



Note

WTO Nairobi Ministerial Decision on Preferential Rules of Origin for LDCs: A review of the implementation and outstanding issues

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Summary

The Nairobi Decision on Preferential Rules of Origin (RoO) for Least Developed Countries (LDCs) established for the first time a set of multilaterally agreed guidelines to facilitate optimal use and benefits from the preferential market access granted to LDCs by WTO Members. This brief note undertakes a focussed assessment of notifications received so far, based on three out of the four criteria that define substantive transformation as set out in the Nairobi Decision, i.e. change of tariff classification; specific working or processing and underlying cumulation and certification procedure, as reported in the notifications submitted by preference granting countries.

Introduction

The Nairobi Decision on Preferential Rules of Origin (RoO) for Least Developed Countries (LDCs) ('Nairobi Decision') established for the first time a set of multilaterally agreed guidelines to facilitate optimal use and benefits from the preferential market access granted to LDCs by WTO Members ('Members').

The Nairobi Decision in paragraph 4.3 specifically provides for notification of the preferential rules of origin in a prescribed form, which has presently been conformed to by most preference granting members. This form requires notification of utilisation rates, which has provided a valuable tool to identify specific difficulties that LDCs face in complying with the rules of origin.

So far findings indicate that some preference-granting countries exhibit low utilisation rates across all products, and also that high utilisation rates reported may in fact hide large pockets of under-utilisation in specific sectors, which implies that there is a significant share of LDC imports subjected to Most Favoured Nation (MFN) tariffs while eligible for preferential treatment.¹

This brief note undertakes a focussed assessment based on three out of the four criteria that define substantive transformation as set out in the Nairobi Decision, namely, change of tariff classification; specific working or processing and underlying cumulation and certification procedure, as reported in the notifications submitted by preference granting countries.

The analysis is largely based on the information as reported in the notifications, without deep analysis of the provisions set out in the online links provided by the preference granting countries. The purpose is to make a preliminary assessment of the notification's vis a vis their conformity to the Nairobi decision.

Based on recent work and deliberations of the LDC group, the note also highlights areas where further work is still required, and the necessary improvements needed to ensure effective implementation of the Nairobi Decision in this regard. The overall objective is to bring this important issue to the fore, so as to ensure LDCs optimally leverage preferential schemes, thereby complementing their development efforts and integration into the multilateral trading system. The notified criteria analysed in the note covers: Change of Tariff Classification; manufacturing or process operation criterion; and cumulation.

(I) Change of Tariff Classification ('CTC')

Article 1.2 of the Nairobi Decision lays down the disciplines for criterion based on CTC to determine substantial transformation. As a general principle, the Preference-granting Member shall inter-alia allow for a simple change of tariff heading or change of tariff sub-heading and eliminate all exclusions or restrictions to CTC rules. Broadly, 3 benchmarks have been introduced in this regard. As per the notifications so far made, 6 Preference-granting Members have opted for this criterion of which some Members such as

¹ LDC Presentation to CRO 2018

China and India, have resorted to more than one criterion to determine substantial transformation.

The first benchmark relates to provision for a simple change of tariff heading or tariff sub-heading. All 6 of the Preference-granting Members have complied with this benchmark exhibiting 100% compliance.

The second benchmark requires Members to eliminate all exclusions or restrictions to CTC rules, except where the Preference-granting Member deems that such exclusions or restrictions are needed, including to ensure that a substantial transformation occurs. China's disciplines in particular were not accessible since the hyperlink for Rules of Origin provided in the notification is not functional.

The third benchmark under this criterion is the requirement for introducing, where appropriate, a tolerance allowance so that inputs from the same heading or sub-heading may be used. It appears that 2 out of the 6 Preference-granting Members, namely, Norway and Switzerland have made a provision for tolerance allowance in their CTC criterion.

In conclusion, it is apparent that CTC criterion is not prevalent amongst Preference-granting Members, with none of the 6 Members within this category having exclusively relied upon this criterion. All 6 Members have relied on CTC in addition to either *ad valorem* value or manufacturing process criteria. A recent submission by the LDC WTO group to the Committee on RoO found that a number of issues still need to be considered so as to bring

Preference-granting Members into conformity with the Nairobi Decision in this regard. The issues include the following:²

- Exceptions to the general rules of change of tariff head (CTH) and change of tariff sub-heading (CTSH) are the norm rather than the exception for the CTC Preference-granting Members. An illustration is the RoO of Japan which provided for CTH as a general rule, but thereafter includes 26 pages of exceptions [to the general rule] covering most parts or all of the Chapters of the Harmonized System ('HS').
- Exceptions to the general rules are more stringent than the general rules, often going beyond any conceivable requirement for substantial transformation and as such un-justified.³
- Some of the Preference-granting Members have adopted more lenient RoO for the same products under Free Trade Agreements, adopting less stringent requirements which should be and could be replicated in the case of LDCs.

