About the Paper
Most-favored-nation/preferential rates of duty under the World Trade Organization and free trade agreements are not automatically granted. Imported goods must meet rules of origin. Teruo Ujiie clarifies conceptual aspects of rules of origin using practical examples.

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Rules of Origin: Conceptual Explorations and Lessons from the Generalized System of Preferences
Teruo Ujiie
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RULES OF ORIGIN:
CONCEPTUAL EXPLORATIONS AND LESSONS
FROM THE GENERALIZED SYSTEM OF PREFERENCES

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DECEMBER 2006

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FOREWORD

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<tr>
<td>AFTA</td>
<td>ASEAN Free Trade Agreement</td>
</tr>
<tr>
<td>APEC</td>
<td>Asia Pacific Economic Cooperation</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>CIF</td>
<td>cost, insurance, and freight</td>
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<tr>
<td>DDA</td>
<td>Doha Development Agenda</td>
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<td>EFTA</td>
<td>European Free Trade Area</td>
</tr>
<tr>
<td>EPZ</td>
<td>export processing zone</td>
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<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FDI</td>
<td>foreign direct investment</td>
</tr>
<tr>
<td>FOB</td>
<td>free on board</td>
</tr>
<tr>
<td>FTA</td>
<td>free trade agreement</td>
</tr>
<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<tr>
<td>GSP</td>
<td>generalized system of preferences</td>
</tr>
<tr>
<td>HS</td>
<td>harmonized system</td>
</tr>
<tr>
<td>MFN</td>
<td>most-favored-nation</td>
</tr>
<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
</tr>
<tr>
<td>NT</td>
<td>national treatment</td>
</tr>
<tr>
<td>QR</td>
<td>quantitative restriction</td>
</tr>
<tr>
<td>SME</td>
<td>small and medium enterprise</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>WCO</td>
<td>World Customs Organization</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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ABSTRACT

Customs valuation, commodity classification system, and rules of origin are the three basic customs laws. Rules to determine a country of origin, or “nationality” of a country of production of goods, are called “rules of origin.” They are widely used in international trade in the application of different tariffs, trade remedy measures, tariff quotas, and trade statistics. With the globalization of economic activities resulting in outsourcing of materials as well as the global proliferation of free trade agreements, rules of origin have become one of the major trade issues among both public and private sectors. Rules of origin often result in the so-called “spaghetti-bowl” effect. Since there is no agreement on product-specific harmonized rules of origin, international trade—both preferential and nonpreferential—is governed by different national laws. This paper intends to describe key conceptual aspects of rules of origin, focusing on lessons learned on origin criteria under the Generalized System of Preferences as well as from the efforts of the World Customs Organization and World Trade Organization to harmonize different origin rules.
I. INTRODUCTION

A country of origin means the “nationality” of a country of production of goods. The rules to determine a county of origin as a whole are called “rules of origin.” Rules of origin—together with customs valuation (assessment of value on imported goods for customs purposes) and nomenclature (commodity classification system)—are the three basic customs laws on substance. In addition to these three customs laws, a set of customs clearance procedures is required to collect customs duties. In general, customs procedures in the context of “trade facilitation” are under negotiations in the ongoing World Trade Organization’s (WTO) Doha Development Agenda (DDA) or Doha Round (Ujiie 2006).

While there are international agreements on these three customs areas, only rules of origin lack detailed rules. An Agreement on Rules of Origin was agreed upon at the Uruguay Round (1986–1994), however, it basically describes a set of principles and a future work program for establishing harmonized product-specific rules of origin. As the WTO has not approved yet the draft harmonized rules of origin developed by the World Customs Organization (WCO), rules of origin are, at present, administered by national laws, adding to the complications.

Rules of origin are widely used in international trade for application of different tariffs depending on a country of origin, trade remedy measures (e.g., antidumping duty action), quantitative restrictions and tariff quotas by country, trade statistics and so on. With the ever-growing globalization of economic activities resulting in outsourcing of materials as a regular private sector practice, rules of origin have become one of the major trade issues among both public and private sectors. In addition, rules of origin play a key role in regulating preferential trade—a result of the global proliferation of free trade agreements (FTAs)—which causes the so-called “spaghetti-bowl” effect.

On substance of rules of origin, no origin dispute arises when a product is defined as a wholly obtained product. However, when a product is produced with the combination of imported and domestic materials, it causes an origin issue. Theoretically, the country of origin is conferred if an imported input is substantially transformed. While the substantial transformation concept may be acceptable, the question is how to interpret the concept in practice, and apply it to an enormous number of different tradable goods. There are basically three interpretations on substantial transformation: (i) manufacturing process criterion including change in harmonized system (HS) heading, (ii) percentage or value-added criterion, and (iii) combination of the first two criteria. Since each criterion has its own pros and cons, these origin criteria are not harmonized but they coexist.

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1 In the case of customs valuation, the WTO’s Customs Valuation Agreement (official title: Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994) sets out detailed rules and procedures. This agreement was established at the Tokyo Round (1973–1979), and elaborated at the Uruguay Round (1986–1994). In the case of commodity classification, the WCO’s Harmonized System or HS (official title: the International Convention on Harmonized Commodity Description and Coding System), put into force in 1988, provides for the basis for nomenclature.
At present, both preferential and nonpreferential rules of origin (except for FTAs) are administered by national laws. These national laws differ significantly from one trading nation to another. Rules of origin under the Generalized System of Preferences (GSP), in operation for more than 35 years (since the early 1970s), provide a good basis for FTA rules of origin. Cumulative rules of origin, donor country content rule, and tough rules on textiles and clothing are peculiar in GSP rules of origin. High level of similarities is found between GSP rules of origin and FTA rules of origin, as described in the actual case below.

This paper intends to describe in simple terms what rules of origin are, what kinds of rules of origin exist; why are rules of origin important; any relevant agreements at the international level, such as WTO or WCO; and what are the major techniques used to determine a country of origin. While FTAs proliferate, many papers recommend that rules of origin should be simplified. This paper focuses on origin criteria, key conceptual aspects, and lessons learned from the GSP rules of origin particularly to show policy options in future FTAs.

II. SIGNIFICANCE OF RULES OF ORIGIN IN INTERNATIONAL TRADE

Rules of origin have become one of the major trade issues among trading nations and trading communities worldwide. While reasons for this could be closely linked to each other, the following factors are pointed out.

