check if an RTA or unilateral preference is in force between the country of production of the goods and the country of destination.
3. If an RTA or unilateral preference is applicable, check the RoO applicable to the product.
4. Once the RoO has been found, assess whether the product to be sold is of preferential origin.
5. If the product is preferential, then the preferential duty rate (if any) would be included in the new calculation; if the product is non-preferential, analyze the cause of the failure and find possible alternative solution.

As mentioned before, the use of preferential origin regimes play a more significant role when import duties in the country of destination are very high and the preferential origin would provide an advantage to access that market. For example, products classified as 39092010 (liquids or pastes, including emulsions, dispersions and solutions) that are exported to Morocco are subject to a MFN tariff of 17.5% duty, unless sourced from preferential origin (e.g. the EU 0%). In such cases, the preferential origin of the goods (EU) may be a key driver in the decision of the manufacturing location as the difference between the preferential and non-preferential origin is very high. Consequently, importing companies in Morocco could receive a substantial benefit from importing preferential products from the EU instead of sourcing them from a country that did not conclude an RTA with Morocco.

It should be stressed that the existence of a preferential origin regime is only one of the several factors taken into consideration when companies decide on locations for supplying and manufacturing. Other elements, in particular product capacity, cost of production, labor costs, availability of products per site, and the costs of logistics play a higher role in the decision. For example, costs of energy in energy-intensive industries such as the fertilizer industry may be more important than the existence of a free trade agreement.

In conclusion, preferential regimes are only one of the several factors that should be considered by companies when deciding manufacturing and sourcing strategies. Depending on the distance, type of industry and products, other factors like the costs of production, labor, logistics or the availability of goods may have a deeper influence on a company’s decision.

## 5. Cumulation and administrative requirements

### 5.1 Cumulation

Cumulation is an interesting instrument that could give companies more chance to obtain preferential origin for their products and offer more opportunities for sourcing decisions to exporters. In addition, at least in theory, cumulation should also enhance trade between countries among whom cumulation is applicable. In practice, little is known about the application of cumulation, and its benefits may not be so evident. In the absence of data on the utilization of cumulation, it is also difficult to assess if this instrument is fully utilized by companies.

Complex rules are an obstacle to companies who want to benefit from RTAs, in particular for SMEs that lack the internal resources for origin calculations. Cumulation requires a deep understanding of the complex rules of origin and the possible regional/country combination (i.e., bilateral, diagonal, full, or regional). Cumulation imposes higher compliance burdens on companies. It requires them to segregate, at least from an accounting point of view, raw materials and finished products depending on different preferential origins and destinations. In addition, only certain software support cumulation of origin.

Despite the differences in their objectives (cumulation promotes bilateral or regional trade), relaxed rules of origin may enhance the possibilities for companies to benefit from preferential origins. This is particularly true for companies that prevalently source their raw materials internationally and have a more “global” supply chain. This approach would be of foremost importance for companies located in small states that do not locally produce all the raw materials needed for the production of domestic goods.

## 5.2 The administrative burden

Companies need to evaluate whether they are able to comply with administrative requirements before deciding whether or not to benefit from preferential origin regimes. Internal procedures have to be drafted and employees trained to avoid any risk of violating relevant customs laws. In fact, companies bear the burden of requesting documents and archiving them for years, as well as providing customers with certificates of proof of origin. If they fail to comply with applicable rules, they may be sanctioned by authorities and this may entail penalties including fines or the withdrawal of licenses and authorizations (e.g., approved exporter, AEOs-C-TPAT) as well as criminal offences. By providing the wrong information to customers, companies may also expose their partners to the risk of sanctions. This may result in legal action taken against the supplier.

RTAs usually contains customs cooperation clauses under which authorities cooperate with each other in order to verify the correctness of the proof of origin certificates. Other RTAs, in particular those concluded by the United States, allow the authorities of importing countries to conduct inspections at the premises of the companies in the exporting states. If, following an inspection, authorities find that certifications of proof of origin were not issued correctly, they can request the importers to pay hitherto unpaid duties plus interest. Therefore, companies must have a robust preferential origin process in place before starting to make use of preferential origin regimes.



During audit, customs authorities request that companies provide copies of:

1. The composition/recipe of the products under investigation.
2. HTS classification description/rationale of finished products.
3. Issued invoices.
4. Invoices of the materials used in the production process.
5. Evidence of the preferential origin of raw materials.

