

The Impact of Rules of Origin on Trade

– a Comparison of the EU's and the US's Rules for the Textile and Clothing Sector



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Foreword

The aim of this report is to examine the effects of rules of origin. We discuss the importance of the design of the rules, for preferential agreements to make a difference. The evident objective of non-reciprocal trade agreements is to stimulate exports from developing countries to industrialised markets. However, actual exports using the preferential arrangements do not increase as one could expect or at least hope for.

One of the main reasons seems to be strict rules of origin. It is evident that these rules often are complicated and not designed to give incentives to trade. It is also evident that complicated rules of origin create uncertainty for traders, while predictability is needed for trade to happen.

In this report we compare rules of origin of two similar preferential arrangements in the textile and clothing sector – the EU's and the US's. And we compare trade effects. This comparison exemplifies our discussion on the potential impacts of different rules of origin.

Bilateral trade agreements are being formed at an ever-increasing pace. The risk is imminent that an abundant flora of different and conflicting rules of origin is being created. Rules of origin are necessary in trade agreements, but they also impede trade. What is more, production has become more fragmented and global, which highlights the importance of well-developed rules of origin. This is given special attention in the report.

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Executive Summary

This report supports the theory that more generous rules of origin facilitate trade, encourage specialisation and sourcing of inputs from the most competitive source and can, thereby, promote economic development.

Trade preferences, such as the European Union's (EU's) Generalised System of Preferences (GSP), are given in order to stimulate trade. The actual use of the preferences is strongly connected to the rules of origin. Rules of origin are an integral part of preferential arrangements, but they also act in the opposite direction of preferences, i.e. rules of origin obstruct trade. The design of rules of origin is therefore of great importance if the preferences are to be useful in practice.

Rules of origin act as a barrier to trade by having negative effects on both utilisation of preferences and trade flows. Some general lessons can be learned about how to diminish the negative effects of rules of origin: allow greater relaxation in the product-specific rules; avoid multiple product-specific criteria; allow greater flexibility (by including provisions on full cumulation, generous tolerance rules and derogations); allow duty drawback and provide for self-certification.

A comparison of the rules of origin for textiles and clothing in the EU's and the US's preferential arrangements with developing countries reveals low utilisation rates of the EU's trade preferences. The US African Growth and Opportunity Act (AGOA), with more generous rules of origin, is associated with higher utilisation rates of trade preferences as well as a large increase in developing countries' exports to the US.

The reformed rules of origin in the EU's GSP are somewhat more generous than the previous EU GSP regime. It is, however, dubious whether enough relaxation in the rules has been made in order to achieve one of the stated main objectives with the reform: simpler and more development-friendly rules of origin.

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1. Introduction

Over the past century, the specialisation of production has led to an ever-increasing degree of trade, as well as to an intricate system of trade regulations and trade agreements. Within this tangle of agreements, special privileges have been agreed upon granting preferential market access to certain countries and regions for a variety of political and economic reasons. Indeed, preferential trade agreements (PTAs) have become an important trade policy tool for virtually all trading nations. Rules of origin are directly linked to the preferences offered under a PTA, as they define how much local processing that needs to take place in order for the product to be a product of the exporting country.

Trade preferences are given in order to stimulate trade. The utilisation of trade preferences is strongly connected to the rules of origin.¹ Preferential rules of origin are a necessary feature of every PTA, both reciprocal free trade agreements (FTAs) and non-reciprocal arrangements such as the Generalised System of Preferences (GSP). Without rules of origin, there would be little meaning in establishing preferential trade areas. On the other hand, rules of origin act in the opposite direction of preferences, i.e. rules of origin obstruct trade. The design of rules of origin is therefore of great importance if the preferences are to be useful in practice.

While rules of origin also appear in non-preferential trade², the focus in this report will be on rules of origin concerned with preferential trade. Their principal objective and economic justification is to prevent trade deflection: to avoid goods from non-preference countries being transhipped through a low-tariff PTA partner to a higher tariff one.³ Precisely how strict rules of origin need to be to fulfil this function is greatly disputed. Strict rules of origin are sometimes motivated by the argument that they stimulate integrated production structures in developing countries and thereby promote economic development. However, most of the literature opposes this view, arguing instead that more generous rules of origin are more likely to promote economic development by encouraging specialisation and the sourcing of inputs from the most competitive sources.

