



Note

WTO Ministerial Decisions on Simplified Preferential Rules of Origin for LDCs

An Overview of their Implementation

By Julian Mukiibi

Summary

Rules of origin provide the basis upon which to determine where a product is made, and hence assess its eligibility to trade preferences such as those granted to Least Developed Countries (LDCs). However, determining origin of most products is increasingly difficult given that raw materials and input components are often sourced from different countries. This is why WTO members adopted in 2013 and 2015 guidelines which may be followed in devising simpler RoO regimes for LDCs. This note analyses the status of implementation of these decisions so far.

Introduction

In recognition of the challenges faced by least developed countries (LDCs) that have hindered their integration in the global trading system, the WTO Hong Kong Ministerial of 2005 committed developed countries and developing countries declaring themselves in a position to do so, to provide preferential market access to LDCs. As a result of this decision, a number of preferential market access schemes have been extended to LDCs and it is in this respect, that rules of origin are required so as to minimize trade deflection by ensuring that the products exported to the preference granting countries through such schemes are produced in LDCs.¹

Rules of origin provide the basis upon which to determine where a product is made which is essential in implementing trade preferences. In doing so, rules of origin set out conditions with which a product must comply in order to utilise the preferential treatment extended by the preference granting country. Determining origin of most product's is increasingly difficult given that raw materials and components used as inputs are often sourced elsewhere than the preference benefiting country, which then necessitates rules of origin.

Despite the important need for rules of origin in implementing preferential schemes, in certain cases, the rules of origin may in themselves constitute a barrier in accessing the market by the intended beneficiaries. It is in this context that the WTO Bali Ministerial Conference of

2013 provided guidelines for WTO Members to develop or build upon their individual rules of origin arrangements applicable to imports from LDCs.² The Decision recognised that each preference granting country had its own method of determining rules of origin, and invited members to draw upon elements contained in the guidelines when developing or building upon their individual rules of origin applicable to LDCs. To operationalise this Decision, and following a proposal by LDCs, the subsequent WTO Nairobi Ministerial Conference of 2015 agreed new provisions that sought to facilitate and enable LDCs better utilise the various preferential market access schemes extended to them. In addition to streamlining and simplification of the Rules of Origin, more detailed directions were provided on issues such as: methods for determining when a product qualifies as “made in an LDC”, and when inputs from other sources can be “cumulated” – or combined – into the consideration of origin.³

In the context of the above WTO ministerial Decisions, this note analyses the issue of preferential rules of origin for LDCs in the WTO, highlighting the status of their implementation so far.

The WTO Nairobi Decision on Preferential Rules of Origin for LDCs

The overarching objective of the WTO Nairobi Decision on Preferential Rules of Origin for

¹WTO Document TN/CTD/W/30

² WTO Ministerial Decision of 7 December 2013 on Preferential Rules of Origin for LDCs www.wto.org

³ WTO Ministerial Decision December 2015 on Preferential Rules of Origin for LDCs available at www.wto.org

LDCs was to streamline and simplify such rules so as to ensure they do not act as barriers but rather enable the LDCs to fully avail themselves of the non-reciprocal market access opportunities provided in the preferential schemes. This was premised on the reality that Rules of Origin deferred and varied, making it very difficult to utilise the market access granted in the schemes.

Beyond simplifying and ensuring transparency in notification of Rules of Origin, the Nairobi Decision provides for a deepening market access by preference granting countries through allowing for situations where a product would be considered as originating from an LDC - to the extent of 75% of the final value - in determining “sufficient or substantial transformation”.

The “sufficient or substantial transformation” requirement is attained where goods satisfy the product-specific rules to the effect that a meaningful manufacturing process has taken place in the LDCs.⁴ The provision in the Nairobi Decision sets out criteria to express substantial transformation, which are: ad valorem percentage criterion; change in tariff classification criterion; and the manufacturing and processing operations criterion.⁵ These operate as described below.