(i) The general trend is to reduce costs of doing business in international trade. Thanks to the series of General Agreement on Tariffs and Trade (GATT) multilateral trade negotiations, “trade liberalization” measures (i.e., reduction or elimination of customs duties) have been implemented, and according to WTO, the average tariff rate is 4%. Generally speaking, tariffs are not regarded as major barriers to trade although high-tariff items and tariff escalation still exist for certain sensitive products. Instead, business and trading communities—in particular, small and medium enterprises (SMEs)—pay greater attention to “trade facilitation” measures, such as establishment or harmonization of customs procedures. In fact, an Asia Pacific Economic Cooperation (APEC) study shows that trade facilitation efforts will produce more fruits than trade liberalization. Customs procedures cover not only export/import clearance procedures, but also certification of rules of origin requirements. Excessive and burdensome government documentation requirements would undermine the benefits from trade liberalization measures.

(ii) Lack of international uniformity and harmonization and proliferation of FTAs. Origin requirements vary from country to country. From an exporter’s point of view, they are burdensome and unnecessarily restrictive. In some cases, a single importing country uses different sets of rules of origin. This is particularly true in the context of the proliferation of FTAs where rules of origin play a key role in granting reduced or eliminated rate of

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2 See for example Part 3 (Routes for Asia's Trade) of the Asian Development Outlook 2006 (ADB 2006, 275 and 279). It argues that preferential rules of origin are discriminatory, complex, and inconsistent. It further states that “There is little hope that rules of origin in preferential agreements will ever be harmonized.”

3 The APEC study on the impact of trade liberalization in APEC conducted in 1997 estimated that trade facilitation programs would generate gains of about 0.26% of real gross domestic product to APEC economies, almost double the expected gains from tariff liberalization; and that the savings in import prices would be between 1–2% of import prices for developing countries in the APEC region.
duty for products covered by an FTA. This fact also means that manufacturers change the proportion of domestic and imported materials they use to meet specific rules of origin in different markets, causing additional production costs.

(iii) **Rules of origin as trade policy instrument.** Rules of origin are supposed to be technical and neutral rules to determine the country of origin of goods. However, rules of origin are frequently used as a trade policy instrument in some importing countries in the form of preferential trade agreements and arrangements, such as GSP and FTAs.\(^4\) In order to protect national interest, rules of origin tend to differ from one FTA to another, reflecting different trade patterns and structures on a bilateral basis.

(iv) **Outsourcing, a common business practice.** Recent increased developments of “globalization” in economic activities, led not only by large firms, but also by many SMEs, make it more difficult to determine the country of origin of goods as they source materials, parts, and components from many foreign countries in order to make their own products more competitive at international markets. This trend of globalization and outsourcing will be expected to further grow through trade liberalization measures under the ongoing DDA as well as FTAs.

(v) **Expansion of foreign direct investments (FDI) and export processing zones (EPZs).** Exports are regarded as an engine for economic growth. Many developing countries offer tax incentives to EPZs to attract FDI. Rapid growth of FDI in developing countries creates a production base for exports to enjoy preferential tariff treatment under GSP and FTAs. In order to benefit from such treatment, goods produced at EPZs must meet the requirements for rules of origin.

(vi) **Circumvention of trade remedy measures.** Some companies tend to circumvent trade remedy measures (e.g., anti-dumping and countervailing duties) by simply transferring their factories to third countries that are not subject to these trade remedy measures, or to the importing country that has imposed such measures and is supplying essential parts and components. Since trade remedy measures are taken against specific exporting countries, rules of origin play a key role in determining the country of origin of the goods in question. Determination by the importing authorities is vital for such companies to waive payment of additional customs duties. Measure-imposing countries may wish to create special origin rules to avoid such circumvention practices, which could lead to another trade policy instrument.

(vii) **Minor rule amendment requires a big operation change.** Authorities often issue technical amendments of rules of origin. Even if such amendments are minor, it could require considerable modification of present production operations. There are instances where the combination of use of domestic and imported materials should be changed to meet the new origin rules.

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\(^4\) See for example the green paper of Commission of the European Communities (2003, 7) on the future of rules of origin in preferential trade arrangements, which states that “the preferential rules of origin are an instrument of commercial policy” .... and that “preferential origin rules also serve the objective of supporting sustainable development and integrating the developing countries into world trade.”
III. WHAT ARE RULES OF ORIGIN AND WHY ARE RULES OF ORIGIN IMPORTANT?

Perhaps the definition of rules of origin stipulated in Article 1 of the WTO Agreement on Rules of Origin may answer these questions. It states that the term rules of origin is defined as “those laws, regulations and administrative determinations of general application by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994” (WTO 2002).

There are two interesting terms in this Article, namely “general application” and “contractual or autonomous trade regimes.” It means that there are two different sets of rules of origin: one set of rules of origin is applicable to the contractual and autonomous trade regimes or preferential trade; and the other set is for general application or nonpreferential trade, i.e., trade on a most-favored-nation (MFN) basis. The WTO rules of origin are government public laws and regulations of general application to determine the country of origin of tradable goods.

Normally, a trading nation provides three different rates of customs duty for the same imported goods depending on the country of origin. Firstly, a statutory rate, the highest of all (e.g., 30%), is applied to trade with non-WTO members, nonparty/beneficiary under preferential trade agreements, or to trade with countries with no trade agreement that commits MFN treatment. Secondly, a concessional rate or MFN rate, which is lower than the statutory rate (e.g., 10%), is applicable to trade with WTO members and with countries where there is a trade agreement that commits MFN treatment. Lastly, a preferential rate, which is the lowest, often, zero rate of duty, is applicable to trade under a preferential trade regime. The basic function of rules of origin is to apply the appropriate rate of customs duty.

Nonpreferential rules of origin, determining the country of origin of goods, are used for the following purposes (Article 1 of the Agreement on Rules of Origin):

(i) MFN tariffs and national treatment (NT)
(ii) trade remedy measures (antidumping and countervailing duties and general safeguards measures)
(iii) quantitative restrictions (QRs) and tariff quotas (TQs)
(iv) origin marking requirement
(v) government procurement
(vi) trade statistics

Simply because nonpreferential rules of origin are for general application, they should be applied in an impartial, transparent, predictable, consistent, and neutral manner so that nonpreferential rules of origin themselves do not create unnecessary obstacles to trade.