In practice, the preferential market access offered by different preferential regimes can be meaningless if the rules of origin impede the usage of these preferences. While little analytical work has estimated the overall minimal level of restrictiveness needed in order for rules of origin to meet

their main objective, to avoid trade deflection, various studies have shown how the cost of compliance with rules of origin often outweighs the benefits of tariff preferences.⁴ Since the objective of PTAs is to facilitate trade it is obviously not satisfying that, due to the costs of complying with rules of origin, this objective is not met. Hence, it is clear that, in these cases, the rules of origin are too strict.

Fragmented production processes and global sourcing networks are an integral part of the world economy. Restrictive rules of origin can reduce the ability of firms to integrate in global value chains (GVCs). Consequently, rules of origin need to be outlined as to comply with international trade in intermediate goods rather than international trade in complete products.

With the growing number of PTAs around the world, customs and traders are faced with an increasingly onerous cluster of different and conflicting rules of origin, often referred to as the “spaghetti bowl”.⁵ As the number of PTAs increases, and the division of production has become more and more international, the need for simple, user-friendly and trade-facilitating rules of origin has become both topical and urgent.

Reform efforts aimed at simplifying rules of origin and its procedures have been initiated among big trading partners, such as the EU. In a Green Book issued by the EU Commission in 2003, it is stated that

*“the Community’s efforts to attain its development objectives are sometimes hampered by the fact that developing countries that are potential beneficiaries of the preferences are unable to take full advantage of them for a series of reasons, among them the difficulty of complying with some of the rules of origin”.*⁶

The recently completed reform of the rules of origin in the EU’s GSP set out to make the EU’s preferential rules of origin simpler and, where appropriate, more development friendly.⁷ Reform progress turned out to be slow, as conflicting voices were raised with regard to what the rules should look like. After several delays, the new GSP rules of origin were adopted in late 2010. A sector that was greatly disputed in this context was the textile and clothing sector. This sector is particularly sensitive to strict rules of origin since it is subject to high tariff protection in developed countries such as the EU and the US. The high tariff rates make the use of the preferences for textile and clothing products more valuable than for other



sectors and crucial for many developing countries. Moreover, the clothing sector is a labour-intensive sector that represents a large proportion of the exports from developing countries to the EU's and US's markets. However, the more capital-intensive textile industry is still an important industry for the EU and the US. Since the quota allocation in the Multi-Fibre Arrangement (MFA) was eliminated⁸, the number of FTAs has increased. Altogether, these sector characteristics and changes in the trading environment are sometimes argued to have led to protectionist influences in the design of the rules of origin in the textile and clothing sector.⁹

1.1. Objective

The aim of this study is to give a deeper understanding of the impact of preferential rules of origin on trade in general and on the textile and clothing sector in particular. Existing theoretical and empirical literature is summarised and applied to the rules of origin for textiles and clothing in the EU's and the US's preferential trade regimes with developing countries. By analysing the impact of preferential rules of origin on trade, conclusions are drawn regarding how these rules of origin should develop in order to facilitate trade.

The report can be viewed as a contribution to the discussion on how rules of origin should be designed in order to facilitate trade. Even though the EU's preferential rules of origin in the GSP have been reformed recently, this paper constitutes a comment on how to further adjust the rules in order to reduce the negative impact on trade.

1.2. Disposition

The structure of this paper is as follows; Chapters 2 contains a brief background to what rules of origin are, what they aim to achieve and how they can be designed. This chapter describes common provisions in rules of origin protocols and provides examples of rules of origin from the EU's GSP.

Chapter 3 summarises existing research on the impact of rules of origin on trade. The point of departure is a discussion on rules of origin and fragmented production chains, followed by the theoretical perspective including costs that are associated with rules of origin. This chapter closes with an overview of empirical studies of mainly the restrictiveness index, utilisation rates of trade preferences in different arrangements, and total aggregated trade flows.

In Chapter 4 the textile and clothing sector is chosen as an example of a sector for which rules of origin are critical. This is a sector of great importance for developing countries and their exports to the EU and the US. The EU's and the US's preferential rules of origin for this sector in trading arrangements with developing countries is scrutinised.