Consequently, companies must appoint a contact person for the authorities, as well as for the employees involved, who would be able to provide the relevant authorities with the requested information in a timely manner. In large corporations this requires cooperation among different departments (finance, legal, supply chain, tax, customer service, product managers) and the persons involved may be located in different countries. Companies using software can easily archive and extract most of the information from software and ERP.

In practice, compliance with administrative requirements requires several persons dedicated to those tasks. Requesting certificates of proof of origin from suppliers may be a daunting task. Very often, several reminders have to be sent to the supplier before such proof is provided. It is also common that suppliers cannot provide certificates of proof of origin when requested, as they cannot perform a calculation before having received the certificates of proof of origin from their own suppliers. This bottleneck in the certificate chain can reduce the ability of companies to declare preferential origin and in turn slows down export activities. Despite the fact that, under certain RTAs, preferential origin can be claimed retrospectively, companies very often complain when suppliers cannot provide certificates of proof of origin in due time, in particular before export documents are sent to their own customers.

In conclusion, if rules of origin are too complex, they risk discouraging companies from making use of preferential regimes. Similarly, burdensome administrative requirements impose high costs on companies that may become reluctant to benefit from RTAs and preferential schemes.

## 6. The cost of compliance

The cost of complying with administrative aspects of RoO are part of the costs related to import/export transactions but might have a considerable financial impact on companies.

On the sale/export side, issuing/requesting documents such as EUR1, LTSD or CoO requires trained personnel who have to request from the competent authorities the necessary certificates. Companies therefore must bear the costs of preparing these requests (filling in templates, preparing invoices and the relevant documentation) and contacting the broker/authorities/chambers of commerce. Very often, requests of evidence of proof of origin are dealt with by the “customer service” team that is in charge of providing clients with all the necessary documents. In large companies, as the documents that need to be sent to clients domestically may be different to those sent to clients abroad, an “export team” may be created to dedicate staff and expertise to export transactions.

CoO and EUR1 forms are requested from customs authorities or chambers of commerce via a broker or directly by the company. Originals have to be sent via post (TNT, DHL, etc.) to the client. These activities involve costs in terms of work hours per person. These hours also include the time spent requesting, collecting, making copies and archiving all the certificates of proof of origin. In terms of time, a EUR1 or a CoO is usually issued within 3 working days, and this may delay the transaction. In terms of money, the price of a EUR1 in the EU may vary from 20 to 30 euros depending on the member state in question. In addition, if the EUR1 or CoO is requested through a broker, a commission is charged for the service.

In large companies, there may be more than 20 exports per day towards preferential destinations, thus creating a cost of more than 180,000 euros only for EUR1 certificates. The possibility of self-declaring preferential origin, as the approved exporter status in the EU, is an important cost saving instrument for export-oriented companies. This waiver from requesting and paying the relevant fees helps companies to save money and resources. Extra savings may be generated by granting companies the possibility to generate certificates of origin for non-preferential origin. Documents proving preferential origin of the material sold to local customers (e.g., CoO in US and LTSD in the EU) are generated by the company and therefore there are no costs, in terms of money, to be paid by the supplier.

In some corporations, the administrative burden and the risk of being sanctioned for non-compliance with preferential regime requirements may be a reason to decide not to make use of them. However, as mentioned before, the decision whether to use preferential regimes should be taken by comparing the benefits as drawn against the costs of compliance.

It should also be stressed that in certain countries, such as in the EU, companies are obliged to provide preferential declarations of origin (supplier’s declarations) to domestic customers. This means that even if they decide not to benefit from RTAs, they are obliged to calculate preferential origin and provide correct information to their domestic customers. In addition, information about the country of origin (non-preferential origin) is a mandatory piece of customs information that must be declared for exports. A company, therefore, cannot sell its products to foreign markets without calculating non-preferential origin.

In conclusion, complying with administrative aspects of RoO imposes considerable costs on companies, particularly in terms of internal resources dedicated to those activities. The level of these costs vary depending on the number of transactions performed. The possibility to self-declare origin generates savings for companies and may reduce export delays. The burden of complying with administrative aspects of RoO should be, in any case, compared to the benefits drawn from the participation in preferential regimes.