On the other hand, preferential rules of origin provide preferential tariff treatment to a limited number of parties under a particular preferential trade regime. For this reason, the main purpose is to ensure that the benefits of preferential tariff treatment are confined to products originating in the parties. Products that originate in third countries, and pass in transit through, or undergo only a minor or superficial process in the parties, should not therefore benefit from preferential
A preferential tariff. In this sense, preferential rules of origin are a condition and a requirement to enjoy special benefits, i.e., reduced or eliminated rates of duty.

As mentioned earlier, there are two types of preferential regimes. One is contractual or an international agreement that is reciprocal. FTAs such as the North American Free Trade Agreement (NAFTA) and ASEAN Free Trade Agreement (AFTA) are good examples. The other type is autonomous or nonreciprocal in nature. The GSP, being a unilateral preferential tariff measure offered by developed countries (i.e., preference-giving countries) to eligible products originating in preference-receiving countries, is a good example.

IV. ORIGIN CRITERIA: VARIOUS TECHNIQUES AND METHODS TO DETERMINE THE COUNTRY OF ORIGIN

The core of rules of origin on substance is origin criteria that determine the country of origin of the goods in question. For the purpose of rules of origin, all tradable goods can be divided into two categories: (i) wholly produced good or 100% made in a particular producing country; and (ii) a product with imported materials and/or origin-unknown materials. If and when a product for export is wholly obtained or produced in a single country, no one can deny that this country has the country of origin. To begin with, there must be a list of “wholly obtained products (Appendix 1).”

However, determining the country of origin becomes difficult due to globalization of economic activities, the trend of outsourcing, and using various inputs supplied by many foreign countries and of domestic origin. The question arises as to how to determine the country of origin for such production processes where a number of different parts and components from various foreign countries are provided. The established concept is that the country of origin title is given to the country where the “last substantial transformation” or “sufficient working or processing” has been carried out. The thing is how to interpret the concept into practice.

A. Substantial Transformation

There are basically three methods to define the concept of substantial transformation.

1. Process Criterion

As a general rule, imported inputs are considered to have undergone substantial transformation if the finished products fall under a tariff heading of a commodity classification system (normally the HS) different from that of any inputs used in the manufacturing process. In other words, a change in an HS heading must take place when imported materials or origin-unknown materials are used. It is best and ideal if product-specific process requirements for all tradable goods that confer substantial transformation are described in detail. However, it is almost impossible to identify and work out processes that are economically justified to confer the country of origin for an

5 In addition, there is another list of examples that is regarded as minor or superficial processing (minimal processing list), such as simple cutting, bottling, and simple mixing. If a processing falls under the list, it does not confer the country of origin of the good in question (Appendix 2).

6 It is left to policymakers whether the HS heading level (4-digit) or subheading level (6-digit) is used to confer substantial transformation. If the HS subheading level is used, it is easier for manufacturers to meet the requirement than the HS heading level.
enormous number of tradable goods. Instead, this criterion relies on the HS, a leading commodity classification system.\(^7\) This is the second best approach since all tradable goods are classified under a nomenclature or commodity classification system that has been widely known and used among authorities and trading communities. The HS is designed to classify any product from raw, intermediate, to finished form in the same chapter. In other words, when a process is further made, a new HS heading is given. HS chapter 18 (Cocoa and coca preparations) and iron and steel are good examples in this sense.

Example (A): HS Chapter 18 (Cocoa and cocoa preparations), having six heading positions

<table>
<thead>
<tr>
<th>Heading Number</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>18.01</td>
<td>Cocoa beans (raw form)</td>
</tr>
<tr>
<td>18.02</td>
<td>Cocoa shells (-ditto-)</td>
</tr>
<tr>
<td>18.03</td>
<td>Cocoa paste (intermediate form)</td>
</tr>
<tr>
<td>18.04</td>
<td>Cocoa butter (-ditto-)</td>
</tr>
<tr>
<td>18.05</td>
<td>Cocoa powder (-ditto-)</td>
</tr>
<tr>
<td>18.06</td>
<td>Chocolate, etc. (final form)</td>
</tr>
</tbody>
</table>

Example (B): Iron and steel

<table>
<thead>
<tr>
<th>Material</th>
<th>HS Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iron ores</td>
<td>25.01</td>
</tr>
<tr>
<td>Pig iron</td>
<td>72.01</td>
</tr>
<tr>
<td>Ingot</td>
<td>72.06</td>
</tr>
<tr>
<td>Bars</td>
<td>72.11; 72.13; 72.14, etc.</td>
</tr>
<tr>
<td>Sheets</td>
<td>72.08; 72.09; 72.10, etc</td>
</tr>
</tbody>
</table>

If cocoa beans (HS Heading 18.01) are imported from Country A into Country B, and cocoa powder (HS Heading 18.05) is produced in Country B, substantial transformation has taken place in Country B as there is a change in HS heading from 18.01 to 18.05. Country B gains the country of origin. Similarly, iron ores (HS Heading 25.01) are imported from Country C into Country D, and ingot (HS Heading 72.06) is produced in Country D, substantial transformation has taken place as there is a change in HS heading from 25.01 to 72.06. Country D gains the country of origin.

The following is an extreme example, where all materials to produce wooden chairs are imported, and substantial transformation has taken place as all HS headings of the imported materials changed. The country of origin is given to the manufacturing country of wooden chairs.

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7 The official title of the Harmonized System is the International Convention on Harmonized Commodity Description and Coding System, developed by the WCO and put into force in 1988. The HS is a systematic commodity classification system, and all the tradable goods are classified in 96 chapters at 2-digit level; more than 1,240 headings at 4-digit level; and more than 5,000 precise codes or subheadings at 6-digit level. HS chapters 1–24 cover agricultural products while chapters 25–97 cover industrial and manufactured products. Any signatory has the discretion to further divide HS, for example, at 8-digit or 10-digit level, amounting to some 12,000 to 15,000 tariff lines. The international trade coverage of HS accounts for more than 95%. The HS has been revised a couple of times to cope with new trade patterns and appearance of new products in markets.
Example (C): Finished products: Wooden chairs falling under HS Heading 94.03

(Imported materials used in production)

Sawn wood  HS 44.07 
Varnishes  32.09 
Leather (bovine)  41.04 
Nails (iron and steel)  73.18 
Glues  35.06 

While HS is a practical tool, it is not designed for origin purposes. There are instances where insufficient processing involves a change in HS heading (Example D), and where sufficient processing does not result in a change in HS heading (Example E). A separate list of these exceptions might be required.