The impact of different rules of origin regimes on trade is compared in Chapter 5, using data from existing empirical research. The two main variables analysed is the trade preference utilisation rate and the total aggregated trade flows.

Finally, the findings are summarised in Chapter 6. Conclusions are made with regard to the direction in which rules of origin should develop in order to facilitate trade.

2. What are Rules of Origin?

Rules of origin define the sufficient level of processing that must take place or the amount of value to be added in a given country in order for a product to be considered to have its origin in that country. Many scholars refer to rules of origin as rules that define the economic, as opposed to the geographic, nationality of goods.¹⁰

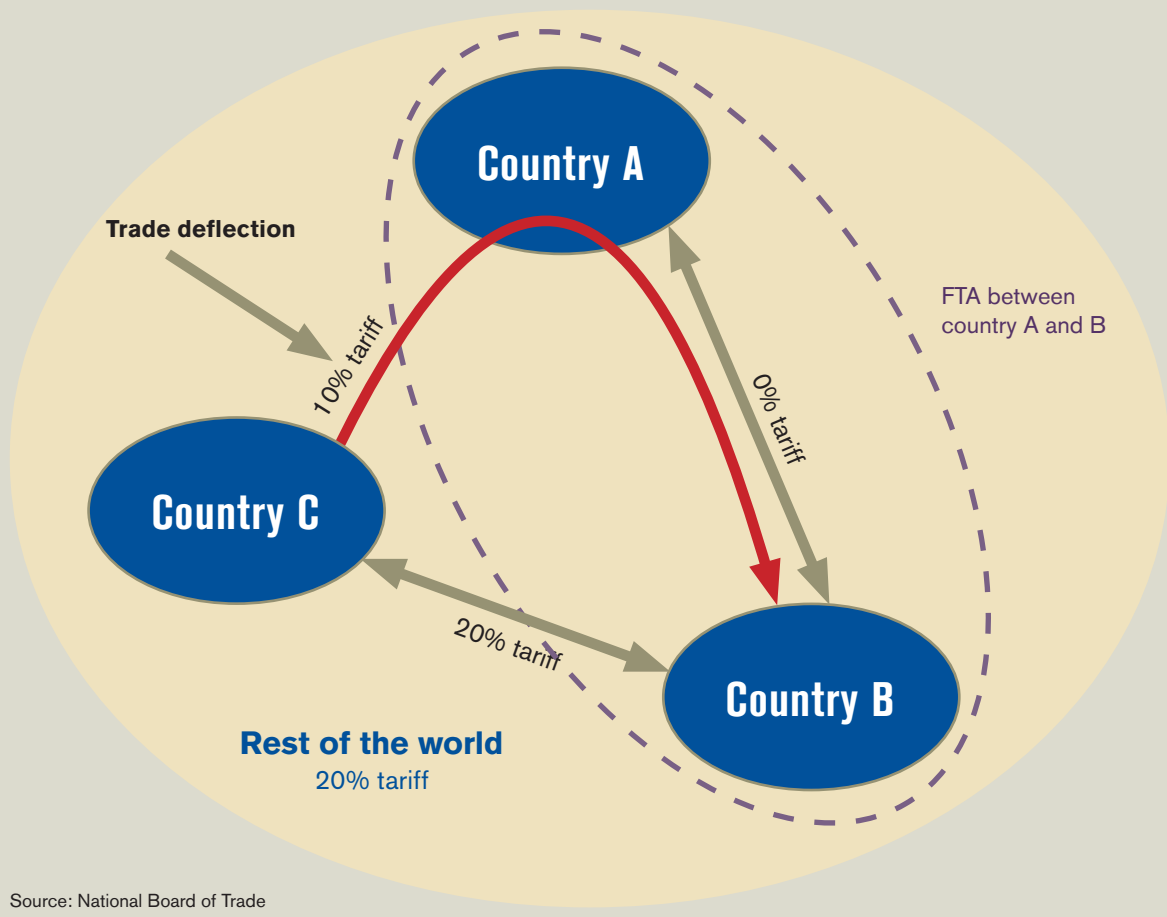
There are two main types of rules of origin: *non-preferential* and *preferential*. *Non-preferential* rules of origin distinguish foreign from domestic goods in non-preferential trade, or so-called Most Favoured Nation (MFN) trade, where all countries face the same tariff. Non-preferential rules of origin are used when applying basic trade policy measures (anti-dumping and countervailing duties, safeguard measures, discriminatory quantitative restrictions

or tariff quotas), for origin-marking requirements, for public procurement and for surveillance and statistical purposes. Since non-preferential rules of origin apply to MFN trade, where all countries face the same tariff, there is usually less incentive to misrepresent the origin of the goods. These rules are therefore argued to have less effect on trade than the preferential rules of origin.¹¹