## 7. The impact of non-preferential RoO on the real economy

Non-preferential origin rules have an impact on the activities of companies for the following reasons:

1. *Trade remedies*: non-preferential origin information is relevant for transactions of product that are subject to antidumping duties. As antidumping duties are adopted only on imports coming from certain targeted countries and/or companies, customs authorities may request additional information on the non-preferential origin of these goods to avoid circumvention. In certain cases, like the provisional antidumping measures of ACE, a special declaration of origin has to be signed by importers to confirm the non-preferential origin of the products imported and its components.<sup>13</sup> The country of origin may thus have an impact on the purchasing strategies of products that are subject to antidumping duties.<sup>14</sup>

---

13 Commission Implementing Regulation (EU) 2015/787 of 19 May 2015 imposing a provisional antidumping duty on imports of acesulfame potassium originating in the People’s Republic of China as well as acesulfame potassium originating in the People’s Republic of China contained in certain preparations and/or mixtures (OJ. L.15 2015).

14 See also, judgment of the Court (Third Chamber) of 10 December 2009, Bundesfinanzdirektion West v HEKO Industrieerzeugnisse GmbH, Case C-260/08.

2. *Certificate of origin*: certain countries require certificates of origin as a mandatory document to be shown to the customs authorities at the time of importation.<sup>15</sup> Therefore, a company may not be able to export toward certain markets without having proved to the chamber of commerce or consulates the non-preferential origin of the product.
3. *Sanctions programs*: certain sanctions programs contain reference to non-preferential origins. For example:
  - a. *US sanctions against Iran* prohibit the re-exportation of US products to Iran unless they have not been “substantially transformed” in another state.<sup>16</sup> Therefore, an assessment on the processing and working that a product has undergone in a non-US country should be performed by the exporter in order to comply with US laws.
  - b. *The EU-Ukraine* related “sanctions” program prohibits the import of products that originate in Crimea.<sup>17</sup> The regulation makes specific reference to the non-preferential RoO adopted by the European Union in its customs code.
  - c. (Certain) *Arab League members still adopt a boycott against Israel* that prohibits importation of any good that is made in Israel or contains Israeli raw materials. At the country level, authorities do not allow the entry into their territories of products originating in Israel. At the company level, companies located in those countries usually request suppliers to provide information about the

---

15 On Lebanon, the market access database lists that in trade practice, the verso of the Certificate of Non-Preferential Origin and/or other commercial documents often contains the following declaration on the origin of the goods, which must be signed by the exporter: ‘We hereby certify that the goods mentioned in this certificate of origin are being exported directly for our own account and that the goods are of pure national origin of the exporting country.’ or: ‘... of pure national origin of the country the goods originated from.’ Alternatively complemented by: “... with components from ... (countries of supply)”. Or ‘Nous déclarons par la suivante que les marchandises mentionnées dans le présent certificat d’origine sont exportées pour notre compte et qu’elles sont d’origine strictement national.’ or: “... d’origine strictement national du pays d’où elles sont originaires’. Alternatively complemented by: ‘... composées de parts originaires de ... (countries of supply)’.

16 31 CFR Part 560 - Iranian Transactions and Sanctions Regulations.

17 Council Regulation (EU) No 692/2014 (OJ L 183, 24.6.2014).

country of origin of the products.<sup>18</sup> More precisely, most of them require suppliers to state that the goods are not of Israeli origin, nor contain Israeli raw materials in their invoices, letters of credit, and contracts. Companies exporting from Israel and other states to boycotting countries may thus face different treatment depending on the origin of the goods. Similarly, producers in boycotting countries shall source their products taking into consideration prohibitions based on the country of origin of the goods purchased.

- d. Finally, the *Antiboycott Laws of the United States* prohibit, under certain circumstances, American companies from providing statements of origin in negative terms. However, they allow giving statements in positive terms. Therefore, US authorities may sanction companies for their declaration of origin based on non-preferential RoO.<sup>19</sup>
5. Products bearing “*made in*” labels are also subject to control by the authorities. *Made in* labelling rules are based on non-preferential rules of origin. In certain countries (e.g., France or Italy) the false use of *made in* labelling on imported or exported products is a criminal offence.<sup>20</sup> Italian authorities are empowered to assess, based on the EU non preferential RoO, whether a product is correctly labelled for *made in* purposes. Customs authorities may use border controls to check products imported or exported to verify the correct use of the *made in* label.

---

18 Saudi’s Israeli Boycott law: Article 2 (a): No Israeli commodities or products of whatever kinds and no Israeli paper money or other movable assets shall be brought in or imported into the Kingdom. Further, no exchange or trading in the foregoing items shall be permitted. b) Goods and commodities made in Israel or in which any percentage of the products of Israel enters whatever such products may be, shall be considered Israeli whether such goods and commodities come directly or indirectly from Israel. c) Commodities and products reshipped from Israel or manufactured outside Israel to be exported for the account of Israel or for the account of the persons or bodies specified in Article 1 shall be treated as Israeli goods. Article 3 Any importer should, in the cases determined by a resolution of the Minister of Commerce and Industry, submit a certificate of origin specifying the following: 1. The country in which the commodities are made. 2. No material of the products of Israel, whatsoever percentage, enters in the manufacture of the commodities.