Example (D): Simple assembling process involves a change in HS heading

Imported parts and components: clock movement (HS 91.09) and clock case (HS 91.12)

Finished product: clocks (HS Heading 91.03)

While this assembly involves a change in HS heading, the country of origin is not given to the assembling country since the process is not considered as substantial transformation.

Example (E): Substantial transformation process does not involve a change in HS heading

Imported materials: rough/unworked diamond (HS Heading 71.02)

Finished product: cut/worked diamond (HS Heading 71.02)

While the cutting process does not involve a change in HS heading, the country of origin is given to the country that carried out the cutting process since the cutting process is the most value-adding process and is therefore regarded as substantial transformation.

---

8 Here is another example on an agricultural product. Minor processing involves a change in HS heading:

Imported materials: fresh vegetables: HS Heading 07.01

Finished products: dried vegetables:  HS Heading 07.12

While this drying process involved a change in HS heading, the country of origin is not granted to the country that underwent the drying process since the process is considered as minor and not as substantial transformation. In this case, the rules of origin require that dried vegetables must be produced from originating vegetables in the producing country.
2. **Percentage Criterion**

As a general rule, under the percentage criterion, imported inputs (i.e., materials, parts, and components) are considered to have undergone substantial transformation if a given percentage of value is added to the imported inputs used for manufacture of the finished product.

There are two ways to describe this criterion. One is to state the maximum percentage allowance of value of imported inputs in the production. For example, the value of the imported inputs does not exceed 40% of the value of the product obtained. In this case, imported inputs can be used up to 40% of the value of the finished product and domestic inputs must be more than 60%.

The other way is to state the minimum percentage requirement of domestic inputs in the production. For example, the value of domestic materials and the direct cost of processing in the producing country must not be less than 40% of the value of the product obtained. In other words, imported inputs can be used up to 60%.

In both ways, the denominator (i.e., value of the product obtained) that policymakers can choose is either ex-factory cost; ex-factory price; free on board (FOB) price; or cost, insurance, and freight (CIF) price.\(^9\) If the maximum allowable imported input method is used as the numerator and CIF price is used as the denominator, more imported inputs can be used since CIF has the largest figure among these prices. Similarly, it is left to policymakers to establish a given numerator percentage.

3. **Third Criterion**

Third criterion, based on the two criteria above, includes the following: combination of the two criteria above; use of either of the two criteria above at importer’s choice; use of either of the two criteria plus additional technical test.

**B. Pros and Cons of the Two Major Origin Criteria**

The origin criterion could be more accurately and objectively defined in the process criterion than in percentage criterion as the necessary process to confer substantial transformation is clearly described. In other words, it is not necessary to consider various cost elements in production in this criterion. The key point is to examine what was imported and what was produced in terms of the HS classification. As a result, less dispute cases between customs authorities and trading communities could be expected. However, criticisms against the process criterion are as follows:

(i) it requires too much detailed description of the process on a product-specific basis, which could be complicated

(ii) it needs a couple of lists of exceptions (e.g., list of wholly obtained products, list of minimal processes)

(iii) a sound knowledge on HS is a precondition

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9 Broadly speaking, an ex-factory cost consists of materials and direct cost of production (e.g., labor and electricity). When a profit is added to the ex-factory cost, it becomes an ex-factory price. When costs of inland transport and insurance from the factory to the side of a cargo vessel are added to the ex-factory price, it becomes an FOB price. When ocean freight and insurance are added to FOB, it becomes a CIF price.
On the other hand, in the case of percentage criterion, requirements for substantial transformation are defined in a simple manner. It does not require long descriptions nor lists of exceptions. When all necessary elements are known, it is a matter of calculation to determine whether substantial transformation has taken place or not. However, the percentage criterion is criticized as follows:

(i) there is no clear logic nor economically justified rationale to determine whether substantial transformation has taken place as it simply provides a given percentage, such as 40%, 50%, and so on

(ii) it does not cope with border-line cases; for example, if the requirement that imported inputs can be used up to 40% is provided, goods with 41% imported inputs cannot be given the country of origin

(iii) the case above often occurs simply because of daily fluctuations of exchange rates for the currencies of material-supplying foreign countries, which is beyond manufacturers’ control

(iv) experience shows that there are always disputes between customs authorities and business communities about various cost elements to be included or excluded from the numerator

(v) advanced bookkeeping is a precondition

V. GSP RULES OF ORIGIN—ORIGIN OF FTA RULES OF ORIGIN

A. GSP Rules of Origin in General

The GSP, one of the remarkable achievements of the United Nations Conference on Trade and Development (UNCTAD), was introduced in the early 1970s with three main objectives, namely to (i) increase export earnings, (ii) promote industrialization, and (iii) accelerate the rate of economic growth in favor of more than 160 developing countries. The GSP is a tariff preference scheme offered by developed countries to eligible products originating in designated preference-receiving countries. Since GSP offers reduced or eliminated rate of duty for eligible products originating in a particular group of developing countries that are GATT-contracting parties in most cases, this differential treatment in tariffs is directly against the MFN principle, the basic GATT rule specified in its Article I (General Most-Favoured-Nation Treatment).10 As a result, GSP was implemented as a temporary, unilateral, and autonomous measure by developed countries. Respective preference-giving countries had to obtain a waiver from GATT.

The GSP rules of origin have played a key role in implementing the GSP schemes for more than 35 years (UNCTAD 1999).11 In the absence of any international agreement on product-specific rules of origin for nonpreferential trade (i.e., MFN trade), it is worth looking into GSP rules of origin. In

10 The enabling clause of the GATT’s Framework Agreement, adopted at the Tokyo Round, (official title: The Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries) allows GSP as the exception to Article I of GATT. Since then, preference-giving countries did not require to get a waiver from the GATT Contracting Parties when extending their scheme.

11 However, GSP rules of origin in each scheme differ substantially from one scheme to another. As an agreement on rules of origin at UNCTAD in 1970 remains as guidelines, the prospective preference-giving countries took appropriate domestic actions to implement their rules of origin, taking fully into account the agreement. After the 35-year operation of the GSP system, the basic structure of rules of origin remains the same (UNCTAD 1970).
addition, it should be pointed out that GSP rules of origin are one of the leading origins of FTA rules of origin as both GSP and FTAs are under the preferential tariff regime. In other words, FTA rules of origin are based on and inspired by the experiences in GSP and other preferential rules of origin.