Preferential rules of origin are more debated and topical. As mentioned in the introduction, these rules are an integral part of every PTA with the principal aim to prevent trade deflection. Hence, rules of origin are needed to ensure that a non-party to a PTA does not benefit from the preferential market access granted to members of the PTA and, thereby, deprive the partners of their tariff revenues.

Figure 1. Trade deflection

Trade deflection: Country A and country B have a free trade agreement. Country C is not part of the free trade agreement. Goods from country C are transported to country B via country A in order to be subject to less duties = 10 % tariff instead of 20 % tariff. This is **trade deflection**. Rules of origin prevent trade deflection, i.e. ensure that only eligible goods receive preferences.



Source: National Board of Trade



While avoidance of trade deflection is the common economic justification for preferential rules of origin, there are, however, different opinions on what the preferential rules of origin are intended to achieve. Given the effect on trade from rules of origin, they are likely to be subject to protectionist pressure. According to Naumann¹², rules of origin have been used as a “discretionary” trade policy instrument, or at least as a complement to existing trade and industrial policies. The key question is whether rules of origin should be used as a trade policy instrument per se, or rather as a tool to achieve the more overt trade policy by preventing trade deflection.

While multilateral efforts have been made to harmonise the non-preferential rules of origin in the Uruguay Round Agreements in 1994 (GATT), the preferential rules of origin have been excluded from this harmonisation process within the World Trade Organization (WTO). The members of the WTO have thereby preserved their right to design preferential rules of origin as they wish, as long as they are consistent with the WTO’s general principles on preferential rules of origin in Annex 2 to the Agreement on Rules of Origin^{13, 14}.

2.1. Different types of rules of origin

The literature often distinguishes between *product-specific* and *general* or *regime-wide* rules of origin.¹⁵ Although there is no harmonised set of preferential rules of origin, there are some common provisions entailed in most rules of origin protocols. While *product-specific* rules of origin differ between different sectors, *general* rules of origin normally apply to all sectors, irrespective of product. A brief discussion of these types of rules of origin follows below.

2.2. Product-specific rules of origin

There are two basic criteria for determining the origin of products: *wholly obtained* or *produced*, and *sufficient working or processing (substantial transformed)*.¹⁶ According to the Revised Kyoto Convention (Annex D1), the *wholly obtained* criterion applies to commodities and related products that have been entirely grown, harvested or extracted from the soil in the territory of that member country or have been manufactured exclusively from these products.¹⁷ Consequently, wholly obtained products cannot contain imported non-originating elements. The wholly obtained criterion is relatively straightforward and easy to apply in practice.

The *sufficient working or processing* criterion is considerably more complicated. It involves three main criteria that can be used separately or in combination with each other: *Change of Tariff Classification (CTC)*, *Ad valorem percentage criteria (VA)* and *Special technical requirements (SPT)*. These criteria are found in the product-specific rules (often called list rules) of the rules of origin protocol, and are typically based on the Harmonised System (HS) nomenclature. The product-specific rules establish the least amount of working or processing required on non-originating materials in order for the resulting product to obtain origin status.

2.2.1. Change of Tariff Classification (CTC)

According to this criterion, the exported product has to be classified under a different number in the tariff classification (the HS) to any of the imported inputs that are used in the production of the product. Normally, it is specified that the change should take place at the heading level, which is the four-digit level of the HS for the classification of goods.¹⁸

Sometimes, however, the rule is specified at the chapter level (two-digit level) or the sub-heading level (six-digit level) or the item level (eight- or ten-digit level). The requirement of change of chapter level is the most restrictive and a change at item-level is the least restrictive (since it implies a lower level of processing).

An example: A producer in country A manufactures straw baskets, classified under HS heading 4602. The straw baskets are manufactured from straw material from country B.

