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Note

Enhancing LDC Utilisation of Preferential Market Access Schemes: A Case for Simplifying Rules of Origin

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Summary

This note reviews the importance of preferential trade schemes for LDCs, taking stock of developments in the World Trade Organization (WTO), with a focus on the need for transparent and simplified Rules of Origin (RoO), which would facilitate better utilisation of the schemes.

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Introduction

Granting preferential market access schemes to developing countries and LDCs can be traced back to the early 1970s. Recognizing the difference in economies and technical capacities of developed and developing countries, member States of the then-General Agreement on Tariffs and Trade (GATT) unanimously sought to create a generalized system of preferences for developing countries, which would be non-reciprocal and non-discriminatory in nature. They therefore, decided to waive the most-favoured nation (non-discrimination) treatment (MFN) treatment for a temporary ten-year period in order to '*permit developed countries to accord preferential tariff treatment to products originating in developing countries*.'[1]

This waiver of MFN obligations was sought to be made permanent by developing countries, leading to the insertion of the 'enabling clause'. This permitted developed states to grant an indefinite exception to Article I (MFN) obligations by allowing preferential tariff treatment to products originating in developing countries, in accordance with the Generalised System of Preferences (GSP).[2] Furthermore, this was also the first time members brought about a distinction between preferences granted to developing countries and preferences granted to least developed countries (LDCs), by recognizing their special economic situation and development needs.[3] In this regard, the clause obliged developed countries to exercise restraint in seeking concessions or contributions from LDCs. It also provided that favourable treatment should be accorded to LDCs,[4] and that the clause would apply to any special treatment on LDCs among developing countries '*in the context of any general or specific measures in favour of developing countries*.'[5]

While the Enabling Clause was limited to developed countries providing such preferential market access, a decision under the WTO in 1999 allowed granting preferential market access by developing countries also who wish to do so. This was achieved through a waiver to the MFN obligation under the 1999 decision on "Preferential-Tariff Treatment for Least-Developed Countries"[6], which has since been extended until 16 October 2029[7].

These preferential schemes aim at integrating LDCs in the international trading regime, and achieve the basic objectives of GATT. In this regard, various developed countries and developing countries (in position to extend preferential schemes) began to formulate their own GSP and Rules of Origin schemes for LDCs.

This note reviews the importance of preferential trade schemes for LDCs, taking stock of developments in the World Trade Organization (WTO), with a focus on the need for transparent and simplified Rules of Origin (RoO), which would facilitate better utilisation of the schemes.

Utilization of LDC Preferential Schemes

The question of whether or not preferential schemes such as those extended to LDCs, are optimally utilised is important, in assessing the extent to which such schemes are useful for the better integration of LDCs in the multilateral trading system. To that end, the major factors determining utilisation of preferences include:

- Attractiveness of the preferential tariff margin. For instance, where the MFN tariff

[1] GATT Resolution 28 June 1971: https://www.wto.org/gatt_docs/English/SULPDF/90840258.pdf

[2] Differential and more favourable treatment reciprocity and fuller participation of developing countries- decision of 28 November 1979 (L/4903)- https://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm *(enabling clause decision)*

[3] Art. 8, Enabling Clause Decision.

[4] Art. 2(c), Enabling Clause Decision.

[5] Art. 2(d), Enabling Clause Decision.

[6] WTO document WT/L/304)

[7] WTO document WT/L/1069

rate and the preference rate are zero rated, utilisation rates will not differ between the two categories

- The cost of compliance with the requirements for preferential treatment. Where they are high, less utilisation of such preference scheme is likely, and where they are low, or user friendly, there is more usage of the scheme.