19 Export Administration Regulation, part 760 and Boycott Provision of the Internal Revenue Code 26, USC Sec. 999.

20 Art. 4.49 Legge 350/2003.

## 8. Improving rules of origin

There is no RoO that fits all products, industries or countries. Every RoO has its own *pros and cons*. Ideally, RoO should be tailored to a specific product depending on its production processes, value, and the origin of materials, production costs and the availability of domestic materials. In reality, RoO often represent compromises between competing industries in RTA countries.

Companies like easy and business friendly legislations. Sometimes, requirements imposed by legislators seem to be very distant from the realities of business. Employees, in particular in SME, are not specialists in customs or trade law and may find it difficult to comply with very complex laws and time-consuming related activities. The costs of external specialists may be very high and unaffordable for many companies. Therefore, certain criteria should be taken into consideration when drafting RoO. In particular, RoO should be:

*Predictable.* It is extremely important for companies to be able to predict whether the products sold or purchased are preferential. Therefore, RoO that enhance predictability should be preferred.

*Simple.* RoO needs to be business friendly and easy to use. When RoO become too complex, companies may simply disregard them even if they are aimed at increasing the chances of companies obtaining preferential status for their products.

*Coherent.* Currently, RoO tend to differ from one RTA to another. For example, sufficient transformation for the same product may differ among RTAs. No drawback rules are applicable to certain RTAs but not all. Non-manipulation and direct transport rules are also not uniformly applied in every RTA. A coherent approach towards RoO among all RTAs concluded by a country would definitely be beneficial for domestic companies.

*IT compatible.* As the number of companies using software increases, the compatibility of RoOs with software should be taken into consideration during negotiations.

*Modern.* RoO should reflect the realities of production processes and value chains. Therefore, mechanisms to update preferential origins should be included in RTA.

*Flexible.* RoO should also impose a very limited administrative burden on companies. Certain rules, such as direct transport, the physical segregation of raw materials and products, and the prohibition of drawbacks are creating unnecessary obstacles to the use of preferential regimes. Companies may have warehouses in different countries from which they decide to supply a geo-

graphical area. A Swiss company, for example, may choose to have a warehouse in Hong Kong where it stocks its products made in Switzerland before selling them to Japan, China, South Korea or other preferential markets. Despite being of Swiss preferential origin, products supplied do not respect the direct transport rule unless a non-manipulation certificate can be provided. Unfortunately, such certificates are difficult to obtain as they need to be requested from customs authorities that do not participate in the RTAs and may have different priorities. Therefore, RTAs should allow companies to prove the non-alteration of the products during transport by using transport documents (e.g., a bill of landing/airway bill, invoices, etc.).

More generally, the participation of companies in RTA negotiations would be beneficial to the negotiating process and the conclusion of an agreement among RTA partners. Knowledge of production processes, markets, products, and value chains can provide negotiators with the necessary input to ensure that RoO correctly reflect market realities and increase the effectiveness of the RTA.

In this respect, an extremely important role must be played by domestic producer associations in promoting discussion among members and collecting their points of view in an industry position paper to be sent to negotiators. Ideally, producer associations should hold discussions with their counterparts in other RTA negotiating countries to ensure alignment among industries on RoO, thus facilitating the role of the negotiators.

## References

- Baldwin, R.E. (2013), “Lessons from the European spaghetti bowl”, ADBI Working Paper 418.
- Barceló, J.J. (2006), “Harmonizing preferential RoO in the WTO system”, Cornell Legal Studies Research Paper No. 06-049.
- Blanchard, E.J., Bown, C.P. and Johnson, R.C. (2016), “Global supply chains and trade policy”, World Bank Policy Research Working Paper No. 7536.
- Hoekman, B. and Inama, S. (2018), “Harmonization of Rules of Origin: an agenda for plurilateral cooperation?”, *East Asian Economic Review*, Vol. 22 No. 1, pp. 3–28.
- House of Lords (2017), European Union Committee, “Brexit: trade in goods” 16th Report of Session 2016–17 – published 14 March 2017 – HL Paper 129, Chapter 5.
- Inama, S. (2015), “Ex ore tuo te iudico: the value of the WTO ministerial decision on preferential RoO for LDCs”, *Journal of World Trade*, Vol 49 No. 4, pp. 591–617.
- Mavroidis, P. and Vermulst, E., ‘The Case for Dropping Preferential Rules of Origin’ (2018) 52 *Journal of World Trade*, Vol 52, No. 1, pp. 1–13
- Soprano, R. (2019), “Brexit and the EU–UK free trade agreement: dos and don’ts when drafting rules of origin”, *Journal of International Trade Law and Policy*, Vol. 18 No. 2, pp. 96–107.