At the beginning, it should be noted that, reflecting different national interests of the preference-giving countries (including protection of domestic industries) resulting in different product coverage in each GSP scheme, individual GSP rules of origin differ from one scheme to another (Appendix 3). This is true in the case of each FTA rules of origin as referred to below.

For example, GSP schemes of the European Free Trade Area (EFTA), European Union (EU), and Japan use the process criterion while those of Australia, Canada, New Zealand, and United States (US) use the percentage criterion. Strictly speaking, rules of origin in each scheme have different definitions and requirements.

One more point to note is that even the GSP schemes of EU and Japan use a percentage criterion for certain products, such as processed foods, chemicals, and machinery. Since it may require a number of different inputs to produce these products, it is almost impossible to identify all possible inputs and impractical to specify necessary processes to confer the origin (see Box 1).

**Box 1**

**Main Elements in GSP Rules of Origin**

<table>
<thead>
<tr>
<th>A. Origin Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) List of wholly produced goods</td>
</tr>
<tr>
<td>(ii) List of minimal processes that do not confer the country of origin</td>
</tr>
<tr>
<td>(iii) Process criterion</td>
</tr>
<tr>
<td>(iii) Percentage criterion</td>
</tr>
</tbody>
</table>

| B. Direct Consignment |

<table>
<thead>
<tr>
<th>C. Documentary Evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Combined declaration and certificate of origin (Form A)</td>
</tr>
<tr>
<td>(ii) Consignment of a small value</td>
</tr>
<tr>
<td>(iii) Verification of Form A</td>
</tr>
<tr>
<td>(iv) Exhibition and fairs</td>
</tr>
</tbody>
</table>

| D. Sanctions |

| E. Mutual Cooperation between Preference-giving and Preference-receiving Countries |

| F. Special Facilities in Favor of Preference-receiving Countries |
| (i) Cumulative rules of origin (cumulation) |
| (ii) Donor country content rule |
Normally, these elements are covered by FTA rules of origin. While there are three core elements in GSP rules of origin, namely origin criteria, direct consignment and documentary evidence, the following are important supplements to the previous section.

B. GSP Rules of Origin in Detail

1. Process Criterion

Double processing requirement for textiles and clothing. Generally speaking, the textiles and clothing sector is very sensitive in all preference-giving countries. In addition to the change in HS heading, an extra tough requirement is imposed to protect this sensitive domestic industry. For example, making cotton jackets involves the following four key processes, which are generally required in the entire textile industry, except for the knitting industry.

Example (F): Cotton Jackets

- First Process: obtain raw cotton (fiber)  HS Heading 52.01 (raw cotton)
- Second process: make cotton yarn  52.05 (cotton yarn)
- Third process: make cotton fabrics  52.08 (cotton fabrics)
- Fourth process: make cotton jackets  62.03 (cotton jackets)

The point is that if Country A produces cotton fabrics for exports to EU or Japan under GSP with imported materials, the imported materials must be raw cotton to meet the double processing requirement because it involves “double processing”, i.e., raw cotton to cotton yarn (from HS 52.01 to HS 52.05) and cotton yarn to cotton fabrics (from HS 52.05 to HS 52.08). If Country B produces cotton fabrics from imported cotton yarn, it does not meet the double processing requirement as it involves only one processing.

The case of knitted articles is tricky as it involves only three key processes.

Example (G): Woolen knitted sweater

- First process: obtain raw wool  HS Heading 51.01 (raw wool)
- Second process: make woolen yarn 51.09 (woolen yarn)
- Third process: make woolen knitted sweater 61.10 (knitted woolen sweater)

Simply because the stage of “fabric” in a knitted article is already in its finished form, unlike the case of cotton jackets, its production involves only three steps. If imported materials are used to produce a knitted sweater, to meet the double processing requirement, raw wool must be imported.

12 In fact, the GSP scheme of the US does not cover entire textiles and clothing articles with the exception of handloom articles. In the case of the GSP schemes of EU and Japan, this sector is generally covered, but subject to the tough extra requirement, i.e., “double processing requirement.”

13 It should be noted that processes, such as dyeing, washing, and printing, are not regarded as a key process in the context of the double process requirement.
2. **Direct Consignment Rule**

As a rule, originating products must be transported directly from the exporting preference-receiving country to the preference-giving country of destination, in order to ensure that the originating goods are not manipulated, substituted, further processed, or entered into commerce in any intervening third country. While “direct consignment”, not “direct shipment” is required, in case the goods in question pass through a third country, a through bill of lading (which describes the port of origin and the port of final destination) or a certificate by the customs authorities of the country of transit is acceptable.\(^\text{14}\)

3. **Documentary Evidence**

Claims for GSP treatment must be supported by appropriate documentary evidence as to origin and consignment. In the case of GSP, a special form called “Combined Declaration and Certificate of Origin Form A” must be used.\(^\text{15}\) Form A must be issued by the designated issuing authorities in preference-receiving countries. Some preference-giving countries do not require Form A since in some preference-receiving countries it is not easy to obtain Form A from an issuing authority.

4. **Cumulative Rules of Origin (“Cumulation”)**

As a general rule, origin rules have to be met by a single preference-receiving country. However, cumulative rules of origin or cumulation are an exception to this general rule.

The concept of cumulation is to treat a group of countries (e.g., all preference-receiving countries under a particular GSP scheme or all members to a regional grouping such as Association of Southeast Nations (ASEAN) as a single entity in determining the country of origin. The effect is that all processes under the process criterion or value-added activities under the percentage criterion, performed by more than one eligible member of such a grouping, can be added, making it easier to meet the GSP rules of origin requirements.

There are a couple of policy options on cumulative rules of origin. One is that the facility may be provided on a global basis (i.e., global cumulation) or on a regional basis such as ASEAN (i.e., regional cumulation). The other is to provide the facility either fully or partially. Under the full cumulation, all inputs by all the recipients concerned can be added together. On the other hand, in the case of the partial cumulation, only parts and components that have the origin status among the recipients concerned can be added together. If the partial cumulation is provided to ASEAN and a particular imported part to assemble an automobile does not confer the country of origin within any of ASEAN, the input of this part cannot be accumulated. The best option in favor of developing countries is therefore a full and global cumulation.