In all cases, preferential schemes specify originating requirements, which usually include: the need to conform with general or product specific rules of origin; proof of certificate of origin as per specified documentary requirements; and transportation requirements.[8] Such requirements are a major determinant in the utilisation of preferential schemes, hence the decision by WTO Members in the Nairobi Ministerial Conference, for preference granting Members to notify the necessary information and data to the WTO secretariate so as to facilitate periodic computation of utilisation rates. This would be the basis of determining existing challenges and actions required to redress them.[9]

It should never the less be noted that although rules of origin are an important factor in determining preference utilisation, there are other considerations, which include: low preferential margin – whereby the deference between the preference and MFN rate is low, giving less incentive for beneficiaries to opt for the preference; and where there are different trade preference schemes available to beneficiary countries, the beneficiaries may prefer a particular scheme over the other, for instance beneficiaries of the U.S. GSP and the Africa Growth Opportunity Act (AGOA), may choose to utilise one over the other.[10] Several WTO Member countries provide LDCs with preferential schemes, these include the following:

Table 1: Preferential Schemes for LDCs[11]

Preference Granting Country	Preferential Scheme
Australia	GSP - providing 100% duty and quota free access to products originating from LDCs
Canada	Least Developed Country Tariff (LDCT) – providing duty and quota free access to LDCs products on 98.6% of tariff lines
Chile	Duty free treatment for LDCs covering 95.5% of tariff lines
China	Providing 97% duty free quota free market access to LDCs
European Union	Every thing But Arms (EBA) providing duty and quota free market access to 100% of all tariff lines
India	Duty free tariff preference scheme for LDCs covering 94.1% of tariff lines, plus additional preferences for Nepal and Bangladesh under SAARC and SAFTA arrangements
Japan	GSP offering duty and quota free market access to imports originating in LDCs covering 97.9% of tariff lines
Korea	Preferential tariffs for LDCs covering up to 89.9% of all tariff lines
Norway	GSP which offers up to 100% duty and quota free access of products originating from LDCs
Switzerland	GSP which offers duty and quota free access to 100% of products originating from LDCs
United States	GSP and AGOA, which cover up to 97.5% of tariff line for eligible countries

[8] Utilization rates Under Preferntial Trade Arragements for LDCs G/RO/168/Rev1
[9] Ibid
[10] Ibid.
[11] Derived from WTO document G/RO/W/203

WTO Ministerial Decisions on LDCs Trade Preference Schemes

Aside from the grant of duty-free, quota-free market access, WTO Members, agreed that there was need of simplifying Rules of Origin. Ministerial Decisions have been made in this regard, which include the following:

The Hongkong Ministerial Conference, 2005

The first discussions with respect to simplifying Rules of Origin for LDCs took place in 2005, with member states agreeing to provide duty-free and quota-free market access on a 'lasting basis' for all products originating in LDCs by 2008. If this was difficult to do, they had to provide the same for at least 97% of products originating in LDCs, defined at the tariff-line level, by the stipulated time period.[12] With respect to Rules of Origin, members recognized the need to ensure that preferential Rules of Origin that are applied to imports from LDCs are '*transparent and simple*', contributing to market access.[13]

Thus, although the emphasis here was still on duty-free and quota-free market access, members for the first time underscored the importance of simplifying preferential Rules of Origin for LDCs in order to effectively ensure utilisation of the market access granted.

The Bali Ministerial Conference, 2013

It was at the Bali Conference[14] that the first comprehensive set of guidelines for harmonizing and simplifying preferential Rules of Origin requirements for LDCs was discussed. WTO members explicitly recognized that duty-free and quota-free market access can only be effectively utilized if they are accompanied by simple and transparent Rules of Origin. The Decision did not attempt to draw out a single set of Rules of Origin criteria, instead recognizing that transparent and simple rules can be achieved in a variety of ways. It therefore sought to provide only guidelines, which members can use to formulate or develop their own Rules of Origin arrangements.

Other than for wholly obtained products, the Decision discussed three main methods of conferring preferential origin by way of substantial or sufficient transformation:

a) Ad Valorem Percentage criterion: The Decision recognized the importance of keeping the level of value addition as low as possible for LDC in order to meet its objectives. In this regard, LDCs sought for the consideration of allowing foreign inputs to up to 75% of the value in order for a product to qualify for benefits. The method of calculation of such value was not specified, with members agreeing that it must be the simplest, based on the principles of simplicity and transparency.

b) Change of Tariff Classification criterion: Under this method, developed countries should generally allow the use of non-originating inputs until and unless such inputs led to the creation of an article of a different heading or sub-heading of tariff classification.

c) Specific Manufacturing or Processing Operation criterion: members here recognized that rules of origin must take into consideration the productive capacity of LDCs, and while doing so, such rules must be made more transparent and easier to comply with.