Ad Valorem Percentage criterion

Here, a product is considered substantially transformed when the value added to it in the LDC represents or exceeds a specified percentage of the overall value of the good,

which can be expressed in two ways: a maximum allowance for non-originating materials, or a minimum requirement for the domestic/local content.⁶ In applying this criterion, the Nairobi Decision encourages preference-granting Members to:

- Adopt a calculation method based on the value of non-originating materials;
- Allow the use of non-originating inputs up to 75 percent of the final value of the product;
- Consider deducting transportation and insurance costs of the non-originating materials from the calculation of the non-originating value part.⁷

Change in tariff classification criterion (CTC)

This is the more widely used criterion, whereby a product is considered substantially transformed when it is classified under a heading or subheading (which usually depends on the rule) which is different from all non-originating materials used.⁸ The method is based on the Harmonised System (HS), which is a structured nomenclature with a series of 4-digit headings, in many cases further subdivided into 5 and 6 digit subheadings.

In its application, change of chapter rules under this method is the most stringent, since non-originating materials of the product should be classifiable in the chapters other than that in which the final product is classified. Change of

⁴ Practical Guide to the Nairobi Ministerial Decision on Rules of Origin for LDCs – June 2018

⁵ Supra foot note 3

⁶ WTO Ministerial Decision on Preferential Rules of Origin for LDCs WT/MIN(15)/47-WT/L/917

⁷ *ibid*

⁸ *ibid*

tariff heading and change of tariff subheading are less stringent.

The Nairobi Decision encourages preference-granting Members as follows:⁹ (i) allow a simple change of tariff heading (CTH) or tariff subheading (CTSH); (ii) eliminate exclusions or restrictions to the rule as much as possible; and (iii) introduce a tolerance for the CTC criterion.

Rules of origin based on tariff classification are found to be predictable, unambiguous and simple to apply and control, moreover they are also independent of variations that can result from input costs and currency fluctuations.¹⁰

The tariff classification criterion may also entail the “Tolerance/*de minimis* rule, which eases the origin criteria by allowing the possibility to use non-originating components to a certain extent (for instance a percentage of value or product). This allowance differs from scheme to scheme and may not be applied to certain products.

Manufacturing or processing operation Criterion

Substantial transformation under this criterion is determined when a product has undergone a specific manufacturing or processing operation, regardless of its change in its classification or the extent of value added. It is a widely used in rules of origin schemes more so in the textile and apparel sectors.¹¹ The Nairobi Decision encourages preference granting countries to allow:¹² (i) chemical reactions that create new chemical products; (ii) transformation of raw agriculture products into processed agricultural products; and (iii) complex assembly of parts

into finished machinery and electronics.

In paragraph 1.4 and 1.5 the Nairobi Decision urges preference granting countries not to use compulsory combination of two or more of criteria for the same product, which would make it more difficult for LDCs to comply and utilise the preferences. Preference granting countries are rather encouraged to offer alternative rules of origin, which would provide options for LDC exporters to comply with the most convenient and therefore utilise the preference scheme.

Cumulation

The Nairobi Decision, in paragraph 2.1 provides for cumulation in relation to rules applied to determine sufficient or substantial transformation. Preference granting countries are encouraged to expand cumulation to facilitate compliance with origin requirements by LDC producers using the following possibilities:

- Cumulation with the respective preference granting country
- Cumulation with other LDCs
- Cumulation with GSP beneficiaries of the respective preference granting country; and
- Cumulation with developing countries forming part of a regional group to which the LDC is party, as defined by the preference granting country.

In paragraph 2,2 it is provided that the preference granting countries remain open to consider requests from LDCs for particular

⁹ Ibid
¹⁰ Ibid

¹¹ Ibid
¹² Ibid

cumulation possibilities in the case of specific products or sectors.

Cumulation enables countries that are members of preferential trade areas to share production, while complying with the rules of origin. This allows for more opportunities to source inputs by widening the definition of originating products and thereby availing LDCs with more options in utilising the preference schemes.