(II) Manufacturing or Processing Operation Criterion

Article 1.3 of the Nairobi Decision establishes 4 benchmarks for Preference-granting Members using Manufacturing or Processing Operation criterion, namely:

² Submission of the LDC WTO Group to the Committee on Rules of Origin, 15-16 May 2019

³ Ibid

a) if applied to clothing of Chapters 61 and 62 of the HS nomenclatures, the rule shall allow assembling of fabrics into finished products;

b) if applied to chemical products, the rule shall allow chemical reactions that form a new chemical identity;

c) if applied to processed agricultural products, the rule shall allow transforming of raw agricultural products into processed agricultural products;

d) if applied to machinery and electronics, the rule shall allow assembling of parts into finished products, provided that the assembly of parts goes beyond simple assembly.

As per the notifications, 6 Preference-granting Members have resorted to using this criterion to determine substantial transformation, out of which none have relied exclusively on this criterion alone.

The first benchmark or condition (a) hereinabove has seen very low compliance with only 2 out of the 6 Members allowing for assembling of fabrics into finished products. The second benchmark witnessed even lower compliance of only 1 Member satisfying the condition. The third benchmark saw higher compliance with 5 out of 6 Members satisfying the condition. Lastly, the fourth benchmark has seen no compliance at all.

Overall, Manufacturing or Processing Operation rules applicable to processed agricultural products have witnessed maximum compliance, but rules under this criterion applying to other products have a high compliance deficit. LDCs should highlight this issue and call for higher cooperation from

Preference-granting Members, especially in the area of Machinery and Electronics.

(III) Cumulation

According to the Article 2.1 of the Nairobi Decision, Preference-granting Members are encouraged to expand cumulation to facilitate compliance with origin requirements by LDC producers in furtherance of which, 4 possibilities of cumulation are laid down:

(a) cumulation with the respective Preference-granting Member;

(b) cumulation with other LDCs;

(c) cumulation with GSP beneficiaries of the respective Preference-granting Member; and

(d) cumulation with developing countries forming part of a regional group to which the LDC is a party, as defined by the Preference-granting Member.

Our analysis shows only 2 countries, namely, Norway and Canada have exhibited 100% compliance with these criteria.

Most of the preferential schemes recognize that where the originating material from Preference-granting Member is incorporated into the production of a product in the territory of the exporting beneficiary country, such material shall be considered to originate in the territory of the exporting beneficiary country (first benchmark).

Concerning the second benchmark, preliminary analysis shows that only 6 Members satisfy the criterion of cumulation with other LDCs. This means that these 6 countries appear to have accepted that where the originating material

from another LDC is incorporated into the production of a product in the territory of the exporting beneficiary country, such material shall be considered to originate in the territory of the latter.

The third benchmark shows that 8 Members comply with the criterion of cumulation with GSP beneficiaries of the respective Member; so that they authorise a cumulation with materials originating in a country with which they have a preferential trade agreement.

The fourth benchmark also witnessed compliance by only 8 Members which applied the criterion of cumulation with developing countries forming part of a regional group to which the LDC is a party, making it possible for cumulation between developing countries forming regional economic groups.

Conclusion and Way Forward

Most of the Preference-granting Members have to some extent complied with the Nairobi Decision. However, some gaps remain with a few preference granting countries yet to fulfil even the basic requirement of notification in the prescribed format.




With regard to effective implementation of the Nairobi Decision, much remains to be done to ensure that the preferences granted to LDC are better utilised and leveraged toward development and integration of LDCs in the multilateral trading system. Best practices can be drawn from the preferential schemes of the compliant Members, which could then be harmonised and implemented on a uniform basis. As highlighted under the different agreed

criteria above, the main issues to further resolve include:

- Limiting exceptions to the general rules under the CTC criteria, and ensuring that such exceptions are not unnecessarily restrictive, in this context preference granting countries with more flexible rules of origin on the same products/sectors under FTA's should extend the same to LDC's. The friendlier rules under FTAs could be adopted as the standard in this criterion;⁴
- With regard to the manufacturing or processing operation, criterial compliance to the rules for non-agricultural products calls for further work to bring it into conformity with the rules;
- The cumulation criterion also calls for further improvements in order to allow the preference granting countries to come into conformity with the Nairobi Decision.

The checkbox here annexed, provides an overview of the country notifications as compared to the Nairobi Decision of preferential rules of origin.

It should be noted that the signs used have the following meanings:

-  Complied as per the information in the Notification
-  Not yet complied as per the information in the notification
-  ! Less than fully complied as per the information in the notification.