The Decision also discussed the concept of cumulation for the first time, allowing LDCs to combine originating materials without losing the originating status of materials, thereby jointly sharing them.

[12] Art. 36(a), Annex F, Hongkong Ministerial Conference, 2005.
[13] Art. 36(b), Annex F, Hongkong Ministerial Conference, 2005.
[14] Bali Ministerial Conference WT/MIN(13)/42, WT/L/917, 11 DECEMBER 2013

Aside from these substantive considerations, the Decision also sought to provide guidelines to members to simplify administrative regulations in the grant of preferential market access. It underlined the need for all documentary requirements to be simple and transparent, and goes on to specify measures that can be taken in order to ensure transparency. It laid emphasis on notification, requiring all members to notify preferential rules of origin for LDCs according to the established procedures. It also mandated that the Committee on Rules of Origin (CRO) annually review of developments in preferential rules of origin, and subsequently report to the General Council of the same.

The Nairobi Ministerial Conference, 2015

The developments at Bali were crucial in recognizing the need for simplicity and transparency in the conferral of preferential rules of origin. The Decision at Nairobi[15] built on those guidelines, by providing more comprehensive and detailed instructions to WTO members. In describing the various criteria to identify products qualifying for benefits, the Decision firstly decided that members should avoid the imposition of two or more criteria for the same product, and that if this was not possible, to relax such requirements subject to a request by LDCs. It went on to describe in detail the three methods as discussed in Bali:[16]

a) Ad Valorem Percentage criterion: Members were obliged to adopt a method based on the value of 'non-originating' materials. This extends to up to 75% of the value of the product. The Decision recognized that LDCs preferred this method the most, but allowed members to continue adopting any other method if they had already done so.

b) Change of Tariff Classification criterion: The Decision provided for three methods; *firstly,* to allow for a simple change of tariff heading, *secondly,* to eliminate all exclusions or restrictions to change of tariff classification rules, and *lastly,* introduce a tolerance allowance to permit the usage of inputs from the same heading.

c) Specific Manufacturing or Processing Operation criterion: The Decision provided specific manufacturing or processing operations to qualify for preferential rules of origin for different kinds of products. For *clothing*, it allowed the assembling of fabrics into finished products; for *chemical products*, chemical reactions that form a new chemical identity were permitted; for *agricultural products,* it allowed the transformation of raw agricultural products into processed agricultural products; and for *machinery and electronics,* it considered the assembling of parts into finished products (other than simple assembly).

It also encouraged members to expand cumulation in order to facilitate more origin requirements by LDC producers. Aside from providing a comprehensive and specific set of substantive commitments to be undertaken by developed countries, the Decision provided various procedural relaxation guidelines as well.[17]

In an attempt to reduce administrative burdens with respect to documentary and procedural requirements regarding origin, the Decision stipulated that products originating from LDCs do not require a certificate of non-manipulation. Furthermore, it obliged states to consider various measures in order to streamline customs procedures even further suggesting self-certification as one such measure.

The Decision also contained an additional heading on '*implementation, flexibilities and transparency*' which specified that preference granting members inform the CRO of any measures taken to implement the substantive

[15] Nairobi Ministerial Conference, WT/MIN(15)/47 — WT/L/917, 19 December 2015.

[16] Ibid

[17] Ibid

provisions of the Decision by 31st December 2016. It also recommended that the CRO develop a template for notification, in order to enhance transparency and simplify the process of conferring preferential rules of origin to LDCs. It further directed the CRO to annually review the implementation of the Decision, in accordance with the guidelines laid out in the Bali Conference.[18]

The Nairobi Decision established a fundamental step in integrating LDCs into the international trading system, with potential to enhance their trade contribution and thereby derive development opportunities

The Decision reaffirms the need to ensure that Preferential Rules of Origin applicable to imports from LDCs are transparent and simple, and continue to facilitate market access.