# 7. The experience of applying rules of origin: a view from the private sector

## Massimo Trabucco<sup>1</sup>

Nestlé was founded in Vevey (Switzerland) in 1867 and is the world's largest food & beverage company. The company employs 276,000 employees and sells its products in 186 countries. It has a global manufacturing footprint consisting of 354 factories spread across 79 countries. Nestlé has a unique portfolio of over 2000 brands, including some of the most iconic products in several food and beverage categories such as Nespresso, Starbucks, and Nescafé (coffee), Purina (pet foods), San Pellegrino and Perrier (waters), and Kit-Kat (confectionery).

Global trade is an important driver of global growth. Global trade policy should set the frame for long-term cooperation between countries with the objective of strengthening their ability to generate added value, incentivize private sector competition, and provide consumers with greater access to better quality products and services, and to ultimately raise living standards. International trade must be conducted in a responsible manner which respects and supports local communities and farmers as well as the environment, and human and labor rights.

Nestlé supports global trade based on common and fair rules underpinned by the multilateral trading system centered on the World Trade Organization

---

<sup>1</sup> Head of Group Customs - Nestlé.

(WTO). Free trade agreements, bilateral or regional, that build on WTO principles, can be useful instruments in the quest to achieve sustainable and inclusive economic growth for all. With this vision, Nestlé engages with international institutions and business associations to support the development of harmonized, clear, and simple systems of rules of origin.

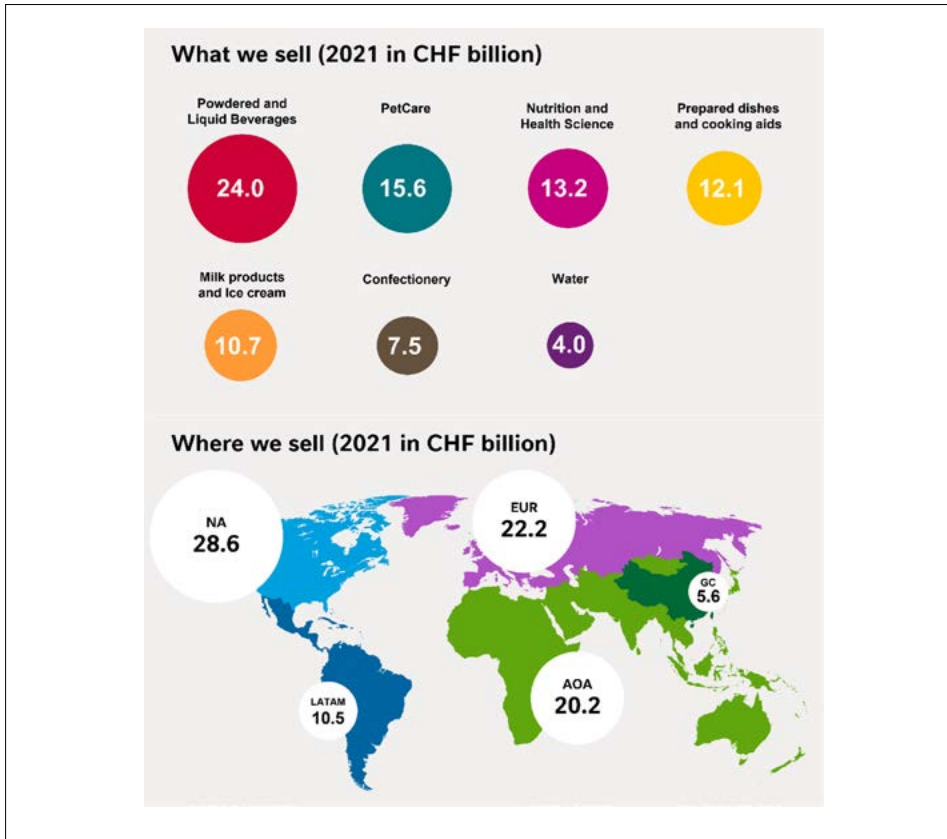


Figure 1

Source: Nestlé Annual Review 2021

## 1. Nestlé and global trade: an overview

Notwithstanding a strong focus on local and regional production, cross-border trade in goods such as raw materials, packaging, plant machinery and some finished products is important for the company.