⁴ Ibid

Checkbox on provisions relating to substantial transformation and cumulation rules, in compliance with the Nairobi Decision on rules of origin

Criterion of Tariff Classification Change				
Member States notifying under this criterion	Benchmarks under the Nairobi Decision			Comments (if any)
	Simple change of tariff heading or change of tariff sub-heading	Eliminate all exclusions or restrictions to change of tariff classification rules, except where the Preference-granting Member deems that such exclusions or restrictions are needed, including to ensure that a substantial transformation occurs	Introduce, where appropriate, a tolerance allowance so that inputs from the same heading or sub-heading may be used.	
India (G/RO/LDC/N/IND/1)	✓	✗	✗	CTC is applied in conjunction with ad valorem percentage.
Japan (G/RO/LDC/N/JPN/1)	✓	!	✗	The country provides for CTH as a rule, but also entail 26 pages of exceptions [to the general rule] covering most parts or all of the HS chapters. In general, the CTC rule is respected but detailed analysis is required on product-by-product basis to establish whether other benchmarks of eliminating restrictions and introducing tolerance allowance, remains to be done.
Norway (G/RO/LDC/N/NOR/1)	✓	!	!	Norway provides for a general rule of tariff classification change based on usage of non-originating materials of different tariff heading than the product to be exported. However, it carves out 3 exceptions to this general rule. This would require deeper analysis to assess whether benchmark 2 and 3 have been confirmed with.

Switzerland (G/RO/LDC/N/CHE/1)	✓	!	!	In general, the CTC rule is respected but detailed analysis is required on product-by-product basis to establish whether other benchmarks of eliminating restrictions and introducing tolerance allowance, remains to be done.
China (G/RO/85)	✓	×	×	The link containing the text of Rules of Origin in a WTO language is not functional. The applicable Rules are determined from the filled-in template in the Notification of Preferential Rules of Origin for the LDCs. China uses both 'Regional Value Content' and 'Change in Tariff Classification' criteria to determine substantial transformation.
EU (G/RO/LDC/N/EU/1)	✓	!	!	In general, the CTC rule is respected but detailed analysis is required on product-by-product basis to establish whether other benchmarks of eliminating restrictions and introducing tolerance allowance, remains to be done.

Criterion of Manufacturing or Processing Operation

Member States notifying under this criterion	Benchmarks under the Nairobi Decision				Comments (if any)
	if applied to clothing of chapters 61 and 62 of the Harmonised System nomenclature, the rule shall allow assembling of fabrics into finished products	if applied to chemical products, the rule shall allow chemical reactions that form a new chemical identity	if applied to processed agricultural products, the rule shall allow transforming of raw agricultural products into processed agricultural products	if applied to machinery and electronics, the rule shall allow assembling of parts into finished products, provided that the assembly of parts goes beyond simple assembly	
India (G/RO/LDC/N/IND/1)	✗	✗	✓	✗	
Korea (G/RO/LDC/N/KOR/1)	✗	✗	✓	✗	
New Zealand (G/RO/LDC/N/NZL/1)	✗	✗	✓	✗	
Norway (G/RO/LDC/N/NOR/1)	✗	✗	✓	✗	
Switzerland (G/RO/LDC/N/CHE/1)	✓	✓	✓	✗	

USA-AGOA (G/RO/LDC/N/USA/3)	✓	×	×	×	
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Cumulation					
Member States notifying under this criterion	Benchmarks under the Nairobi Decision				Comments (if any)
	Cumulation with the respective Preference-granting Member	Cumulation with other LDCs	Cumulation with GSP beneficiaries of the respective Preference-granting Member	Cumulation with developing countries forming part of a regional group to which the LDC is a party, as defined by the Preference-granting Member	
India (G/RO/LDC/N/IND/1)	✓	×	×	×	
Japan (G/RO/LDC/N/JPN/1)	✓	×	×	×	
Korea (G/RO/LDC/N/KOR/1)	✓	×	×	×	
New Zealand (G/RO/LDC/N/NZL/1)	✓	×	✓	×	
Norway (G/RO/LDC/N/NOR/1)	✓	✓	✓	✓	

Switzerland (G/RO/LDC/N/CHE/1)	✓	✓	✗	✓	
Chinese Taipei (G/RO/LDC/N/TPKM/1)	✓	✗	✗	✗	
USA-GSP (G/RO/LDC/N/USA/1)	✗	✓	✓	✓	
USA-AGOA (G/RO/LDC/N/USA/3)	✓	✗	✓	✓	
Kyrgyz Republic (G/RO/LDC/N/KGZ/1)	✓	✓	✓	✗	
China (G/RO/85)	✓	✗	✗	✓	
Canada (G/RO/LDC/N/CAN/1)	✓	✓	✓	✓	
Chile (G/RO/LDC/N/CHL/1)	✗	✗	✗	✗	
EU (G/RO/LDC/N/EU/1)	✓	✗	✓	✓	
Russia (G/RO/LDC/N/RUS/2)	✓	✓	✓	✗	

USA (G/RO/LDC/N/USA/4)	✓	✗	✗	✓	
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Other observations	
Country	Comment
Kazakhstan (G/RO/LDC/N/KAZ/2)	The Notification refers to the “Rules of origin for developing and least developed countries, adopted by the Decision No. 60 of the Council of the Eurasian Economic Commission of 14 June 2018. https://docs.eaeunion.org/docs/en-us/01418281/cncd_20072018_60 ”. The resources under this link are written in Russian; so, It could not be possible for some LDCs to access these rules. It is necessary for the Kazakhstan government to translate them into at least one WTO’s language.
Colombia (G/RO/N/172)	The notification simply links to the National Government’s website, without addressing specific questions as stated in the CRO template. Further, the link is not functional.



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