Documentary requirements

The Nairobi Decision also addresses the issue of documentary requirements in paragraph 3.1 wherein it is provided that in order to reduce the administrative burden related to documentary and procedural requirements related to origin, preference granting countries shall:

- As a general principle, refrain from requiring a certificate of non-manipulation for products originating from LDCs but shipped across other countries unless there are concerns regarding transshipment, manipulation, or fraudulent documentation;
- Consider other measures to further streamline customs procedures, such as minimising documentation requirements for small consignments or allowing for self-certification. Self-certification in this case would be made by either the producer, manufacturer, exporter or importer, it does not require to be made by an issuing authority for proof of origin, which reduces costs and simplifies utilisation of preference schemes.

Notification and Transparency: Implementation

The Nairobi Decision requires preference granting developed countries, as well as Preference granting developing countries to inform the WTO Committee on Rules of Origin (CRO) of the measures being taken to implement the decision.

The Decision also requires preference granting countries to notify their preferential rules of origin as per the established procedure pursuant to the Transparency Mechanism for Preferential Trade Agreements (PTAs), which basically entails adopting the agreed format in designing and implementing Rules of Origin.

The CRO is mandated to annually review implementation of the Nairobi Decision in accordance with the transparency provisions that were adopted in the Ministerial Decision on Preferential Rules of Origin for LDCs adopted at the Bali Ministerial Conference.

In line with the above requirements, the WTO developed a template for notification of preferential rules of origin, which has promoted transparency and clearer understanding of the rules of origin in relation to imports from LDCs. The information can also be used for assessing utilisation rates of the preferential schemes extended to LDCs.

Highlights from the annual review on implementation of the Nairobi Decision, conducted in 2018 included the following

developments:¹³

- Most preference granting Members had submitted their preferential rules of origin in the agreed template. This has facilitated access to detailed and standardised information on the origin requirements of most preferences for LDCs;
- The European Union (EU) is implementing a self-certification system (Registered Exporter system, REX) on which implementation status was reported to the CRO;
- There has been a marked improvement on tariff and trade data concerning non-

reciprocal trade preferences for LDCs since the adoption of the Bali and Nairobi Ministerial Decisions in this respect. This has made it possible for Members to analyse trade patterns and understand the impact origin requirements have on the ability for LDC exporters to effectively use the preference schemes. It was however reported that some gaps remain as a result of tariff and/or trade data still missing for ten preference granting Members.

Notifications and import data from preference granting WTO Members for the period 2017-2018 is shown in the table below:

Status of Notifications and Import Data

Preference Granting Member	Notification CTD	Notification CRO	2017	2018
Armenia	-	-	-	-
Australia	WT/COMTD/N/18	G/RO/LDC/N/AUS/1	Yes	Yes
Canada	WT/COMTD/N/15/Add.3	G/RO/LDC/N/CAN/1		
Chile	WT/COMTD/N/44	G/RO/LDC/N/CHL/1	Yes	Yes
China	WT/COMTD/N/39	G/RO/LDC/N/CHN/1	Yes	
EU	WT/COMTD/N/4/Add.7	G/RO/LDC/N/EU/1	Yes	
Iceland	-	-		
India	WT/COMTD/N/38	G/RO/LDC/N/IND/1	Yes	Yes
Japan	WT/COMTD/N/2	G/RO/LDC/N/JPN/1	Yes	Yes
Kazakhstan	-	G/RO/LDC/N/KAZ/1	Yes	Yes
Korea	WT/COMTD/N/12	G/RO/LDC/N/KOR/1	Yes	Yes
New Zealand	WT/COMTD/N/27	G/RO/LDC/N/NZL/1	Yes	Yes
Norway	WT/COMTD/N/6	G/RO/LDC/N/NOR/1	Yes	Yes
Russia	WT/COMTD/N/42	-	Yes	Yes
Switzerland	WT/COMTD/N/7	G/RO/LDC/N/CHF/1	Yes	Yes
Chinese Taipei	WT/COMTD/N/40	G/RO/LDC/N/TPKM/1	Yes	Yes
Tajikistan	-	-	-	-

¹³ Report (2018) of the Committee on Rules of Origin to the General Council on Preferential Rules of Origin for LDCs