Import tariffs applied to agricultural goods are, on average quite high in many countries of the world, despite the application of Most Favorable Nation (MFN) rates among WTO member states. For example, import tariffs applied to raw materials such as wheat, sugar, or milk, can be subject to peak import duty rates reaching 100% in some countries. There are also import duties on finished agricultural goods, for example, 30% to 50% in dairy and confectionery sectors in many countries. Tariffs, duties, and administrative procedures, such as rules of origin, can play an important role in companies' procurement strategies and investments.

It is important that business operators of any size can benefit from the swift application of free trade agreements. According to WTO statistics, more than half of global trade is conducted under preferential agreements; the rest is mainly trade between the EU, the US and China which, to date, do not have any preferential trading arrangements between them.

Progress in market access for goods is continuing with the recent entry into force of two sizeable free trade agreements: the Regional Comprehensive Economic Partnership Agreement (RCEP) (in the Asia-Pacific Region) and the African Continental Free Trade Area (AfCFTA) (in Africa), which in the coming years will open markets for respectively 2.3 and 1.2 billion people.

In 2016, Nestlé created a Group Customs Department with the responsibility of centrally overseeing customs duties, in close collaboration with country-based teams. The mission of the Group Customs Department is also to ensure trade compliance with rules of origin and to identify potential opportunities in free trade agreements, following the Nestlé Group Customs Strategy which is based on 3 pillars: leveraging technology, developing expertise, and driving internal/external collaboration.

## 2. Key challenges concerning rules of origin

Rules of origin play a key role in global trade to protect contracting parties, producers and consumers from fraud and the unfair circumvention of trade agreements. However, the current fragmentation of rules of origin and certification systems applied by different trade agreements can represent an indirect barrier to the development of trade and the actual application of preferences.

A report published in 2018 by the National Board of Trade Sweden and United Nations Conference on Trade and Development UNCTAD<sup>2</sup> shows, for instance, that there is a significant potential to increase the use of the EU's free trade agreements in trade in goods.

Based on our trade experience, we can share some examples that shed light on current challenges regarding the smooth application of rules of origin.

## 2.1 Different rules of origin

Despite preferential rules of origin being based on general principles established by the WTO, they can substantially differ across free trade agreements, making their application more challenging for economic actors.

In this framework, it is worth quoting from cases showing two or more countries which are signatory parties of more than one free trade agreement, either because they have signed a bilateral agreement between them and, in parallel, they both belong to same regional trade area, or because they both belong to more than one trade bloc.

For example: Qatar and United Arab Emirates (UAE) are both part of the Gulf Cooperation Council (GCC) and the Great Arab Free Trade Area (GAFTA) while Egypt and Morocco are both part of the GAFTA and the Arab-Mediterranean Free Trade Area (so-called Agadir Agreement).

The rules of origin of the GCC, GAFTA and the Arab-Mediterranean Free Trade Area are quite different from each other, and yet all are potentially applicable by manufacturing operators located in these countries. Such differences relate, for instance, to the “regional value content” required in order to fulfill rules of origin, as well as forms given that each agreement has its own certification system.

Different rules can translate into challenges for companies, for instance, considering that most of the rules of origin in food and beverage sectors are based on the so-called “regional value content”, meaning that a minimal content of originating materials is required, and these figures are normally tracked by internal ERP systems. Intuitively more rules to fulfil imply separate accounts and higher administrative costs.

Beyond the actual rules of origin - the conditions that a product must fulfill to be qualified as “preferential” (normally expressed with criteria as “RVC” or

---

2 National Board of Trade Sweden and UNCTAD (2018), ‘The Use of the EU’s Free Trade Agreements Exporter and Importer Utilization of Preferential Tariffs’. Available at [http://unctad.org/en/PublicationsLibrary/EU\\_2017d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/EU_2017d1_en.pdf).

“Change of HS chapter”) - there is a set of complementary rules that must be applied to obtain preferences, and most of these are subject to certification. Similarly, provisions can also differ across free trade agreements, thereby increasing complexity for operators.

## 2.2 No drawback rule, is this still a reasonable rule?

One of the most debated rules is the so-called “no drawback rule” is the requirement still referenced to by many free trade agreements (in particular those signed more than ten years ago) that obliges operators to declare that no non-originating components included in the exported products are subject to drawback status (or Inward Processing Relief or similar schemes).