In the EU's rules of origin (GSP), one of the optional rules for the whole of Chapter 46 is "manufacture from materials of any heading, except that of the product". The straw basket is classified under HS 4602 while the straw material was imported under HS 1401: there is a CTC on chapter level and the origin criterion is clearly satisfied.

Thus, the change of tariff classification on chapter level (from the imported straw material of HS 1401 to the straw basket of HS 4602) ensures that a substantial transformation of the straw material has been made. The product – the straw basket – can be considered as originating in country A.

2.2.2. Ad Valorem Percentage Criteria (VA)

When the value that is added to the product in a particular country exceeds a specified percentage, the product is defined as originating from that country. This criterion is often referred to as the *Ad valorem percentage criteria* (VA) or the *value-added rule* and can be defined in two main ways:

- the *minimum percentage* of the value of the product that must be added in the exporting country (domestic or regional value content, VC).
- a *maximum percentage* of imported inputs of the value of the product (import content, MC).

The calculation of this rule can, in turn, be based on a different basis for the valuation of the product, such as the ex-works price (EXW), Free on Board (FOB) and Cost, and Insurance and Freight (CIF). The EXW is used in the EU's preferential schemes. It represents the price paid for the final product when it leaves the last manufacturer, minus any internal taxes, which are repaid when the product obtained is exported (profits are included).¹⁹

An example: A producer in country C manufactures embroidery which is classified under HS heading 5810. The embroidery is manufactured from thread which is imported from country B.

In the EU's rules of origin (GSP), the product-specific rule for embroidery dictates "manufacture in which the value of all the materials used does not exceed 50 % of the ex-works price of the product".

This means that **the value of all the imported material has to be maximum 50 per cent of the price paid ex-works to the manufacturer** in order for the product to obtain originating status.²⁰

If the producer in country C pays € 50 for the imported thread, and sells the embroidery for € 110 EXW, the embroidery is considered to be substantially transformed and originating in country C.

2.2.3. Special Technical Requirement (SPT)

This criterion prescribes for each product or product group certain manufacturing or processing operations that define origin (positive test) or that do not confer origin (negative test). For the textile and clothing sector, the SPT criterion is commonly used.²¹

An example: the EU's rule of origin (GSP) for clothing products of HS 62 stipulates the "manufacture from fabric" for LDCs. This implies a single transformation: making the fabric into clothing products is enough for the clothing products to be substantially transformed and have originating status.

For non-LDCs, the rule stipulates "weaving accompanied by making-up (including cutting)" or "making-up preceded by printing accompanied by at least two preparatory or finishing operations (such as sourcing, bleaching, mercerising, heat setting, raising, calendaring, shrink resistance processing, permanent finishing, decatizing, impregnating, mending and burling), provided that the value of the unprinted fabric used does not exceed 47.5 per cent of the EXW of the product".

Thus, the first rule for non-LDCs stipulates a two-stage transformation process: stage one being the yarn woven into fabric and stage two the fabric made into clothing. It means that non-LDC beneficiary countries are not allowed to import fabric and then make it into clothing. The second rule is a special technical requirement combined with a value added rule.

These different criteria can also be used in combination. There is no consensus with regard to which of these three criteria for determining sufficiently transformed products (CTC, VA and SPT) is superior. A discussion about the advantages and disadvantages of the different criteria as well as the frequency of the different criteria can be found in Annex 1.

2.3. General rules of origin

Rules that are the same for all sectors irrespective of product type are often referred to as *general* or *regime-wide* rules of origin. Some of these rules allow for leniency or "allowances" in the application of the product-specific rules of origin (such as *cumulation* and the *tolerance rule*), while some consti-

tute additional criteria to be met (*list of insufficient working or processing* and *the no drawback rule*). Below, a summary of the principal common provisions of rules of origin follows.