Thailand	WT/COMTD/N/46	-	Yes	Yes
Turkey	WT/COMTD/N/15/Add.3	-	Yes	Yes
USA-GSP	WT/COMTD/N/1/Add.9	G/RO/LDC/N/USA/1	Yes	Yes
USA-Haiti	-	-	-	-
USA-AGOA	WT/L/1006	G/RO/LDC/N/USA/3	Yes	Yes

Source: Adapted from WTO Status of Notification of Preferential Rules of Origin for LDCs and Preferential Import Data - Report G/RO/W/163/Rev.4

LDC's Views on Implementation Status

In a presentation by the LDC Group during the Committee on Rules of Origin meeting of October 2018, a number of observations were made on the implementation status of the WTO Decisions on Rules of Origin regarding preferential trading schemes in their favour.

It was noted that three years after the Nairobi decision was a good time to recap and analyse progress made by preference granting countries towards transparent and simple rules that would facilitate market access.

LDC's observed that the use of Change of Tariff Classification (CTC) – towards simplification of Rules of Origin – could be further eased by some preference granting countries. It was noted that the EU and Japan were using the CTC, with the former having undertaken broad reforms of its Rules of Origin. LDC's will undertake further analysis on other methodologies such as ad valorem percentage and specific working of processing criteria to suggest ways in which they could be improved in addition to other elements of the Nairobi decision.¹⁴

In the spirit of the WTO Decisions on Rules of Origin under preferential trade schemes for LDC's, it is acknowledged that no one criterion is better than the other, but that each criterion on its own can be made more transparent and simpler so as to contribute to facilitating market access.¹⁵

LDC's emphasised that in the case of rules based on the change of tariff classification criterion, a substantial or sufficient transformation should generally allow the use of non-originating inputs as long as an article of a different heading or sub-heading was created from those inputs in an LDC – that is not withstanding that product specific rules with different requirements may also be more appropriate.¹⁶

As per the Rules of Origin notifications that have so far been made by preference granting countries, the table below highlights some of the WTO Preference granting Members that have applied the change of tariff classification (CTC).

¹⁴ LDC Group Presentation During the Committee on Rules of Origin Meeting 15 Oct. 2018

¹⁵ Ibid

¹⁶ Ibid

Preference Granting Countries Schemes: Application of CTC

Country/Group of Countries	Using CTC Requirement	How it is Used
EU (EBA)	Yes, as stand-alone or alternative to percentage criterion	<ul style="list-style-type: none"> • Manufactured from any heading • CTH • CTH with single or multiple exceptions • CTH with HS headings exceptions • CTC with HS chapter exceptions • CTC or percentage criterion
Japan	Yes, as stand-alone or as alternative or in addition to a percentage criterion	<ul style="list-style-type: none"> • CTH main criteria with following rules: (i) CTH with single or multiple exceptions; (ii) CTC with single or multiple HS chapter; (iii) exclusions; (iv) CTC and percentage criterion
Canada	No	
United States	No	
China	Yes, as alternative rules to percentage criterion	<ul style="list-style-type: none"> • Simple CTH • No exceptions
India	Yes, CTC in addition to percentage criterion	<ul style="list-style-type: none"> • Simple CTH • No exceptions
South Korea	No	

In light of the implementation status of the WTO Decisions on Rules of Origin for LDCs under preferential Schemes in October 2018, LDCs made the following observations and suggestions on the way forward:¹⁷

- Use of CTC in many cases excludes whole HS chapters or key headings, resulting in very stringent rules
- There is need for preference granting countries to refrain from using multiple exceptions to the CTC
- Japan should abolish the double requirement of CTC and ad valorem percentage criterion according to paragraph 1.4 of the Nairobi Decision
- India should also abolish the double

requirement of CTC and ad valorem percentage criterion.

Conclusion

Implementation of the WTO Ministerial Decisions on Preferential Rules of Origin for LDCs is an ongoing process that still requires further simplification and reform. Preference granting countries are encouraged to follow elements as contained in the WTO Bali and Nairobi Decisions when developing and reviewing their rules of origin applicable in preferential schemes in favour of LDCs, which would enable them to better utilise the preference schemes.

¹⁷ Ibid



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