---

\(^{14}\) A certificate by customs authorities in transit must show that the goods in question have remained under customs control in the country of transit or warehousing and have not entered into commerce or have been delivered for home use there, and have not undergone operations other than unloading, reloading, and any other operation required to keep them in a good condition. In practice, it is not easy to obtain this certificate from the customs authorities concerned. UNCTAD advises traders to obtain a through bill of lading instead.

\(^{15}\) There are a couple of strict specifications for Form A: the combined declaration and certificate of origin Form A should measure 210 x 297 mm; the paper used must be writing paper not containing mechanical pulp and weighing not less than 25 grams per square meter; it should preferably have a green machine-turned background making any falsification by chemical or mechanical means apparent to the eye. Least developed countries normally buy the forms from developed countries as there is no such a printing facility at home.
With regard to the cumulation facility in FTAs, how are the concepts of full or partial cumulation, and the global or regional cumulation treated? Since GSP is a unilateral measure, preference-giving countries can choose a cumulation facility. However, an FTA is an international agreement (just like a treaty) to bind member countries on an equal footing. In practice an FTA has an option to choose full or partial cumulation.

5. Donor Country Content Rule

This rule treats inputs from a preference-giving country as inputs originating in the preference-receiving country that produces the final product for the purpose of determining the country of origin of the finished product, subject to re-export to that preference-giving country. Some GSP schemes do not provide this facility.

When discussing this facility in the 1960s, potential GSP recipients had a negative view. A number of developing countries, having gotten independence politically, also wanted economic independence. According to them, this facility might establish vertical lines of trade or vertical integration. It should be noted that this facility does not have any meaning in the context of an FTA as this concept is incorporated in the cumulation concept.

Example (H) shows the effect of both cumulative rules of origin and donor country content rule.

Example (H): Manufacture of Product X in ASEAN State Y

(i) Materials:  
- From own domestic  
- From Case I - ASEAN State Z; Case II–EU  
- From Japan

(ii) Labor cost

(iii) Other direct costs

(iv) Packing costs (for export)

(v) Profit

Total (ex-factory price/per unit) $100

In this hypothetical example, if the origin criterion under a particular GSP scheme requires that imported materials can be used up to 40% of the ex-factory price of the product under the normal rules, it does not qualify for GSP treatment as the total imported contents are 50% (20% from ASEAN State Z [Case I] and 30% from Japan) of the ex-factory price of $100/unit.

However, if the cumulative rules of origin are granted to the regional grouping of ASEAN by that GSP scheme, the total imported contents are 30% from Japan (inputs of 20% from ASEAN State Z [Case I] can be regarded as ASEAN X origin) and within the limit of 40%; thus, qualified for GSP treatment. If the current operation is based on Case II (20% from EU) and other conditions are the same, and if the manufacturer can find a supplier for the materials provided currently by EU from any other ASEAN State (i.e., Case I), it qualifies for GSP for the same reason above. This is a case for a regional cumulation. In a way, the regional cumulation will facilitate regional cooperation.
and integration by changing sources from nonregional grouping to designated regional grouping members (i.e., non-ASEAN to ASEAN states in this case).

If the operation is based on Case II, the total imported inputs are 50% (20% from EU and 30% from Japan) of the ex-factory price of $100/unit. This operation does not qualify for GSP as the imported materials exceed the maximum allowable imported inputs of 40%. However, if the product is for export to Japan whose scheme allows the donor country content rule, it qualifies for Japan’s GSP as 30% of the Japanese inputs are regarded as ASEAN X inputs and the total inputs go down to 20%, which is within the maximum allowable imported inputs of 40%.

C. FTA: Japan–Singapore Case

In the preceding paragraphs, key elements of GSP rules of origin were examined. Questions arise as to how they are introduced in FTA rules of origin and what are the elements used at an FTA. To illustrate, Box 2 below is a framework of rules of origin in the Japan–Singapore economic partnership agreement, the first FTA entered into by Japan effective 30 November 2002 (Ministry of Foreign Affairs of Japan 2006).

<table>
<thead>
<tr>
<th>Box 2</th>
<th>Framework of Rules of Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter 3</td>
<td>Rules of Origin</td>
</tr>
<tr>
<td>Article 22:</td>
<td>Definitions under Chapter 3</td>
</tr>
<tr>
<td>Article 23:</td>
<td>Originating Goods (list of wholly obtained goods and origin criteria—substantial transformation requirements when imported inputs are used under either process or percentage criterion)</td>
</tr>
<tr>
<td>Article 24:</td>
<td>Accumulation (cumulation)</td>
</tr>
<tr>
<td>Article 25:</td>
<td>De Minimis</td>
</tr>
<tr>
<td>Article 26:</td>
<td>Insufficient Operations (list of minimal processes that do not confer the country of origin)</td>
</tr>
<tr>
<td>Article 27:</td>
<td>Consignment Criteria (direct consignment rule)</td>
</tr>
<tr>
<td>Article 28:</td>
<td>Unassembled or Disassembled Goods</td>
</tr>
<tr>
<td>Article 29:</td>
<td>Claim for Preferential Tariff Treatment (documentary evidence)</td>
</tr>
<tr>
<td>Article 30:</td>
<td>Denial of Preferential Tariff Treatment</td>
</tr>
<tr>
<td>Article 31:</td>
<td>Certificate of Origin</td>
</tr>
<tr>
<td>Article 32:</td>
<td>Advance Rulings</td>
</tr>
<tr>
<td>Article 33:</td>
<td>Assistance for Checking of Certificate of Origin</td>
</tr>
<tr>
<td>Article 34:</td>
<td>Joint Committee on Rules of Origin</td>
</tr>
<tr>
<td>Annex II A:</td>
<td>Product-specific Rules (detailed requirements)</td>
</tr>
</tbody>
</table>
As seen from the above, the main elements of GSP rules of origin are found in this FTA, such as origin criteria, direct consignment, documentary evidence, cumulation, and mutual cooperation while the wording is slightly different.

D. Selected FTA Rules of Origin in Asia

There are several FTAs in operation in Asia and a number of negotiations toward FTAs are ongoing. The negative effect of the “spaghetti-bowl” can be found by referring only to a couple of FTAs in the region. Perhaps, Singapore, member to ASEAN, is a good example in this context. Singapore is not only a member to AFTA, but also has concluded FTAs with its major trading nations, such as Australia, Japan, New Zealand, and US (APEC 1997).