2.3.1. Cumulation

Cumulation allows (originating) products of country A to be further processed or added to products originating in country B, just as if they had originated in country B. By applying a cumulation system, materials originating in one party of the agreement/arrangement are considered to be materials originating in the other party when incorporated into a product obtained there. In effect, the imported materials from the other PTA party will be treated as being of domestic origin in the PTA party requesting preferential access. A prerequisite for cumulation is that identical rules of origin apply between the parties. There are three types of cumulation: *bilateral*, *diagonal (regional)*, and *full*:

The most basic is *bilateral cumulation*. This type of cumulation applies to all materials provided by the two parties to a PTA and implies that originating inputs/components imported from the PTA partner, can be used in the production of the other PTA partner and qualify as originating material from that country. Some scholars have questioned the benefits of this rule in the EU trade regime. They highlight how the EU is often not the cheapest supplier of inputs, which limits the benefits of bilateral cumulation.²²

Diagonal cumulation applies to all countries in a specified region, allowing parts and material from anywhere in the region that qualifies as originating to be used in the manufacture of a final product exported with preferences to the other PTA partner's market. The flexibility in sourcing is, however, often constrained by further requirements. Examples of such requirements are that the value added in the final stage of production must exceed the highest customs value of any of the inputs used from countries in the regional grouping and/or that the processing carried out must be more than what is stipulated in the list as "insufficient working or processing" (as described below). The latter is typical for EU agreements, but it is not used in other countries' agreements as often.²³ A study by Augier et al., on the trade effects of the Pan-European (PANEURO) cumulation system,²⁴ shows how the introduction of diagonal cumulation in Europe stimulated trade flows between the countries in the area. Moreover, it reduced the negative effects of overlapping rules of origin without undermining their objective to prevent trade deflection. While the study highlights how diagonal cumulation can introduce important

leniency in otherwise strict rules of origin regimes, Augier et al., encourage the introduction of full, as opposed to diagonal, cumulation since full cumulation has even more lenient conditions and is therefore likely to alter even greater positive effects on trade.²⁵ As with bilateral cumulation, some scholars have questioned how much value diagonal cumulation has in practice. The United Nations Conference on Trade and Development (UNCTAD) and the Commonwealth Secretariat²⁶ indicate how the value-added requirement sometimes undermines this type of cumulation. *Regional cumulation*, as in the EU's GSP, is a form of diagonal cumulation and operates within a regional group of beneficiary countries.

Full cumulation extends diagonal cumulation by involving more generous criteria. Any operations performed in any of the participating countries with the same set of preferential rules of origin among each other can be counted as qualifying, whether or not the processing is sufficient to confer originating status to the materials themselves. All of the processing done in the zone is taken into account as if it had taken place in the final country of manufacture. As such, full cumulation allows a greater use of third-country material and allows for more fragmentation of production processes within the region. This is often argued to stimulate deeper integration among participating countries. Full cumulation enables countries to use inputs from the most competitive source. For example, more developed, higher labour cost countries can out-source labour-intensive low-tech production stages to the less developed countries with lower wage partners while maintaining the preferential status of the goods produced in low-cost locations. However, the documentary requirements of full cumulation can sometimes be more burdensome than those required under diagonal cumulation. Often suppliers are requested to provide detailed information of inputs in addition to the certificate of origin, which is not required under diagonal cumulation.²⁷

By applying a cumulation system, the restrictiveness of the rules of origin is reduced. At the same time, the preference-giving country is not undermined by generous cumulation provisions as the requirements for substantial transformation is simply met in more country than one. Especially for LDCs, where rules of origin requirements are harder to meet individually and only from local resources, a generous cumulation system is vital.²⁸ Estevadeordal and Suominen have summarised the frequency of the various cumulation rules in 93 PTAs: 6 custom unions and 87 FTAs around the world.²⁹ The findings show that bilateral cumulation is the most commonly used type of cumulation,

used by all 93 PTAs. In addition to bilateral cumulation, diagonal cumulation is allowed in 58 PTAs. Full cumulation is only allowed in 8 PTAs.

2.3.2. De minimis/general tolerance rule

What is often called the *de minimis*, or the *general tolerance rule*, stipulates a maximum percentage of non-originating materials that can be used in production without affecting the defined origin of the final product.³⁰ Hence, by excluding a certain proportion of non-originating material from the product-specific origin rule, the tolerance rule can make it easier to satisfy origin rules.³¹ The percentage is normally set between 7 – 15 per cent.³² However, there is often an exception to this rule, as in the EU's rules of origin (with the Pan-Euro-Mediterranean partners and the GSP) where the general tolerance rule (of 10 per cent in the former and 15 per cent in the latter arrangement) does not apply to textiles and clothing.³³

2.3.3. Minimal operations/list of insufficient working or processing

Another common provision in rules of origin protocols is a separate list indicating the operations

which are considered to be too minimal and insufficient to give the product originating status (either individually or in combination). Such a list is enshrined in most origin protocols and stipulates that operations such as: preservation during transport and storage, as well as operations such as cleaning, simple painting, packaging and assembling etc., are of such a minor importance that they never confer origin status.