Under the no drawback rule goods do not qualify for preferential treatment in the importing country if custom duties for one or more of its components were previously refunded or exempted. This is the case, for example of Inward Processing Relief in the EU whereby duties on imported products that will undergo further processing and re-exportation are suspended. In practice, companies must choose between a) the duty drawback for components, which allows them to benefit from the duty suspension of such components imported in the country of manufacturing, or b) obtaining preferential status for exported finished goods, generating duty preferences in the country of destination.

The above-described trade-off decision no longer reflects the reality of modern supply chains, built around components originating from different countries.

Recent trade agreements normally do not apply this rule, a scenario that increases competitiveness and attracts investments, but implicitly creates an unlevel playing field.

### Example

- Company A established in Germany and exporting goods to Chile
- Company B established in Mexico and exporting goods to Chile

Chile has signed free trade agreements with both the EU and Mexico; the EU-Chile FTA includes a no-drawback rule while Mexico-Chile FTA does not. This mismatch, not considering the clear differences among manufacturing countries, provides an incentive for companies to manufacture goods in Mexico, where they can import non-originating components (e.g., raw materials or packaging) under duty suspension without losing preferences for exported goods.

## 2.3 Third-country invoicing (TCI)

Another very important topic refers to the so-called “third country invoicing (TCI)” principle, often called “third-party invoicing”. This scheme foresees that in a typical triangular flow with three (or more) companies involved in the supply flow, the last transaction should take place between a selling-company not resident in any of the signatory party of the agreement, issuing an invoice to an importer (based in a signatory party country).

The most updated release of WCO Guidelines on rules of origin 2018 clearly foresee ‘third-country invoice - intermediary trade’ as applicable by operators - ref. paragraph 6.6.2 hereafter.

It is common practice in today’s international trade to involve an intermediary between the importer and the exporter. This practice must be recognized and the related procedures must be in place. In trade involving an intermediary residing in a third country, the invoice issued in the third country (a third country invoice) would be submitted to the Customs of the importing country to support the import declaration. [...] Guidelines also establish that “Recognizing the current practices of trade, a proof of origin issued in the country of origin should be accepted in cases where the commercial invoice is issued in a third country, as long as it is discernible that the goods referred to in the proof of origin and the invoice corresponds to each other and that the goods satisfy the applicable rules of origin.”

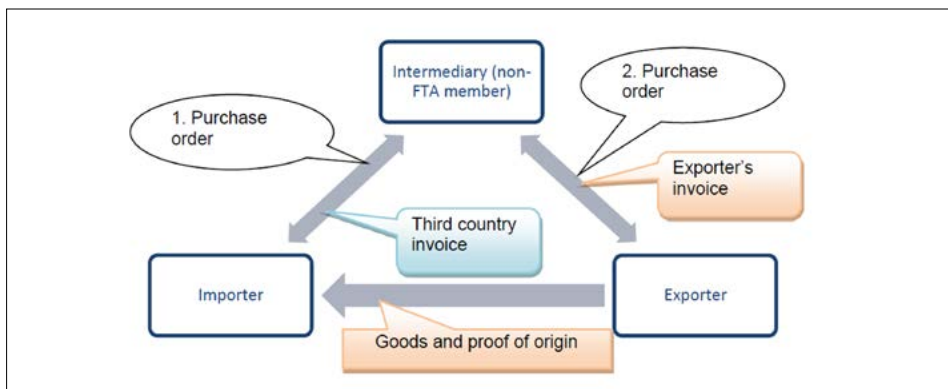


Figure 2: WCO Diagram on Third Country Invoice – Intermediary Trade

The concept of third-country invoicing is widely recognized in international trade business. As explained by the WCO diagram above, this scheme

foresees a *Bill-to-Ship-to* triangular model between three parties and it is also well foreseen in most free trade agreements notified to the WTO and WCO. In such cases, companies must tick a specific third-country invoicing box on certificate of origin, indicating the name and country of the company issuing the invoice.

Notwithstanding the above-cited position by the WCO, some free trade agreements still do not explicitly refer to third-country invoicing making this scheme *de facto* not applicable. For instance, member states of the South Asia Free Trade Area (SAFTA), a key agreement encompassing 1.6 billion people, still do not foresee this scheme.

Moreover, even where the scheme is accepted, it is common practice by customs authorities of the importing country to require all invoices of transactions, leading to potentially sensitive situations where the customer/importer has visibility over the profits of their suppliers, as they have access to all transaction values. This issue would benefit from clearer guidance from the WTO and WCO.