Developments since the Nairobi Decision

Various member states took multiple efforts in order to comply with the Nairobi Decision. The 2017 report of the CRO to the WTO General Council summarises these efforts as follows:

- China adopted new legislation introducing a series of simplifications to its Rules of Origin
- Canada announced changes to facilitate the requirements for some apparel items
- Norway announced that it allows for cumulation among LDCs while Australia stated it was conducting a comprehensive review of its Generalized System of Preferences
- Thailand also reported the intention to review their rules of origin
- It is expected that the Eurasian customs union will announce their revision shortly
- The remaining preference granting WTO Members were of the view that their existing preferential RoO for LDCs were already complying with the Nairobi Decision.

Apart from these specific efforts, renewed steps were taken to start constructive dialogue at CRO, which involved a progressive examination of the each of the substantive components of the Nairobi Decision to show to the preference granting WTO Members the deviation of their rules of origin from the Nairobi decision and best practices that could be adopted.

Key Developments for Rules of Origin- Leaning from the Best Practices of Reforms under LDC Preferential Schemes

Despite steps taken to implement the Nairobi Decision, analysis of the utilization rates, still shows that the existing rules of origin adopted by preference giving countries were linked to low utilization of these trade preferences;

- In 2018 LDC analysis found EU and Japan rules of origin not wholly in compliance with the Nairobi Decision
- Majority of the preference giving countries do not meet the LDC's requests of: (i) 75% of non-originating materials; (ii) Cumulation; and (iii) Other Elements of the Nairobi Decision.

Subsequently, in 2019 the LDC Group submitted a substantive paper on direct consignment to the CRO. The Document revealed that legal texts of some preference granting WTO Members were not in conformity with the Nairobi Decision, for instance the Non-Alteration Principle of the EU being a case in point. All things considered, the LDC group have highlighted the following:

[18] Ibid

- The possible impact that direct consignment rules could have on utilization rates confirmed findings of the WTO Secretariat (See WTO document G/RO/W/185)
- Some preference granting Members, like India, showed close to zero utilization rates
- The fact that multiple preferences available to LDC under other preferential arrangements have to be taken into account in order to correctly assess the impact of rules of origin under each preferential scheme

The issues related to the Notification of Utilization Rates include:

- Lack of notification or incomplete notification of utilization rates by preference giving countries
- The quality and accuracy of the data notified to the WTO secretariat
- Completeness of the data notified that should encompass utilization rates of other schemes available to LDCS
- Preference giving countries should progressively notify the utilization rates of their preferences granted to the LDCs to make a transparent and efficient assessment possible.

The LDC Group in the WTO has highlighted these issues in the CRO, calling for preference granting countries to consider their submissions about reforming rules of origin in order to make trade preferences more effective especially on the issue of direct consignment – G/RO/W/191[19] and change of tariff classification.[20] They also recommend that such countries abolish the requirement of a certificate of non-manipulation or any other form of certification required for products originating in LDC and shipped through other countries – G/RO/W/184.[21]

The LDC Group has requested preference giving countries that are adopting change of tariff classification, to avoid multiple exceptions to such criteria as provided in paragraph 1.2 (b) of the Nairobi Decision and adhere to the specific recommendations contained in the LDC submission. Those that are unable to do so are to explain the reasons for such non-conformity and provide justified evidence to the Committee about the need for maintaining such non-conformity.[22]

Conclusion

Preferential market access schemes are no doubt an important avenue for integrating LDCs in the multilateral trading system, however their effective utilisation, according to analysis, remains less than optimal. Effective implementation of the Nairobi WTO Ministerial Decision in this respect, would no doubt go a long way in facilitating LDCs better access and utilisation of the schemes. To achieve this result, the CRO needs to be better mandated in its oversight role. In addition, constructive bilateral engagement between the LDCs and preference granting countries could help address limitations and improve utilisation.

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[19] « Direct consignment rules and low utilization of trade preferences, Submission by the LDC group dated 7 October 2019, G/RO/W/191, 9 October 2019.

[20] « Rules of origin based on a change of tariff classification », Submission by the LDC Group, dated 3 May 2019, G/RO/W/184, 7 May 2019

[21] Ibid

[22] Direct consignment rules and low utilization of trade preferences, Submission by the LDC group dated 7 October 2019, G/RO/W/191, 9 October 2019

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