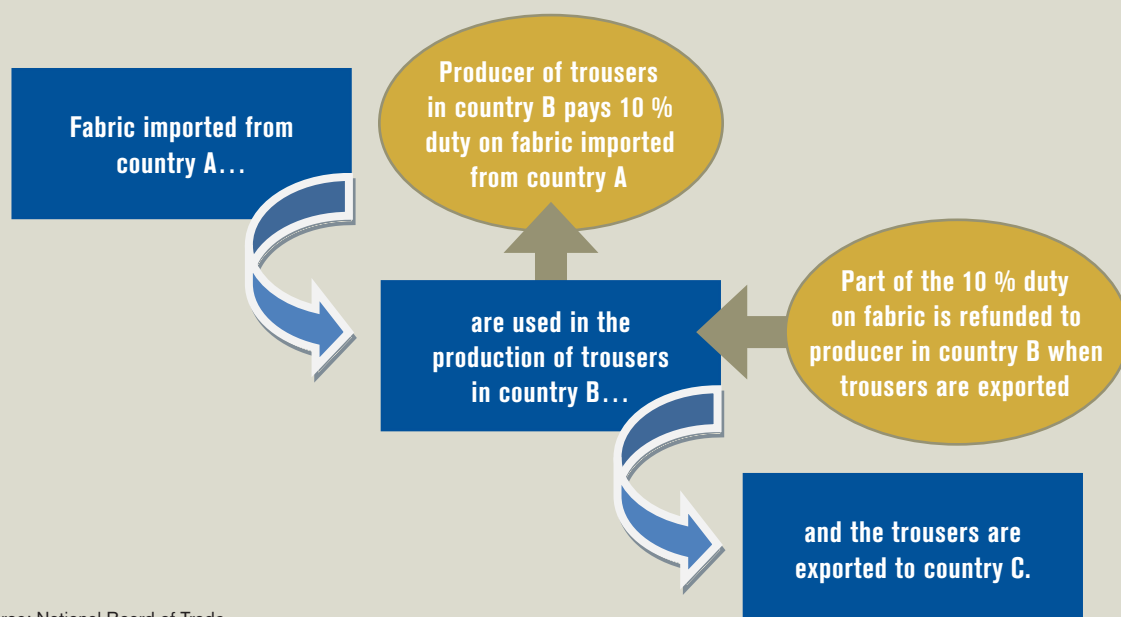
2.3.4. Prohibition of duty drawback

By including a *no-drawback rule*, some PTAs prohibit duty drawback. The no-drawback rule prohibits the refund of tariffs on imported inputs that are later included in a final product exported to a PTA partner under preferential tariff rates. The aim of this prohibition is to avoid double preferences being given and thus create unfair competition in national markets. On the other hand, duty drawback is argued to encourage trade with intermediate goods and to secure the export industry's access to cheap intermediate goods.³⁴ A duty drawback prohibition could therefore have negative effects on the domestic industry due to more expensive inputs.

Figure 2. Duty drawback

The trousers producer in country B is using fabric as an intermediate good when making trousers. The producer pays a 10 per cent customs duty on the fabric when imported from country A. When the final product, the trousers, is exported to country C, the producer in country B is reimbursed the duty paid for the fabric. The producer can only be reimbursed a part of the 10 % duty, depending on how much of the imported fabric that is used in the trousers. There will be spillovers for which the duty cannot be reimbursed.

The possibility to use duty drawback is argued to encourage trade with intermediate goods and to secure that the export industry has access to efficient inputs.