## 2.4 Direct shipment

Many free trade agreements still require the so-called “direct shipment” condition, meaning that goods must be directly transferred from the country of manufacturing (and preferential origin) to the country of destination. Despite some derogations that can be applied, for example by declaring “no manipulation process” in the case of trans-shipment, this rule does not reflect the reality of current supply chains, which are organized through logistics hubs.

## 2.5 Rule of origin is often a “magic formula”

Rules of origin concerning the agricultural sector (Chapter 1-24 of WCO Harmonized System) are often very complex, sometimes requiring that a magic formula be reached. On top of common criteria such as “change of tariff chapter” (of non-originating components vs. exported products) or “regional value content”, several trade agreements require key raw materials - such as sugar or milk - to be wholly originating.

It is also worth noting that in some cases, customs authorities of origin and destination countries have different views concerning HS tariff codes to be applied to the same product. If misalignment is not solved, this can impact the certificate of origin, which is normally not accepted in the destination country and therefore, preferences would be denied.

## 2.6 Limitation of trade facilitation benefits for non-resident company

Over the last 20 years, many international companies have decided to simplify and standardize their own transactions flows, either intercompany or with suppliers and customers. This process normally requires groups to organize supplies via trading companies or central companies where risks and responsibilities are centralized.

The above structure sits in parallel to the already mentioned process of re-organization of supply chains by logistic hubs. In this case, stocks of goods are stored in regional warehouses before being dispatched to customers, including e-commerce goods that, by nature, require flexibility.

The way companies do business evolves rapidly and in most of the above cases the owner of goods at the time of exportation is a non-resident company (e.g., a US company exporting goods to the UK from its own regional hub in the Netherlands).

It must be pointed out that trade facilitation benefits granted to resident companies are often precluded to non-resident companies, including for instance the possibility of stating declarations of origin in the invoice, which forces non-resident companies to appoint representatives (i.e., exporter definition in the EU).

## 3. A specific example

Korea has two separate free trade agreements with both the EU and Switzerland, but sometimes it is not straightforward to grant preferential tariff benefits. Different rules of origin, as well as different origin certifications, could jeopardize the applicability of trade preferences, in particular in cases where such goods are stored in intermediate locations (e.g., logistics hubs) before reaching their final destination.

In the graph below we consider goods manufactured in Korea and shipped to a Belgian hub before being shipped to Italy and Switzerland. Let us also assume that inside the hub (bonded status) the goods are simply divided into two separate parts without any further processing.

The company importing goods in Belgium would most likely receive origin certification from Korea to benefit from trade preferences. However which origin documentation would support re-exportation to Switzerland? Which rule of origin would apply, that of the EU-KR, or that of the CH-KR agree-



ment? Which authority in Belgium can validate this towards Korean and Swiss Customs?

This example shows that even goods that fulfil rules of origin, even of more than one free trade agreement, may still not allow operators to benefit from trade preferences.

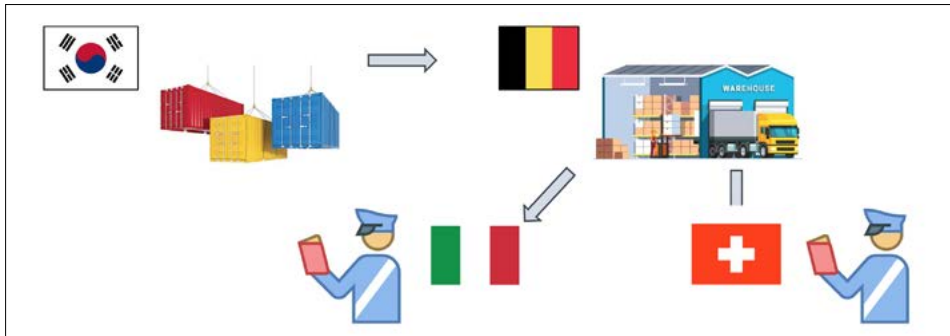


Figure 3

## 4. The future of rules of origin: hopes and expectations

One of the key challenges faced by businesses in an integrated global economy is the absence of global rules in many crucial areas, including rules of origin. Strengthening and improving the capacity of the WTO to expand the international rulebook in this area would help us to address this.

A common global framework on rules of origin certification would benefit farmers, companies, governments, and consumers alike. A harmonized framework could be applicable to all trade agreements notified to the WTO and should be based on electronic systems, reliable operator status, standard rules on cumulation, third party invoicing, and renewed direct consignment rules.