Origin criterion under ASEAN AFTA is solely based on the 40% domestic content rule, supported by the regional cumulation among 10 member states of ASEAN. In the case of the FTA with Japan, as mentioned earlier, its origin criterion follows Japan’s GSP rules of origin. Origin criterion under the Singapore–Australia FTA is based on the 50% domestic content rule. The Singapore–New Zealand follows the 40% domestic content rule. It should be noted that GSP rules of origin of Australia and New Zealand also use a percentage criterion.

The Singapore–US FTA chiefly follows those rules of origin under NAFTA. While NAFTA origin rules are comprehensive, specific, and detailed, its origin criteria are either (i) change in tariff heading (either at 4, 6, or 8-digit level depending on goods produced) for a number of products; (ii) substantial process (assemble process plus manufacture of major part) for color televisions and other products; (iii) assemble process plus percentage criterion (e.g., 50% domestic content) for watch movements and others; (iv) manufacture of major part plus percentage criterion for footwear and other products; or (v) percentage criterion for automobiles (USTR 2006).

The Singapore case clearly implies that more different origin rules will appear in the near future, creating not only more administrative costs both public and private sector, but also more burdens especially for newcomers entering various markets. This is a major concern among the manufacturing and trading communities.

VI. HARMONIZATION WORK ON NONPREFERENTIAL RULES OF ORIGIN AT WTO AND WCO

This section briefly addresses the current nonpreferential and GSP rules of origin on substantial transformation in major trading nations (Vermulst, Waer, and Bougeois 1994), two international agreements on rules of origin agreed at WTO and WCO, and the status of harmonization work on nonpreferential rules of origin.

16 For example, in the case of more than 15-inch color television sets (HS 8528.10), in addition to the change in HS headings for selected parts, essential parts (e.g., television picture tubes) must be originating in the NAFTA region in order to qualify for the NAFTA origin.
A. Substantial Transformation Requirement under the Nonpreferential and GSP Rules of Origin of Major Trading Nations

1. European Union

Goods whose production involved more than one country shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing or working in an undertaking equipped for that purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture. This basic concept is interpreted into process criterion, percentage criterion, or combination of these two criteria in determining the country of origin. The importance of the EU nonpreferential rules of origin lay down specific rules on a product-specific basis reflecting the EU's interest such as radios, televisions, tape recorders, integrated circuits, photocopiers, and textiles and clothing.

In the case of GSP, rules of origin are based mainly on the process criterion, supported by the percentage criterion for certain products.17

2. Japan

The country of origin is given to the country where the last substantial process or operation resulting in the manufacture of new characteristics took place. Japan has a shortlist of product-specific rules on selected products. Japan’s nonpreferential rules of origin are solely based on the process criterion.

Japan basically applies identical GSP origin rules of EU.

3. United States

The US's nonpreferential rules of origin are based on a case law (i.e., court judge ruling) and nowhere defined in a statutory law. However, the established interpretation by the court is that “It occurs when, as a result of manufacturing process, a new and different article emerges, having a distinctive name, character, or use, which is different from that originally possessed by the article or material before being subject to the manufacturing process.” It is, therefore, prudent to obtain a binding advance ruling that the product in question is conferred the country of origin from the customs service of the US before exportation.

In the case of GSP rules of origin, the US applies the percentage criterion. The cost or value of materials produced in the preference-receiving country and the cost or value of any article incorporated in the eligible article that has resulted from substantial transformation of any imported materials into a new and different article of commerce, plus the direct cost of processing operations performed in the preference-receiving country must not be less than 35% of the appraised value of the merchandise in the US. In short, a minimum 35% local content rule is observed.

17 Until 1 May 2005 when the EU consisted of 15 member states, there were 14 different sets of preferential rules of origin, and GSP rules of origin was just one of them.
B. International Agreements on Rules of Origin and Status of Harmonization Work at WTO and WCO

As seen from the above, national nonpreferential rules to confer origin substantially differ from one major trading nation to another. As a result, a particular process that meets particular rules of origin may not meet other rules of origin. This is actually a big headache for business and trading communities that prefer a process meeting one rules of origin should also meet other rules of origin. To this end, harmonization efforts have been made at WCO and WTO.

1. WCO

At WCO, the International Convention on the Simplification and Harmonization of Customs Procedures of 1974, providing international standards on customs procedures and various techniques, was amended and the revised convention was put into force on 1 February 2006 (CCC 1973 and WCO 1999). This revised convention has a number of annexes, and Specific Annex K is for rules of origin.

Annex K provides three origin criteria, namely (i) change in HS heading, (ii) specific process, and (iii) percentage criterion. However, it is left to members to select a particular criterion. In addition, it lacks product-specific detailed origin rules, reflecting the ongoing efforts at WTO to develop harmonized rules of origin.

2. WTO

While GATT of 1947 contains the terms “origin” and “originating”, there are no precise and detailed provisions pertaining to the determination of a country of origin and other elements of origin rules.

The Agreement on Rules of Origin, as Annex 1A to the WTO Agreement, was established as a result of the Uruguay Round in 1994. It basically provides a set of principles over rules of origin (e.g., fairness, neutrality, predictability, consistency, uniformity, reasonableness, and transparency) as well as future work program for harmonization of nonpreferential rules of origin. Harmonization work is done by WTO on policy aspects and by WCO on technical aspects by establishing a committee in each organization. When this process is completed, the outcomes (i.e., detailed product-specific origin rules) will be annexed to the Agreement on Rules of Origin as an integral part thereof.

WCO, after several years’ work, submitted a draft of Harmonized Rules of Origin to WTO for its consideration and adoption. The draft Harmonized Rules of Origin consists of Definitions, General Rules, and two appendixes. Appendix 1 sets out rules for wholly obtained products while Appendix 2 provides for precise product-specific rules of origin for goods. To date, 94 core policy issues relating to product-specific rules under Appendix 2 remain unsolved at WTO. They represent highly protected products mostly by industrialized countries, such as certain agricultural products, textiles and clothing articles, and engineering products. WTO mainly argued about the so-called “implementation issue” as to whether the Harmonized Rules of Origin should be applied on a mandatory basis to other WTO instruments, in particular, the Anti-Dumping Agreement (Imagawa and Vermulst 2005).

In developing product-specific detailed rules and in interpreting substantial transformation requirements, WCO followed the respective provisions of the Agreement on Rules of Origin (Article
9.2): “change in tariff classification” based on HS as a general rule; and “ad valorem percentage and/or manufacturing or processing operations” as supplementary criteria. WCO also developed two lists of “wholly obtained products” that confer the origin, and “minimal operations or processes” that do not confer the origin.

VII. CONCLUSION

Despite the great efforts by WCO and WTO to harmonize nonpreferential rules of origin, detailed product-specific origin rules have not yet been adopted. For the time being, the situation where a particular process that meets particular rules of origin in an importing country does not meet rules of origin in other importing countries will continue. Thanks to the series of multilateral trade negotiations for trade liberalization under the auspices of GATT/WTO, the average tariffs are now much lower. However, the lack of uniformity in rules of origin would cause unnecessary delay and cost, not only to customs authorities, but also to business and trading communities. This situation must be changed.

The establishment of a single set of rules of origin brings about a number of benefits to public and private sectors. It will certainly reduce the time and costs required thus facilitating trade. It will equally contribute to the international trading system by strengthening certainty, predictability, and consistency of origin determination. It will also reduce number of trade dispute cases by implementing a single set of origin rules.

The WTO should be encouraged to act on the remaining 94 draft product-specific rules developed by WCO, and to adopt the Harmonized Rules of Origin as a whole hopefully during DDA. In the event that WTO adopts the Harmonized Rules of Origin, FTA negotiating countries should be invited to apply them to their respective FTA rules of origin as far as possible so that the “spaghetti bowl” effect could be minimized, also paving the way to harmonization of GSP rules of origin.
APPENDIX 1

LIST OF “WHOLLY OBTAINED” PRODUCTS

All preference-giving countries\(^1\) accept the following categories of goods as “wholly obtained” in a preference-receiving country:

(a) Mineral products extracted from its soil or from its sea bed
(b) Vegetable products harvested there
(c) Live animals born and raised there
(d) Products obtained there from live animals
(e) Products obtained from hunting or fishing conducted there
(f) Products obtained from sea fishing and other products taken from the sea by its vessel\(^3\)
(g) Products made on board its factory ships exclusively from products referred to in (f) above
(h) Used articles collected there fit only for the recovery of raw materials
(i) Waste and scrap resulting from manufacturing operations conducted there
(j) Products obtained there exclusively from products specified in (a) to (i) above\(^4\)


---

1 Australia in general accepts the products in the list above as “wholly obtained”, although these have not been specified in its legislation.

2 The US, while not including a list of “wholly obtained” products in its legislation, recognizes the products listed above as examples that are likely to meet the US’s percentage criterion.

3 Many preference-giving countries apply restrictive definitions of the term “its vessels” and “its factory ships.”

4 Such as iron sheets, bars produced from iron ore, cotton fabrics woven from raw cotton, recovery of lead from used motor car batteries, and recovery of metal from metal shavings.
APPENDIX 2

LIST OF MINIMAL PROCESSES THAT MOST PREFERENCE-GIVING COUNTRIES DO NOT CONSIDER AS ORIGIN-CONFERRING EVENTS¹

(a) Operations to endure the preservation of products in good condition during transport and storage (ventilation, spreading out, drying, chilling, placing in salt, sulfur dioxide or other aqueous solutions, removal of damaged parts, and like operations

(b) Simple operations consisting of removal of dust, shifting or screening, sorting, classifying, matching (including the making-up of sets of articles), washing, painting, cutting up

(c) Changes of packing and breaking-up and assembly of consignments, simple placing in bottles, flakes, bags, cases, boxes, fixing on cards or boards, etc., and all other simple packing operations

(d) Affixing of marks, labels, and other like distinguishing signs on products or their packaging

(e) Simple mixing of products, whether or not of different kinds, where one or more components of the mixture do not meet the conditions laid down in the rules to enable them to be considered as originating products

(f) Simple assembly of parts and products to constitute complete products

(g) A combination of two or more operations specified in (a) to (f) above

(h) Slaughter of animals²


¹ This list is applied by all preference-giving countries using the process criterion. Australia, Canada, New Zealand, and US regard this list as only an indication of processes that are unlikely to enable the finished product to be accepted as an originating product.

² Japan does not regard slaughter as minimal process.
### APPENDIX 3

**SUMMARY OF PRINCIPAL PERCENTAGE CRITERION RULES, CUMULATION, AND DONOR COUNTRY CONTENT RULE**

<table>
<thead>
<tr>
<th>Preference-giving Countries</th>
<th>Principal Percentage Criterion Rules</th>
<th>Percentage Level</th>
<th>Scope of Cumulation</th>
<th>Donor Country Content Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Numerator</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>Labor and materials from preference-receiving country and other preference-receiving country and Australia</td>
<td>Ex-factory cost</td>
<td>Minimum 50%</td>
<td>Full</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Expenditure on materials and components originating in the preference-receiving country, and other preference-receiving country and New Zealand</td>
<td>Ex-factory cost</td>
<td>Minimum 50%</td>
<td>Full</td>
</tr>
<tr>
<td>Canada</td>
<td>Value of imported inputs</td>
<td>Ex-factory price</td>
<td>Maximum 60% for LDCs; maximum 40% for others</td>
<td>Full</td>
</tr>
<tr>
<td>European Union</td>
<td>Customs value of imported inputs or the earliest ascertainable price paid in the case of materials of unknown, undetermined origin</td>
<td>Ex-factory price</td>
<td>Maximum 40% or 50%</td>
<td>Full</td>
</tr>
<tr>
<td>European Free Trade Area</td>
<td>(same with EU)</td>
<td>Ex-factory price</td>
<td>(same with EU)</td>
<td>Partial</td>
</tr>
<tr>
<td>Japan</td>
<td>(same with EU)</td>
<td>FOB price</td>
<td>(same with EU)</td>
<td>Full</td>
</tr>
<tr>
<td>US</td>
<td>Cost of materials produced in the preference-receiving country plus the direct cost of processing carried out there</td>
<td>Ex-factory price or appraised value by US customs</td>
<td>Minimum 35%</td>
<td>Full</td>
</tr>
</tbody>
</table>
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About the Paper

Most-favored-nation/preferential rates of duty under the World Trade Organization and free trade agreements are not automatically granted. Imported goods must meet rules of origin. Teruo Ujiie clarifies conceptual aspects of rules of origin using practical examples.