Source: National Board of Trade

The no-drawback rule affects decisions relating to the sourcing of inputs by firms exporting within the trade area, encouraging firms to switch from imported inputs from non-participating countries towards sourcing inputs from participating countries. Since the customs duties applicable to non-originating materials in some countries are considerably higher than those applicable in the other party of the agreement, some agreements allow a refund to a certain level in order to even out the imbalance for a limited period (often referred to as “partial drawback”). The prohibition of duty drawback is a so-called “standard rule” in the EU’s current rules of origin protocol, although it is not included in the EU’s GSP. In a comparison of 34 different FTAs, Estevadeordal and Suominen find that only 9 out of 34 agreements prohibit duty drawback (often time limited to between 3 and 8 years) while 8 PTAs explicitly allow it and 16 FTAs do not mention anything about it.³⁵

2.3.5. Principle of territoriality

The principle of territoriality is another general rule that is common in PTAs. This principle implies that the working or processing must be carried out in the territories of the parties. However, some agreements have derogations that allow for outward processing by firms located within the FTA area to locations outside provided that certain conditions are met. Commonly, textile products of Chapters 50 – 63 are exempted from derogation from the principle of territoriality, e.g. in the EU’s standard rules of origin.

2.3.6. Direct transport rule

This rule concerns the transportation of preferential goods from one PTA party’s territory to another. The purpose of direct transport is to ensure that the goods arriving in the country of import are the same as those which left the country of export. However, the conditions of direct transport allow goods to pass through or stop over in the territory of a third country, provided that they stay under customs supervision. A proof of compliance with the direct transport rule may be given by a single transport document covering the passage of the goods through the country of transit or, for example, a “non-manipulation certificate” issued by the authorities of that country. In the EU’s rules of origin, the direct transport rule is included in the so-called standard rules. The direct transport rule has been relaxed in the GSP reforms, now implying that the customs authorities in the importing country should believe that no manipulation has been made unless there are reasons to suspect otherwise.

2.3.7. Administrative procedures

In addition to the general rules concerning the fulfilment of the rules of origin, administrative procedures exist for the certification and proof of the originating status. These procedures and certifications vary across different PTAs. The most commonly used models for certification are self-certification by exporters, certification by an industry umbrella group, certification by the exporting countries government/public authorities – or a various combination of the three.³⁶

Summary

Rules of origin are a tool to determine the nationality of the goods and to ensure that trade preferences are not misused. Rules of origin define the sufficient level of processing that must take place or the value to be added in a given country in order for a product to be considered to have its origin in that country.

Non-preferential and preferential rules of origin

Non-preferential rules of origin distinguish foreign from domestic goods in non-preferential trade, or so called Most Favoured Nation (MFN) trade, where all countries face the same tariff. They are used when applying basic trade policy measures, for origin marking requirements, for public procurement and for surveillance and statistical purposes. *Preferential* rules of origin aim to prevent trade deflection: to ensure that a non-party to a PTA does not benefit from the preferential market access granted to members of the PTA and thereby depriving the partners of their tariff revenues.

Product-specific and general rules of origin

The literature often distinguishes between *product-specific* and *general* or *regime wide* rules of origin. Although there is no harmonized set of preferential rules of origin, there are some common provisions entailed in most rules of origin protocols. While *product-specific* rules of origin differ between different sectors, *general* rules of origin normally apply to all sectors, irrespective of product. Examples of general rules of origin are cumulation provisions, general tolerance rules, duty drawback prohibitions and administrative procedures.

3. The Impact of Rules of Origin on Trade

Following the growth of overlapping PTAs worldwide and the increased global fragmentation of production, rules of origin have become more topical than ever. Studies have tried to capture and assess the impact of different types of rules of origin on trade, both from a theoretical and an empirical perspective. While the trade effects of origin rules have been discussed broadly in the theoretical literature, the empirical evidence is scarcer.

The logic derived from rules of origin is that partner countries are encouraged to trade *between* them, instead of with the rest of the world. This can be problematic from a WTO perspective: according to article XXIV in the General Agreement on Tariffs and Trade (GATT), trade barriers toward third countries cannot be raised. This implies that the members of WTO are liable not to have too strict rules of origin in PTAs.³⁷

The design of the rules of origin in PTAs can result in trade creation or trade diversion (suppression). Trade creation takes place when less efficient domestically produced goods are replaced with more efficiently produced goods from the PTA partner country. Trade diversion arises when more efficient supply sources in non-partner countries are replaced with less efficient supply sources in partner countries. Trade diversion occurs when the producer in country B (PTA partner country) uses

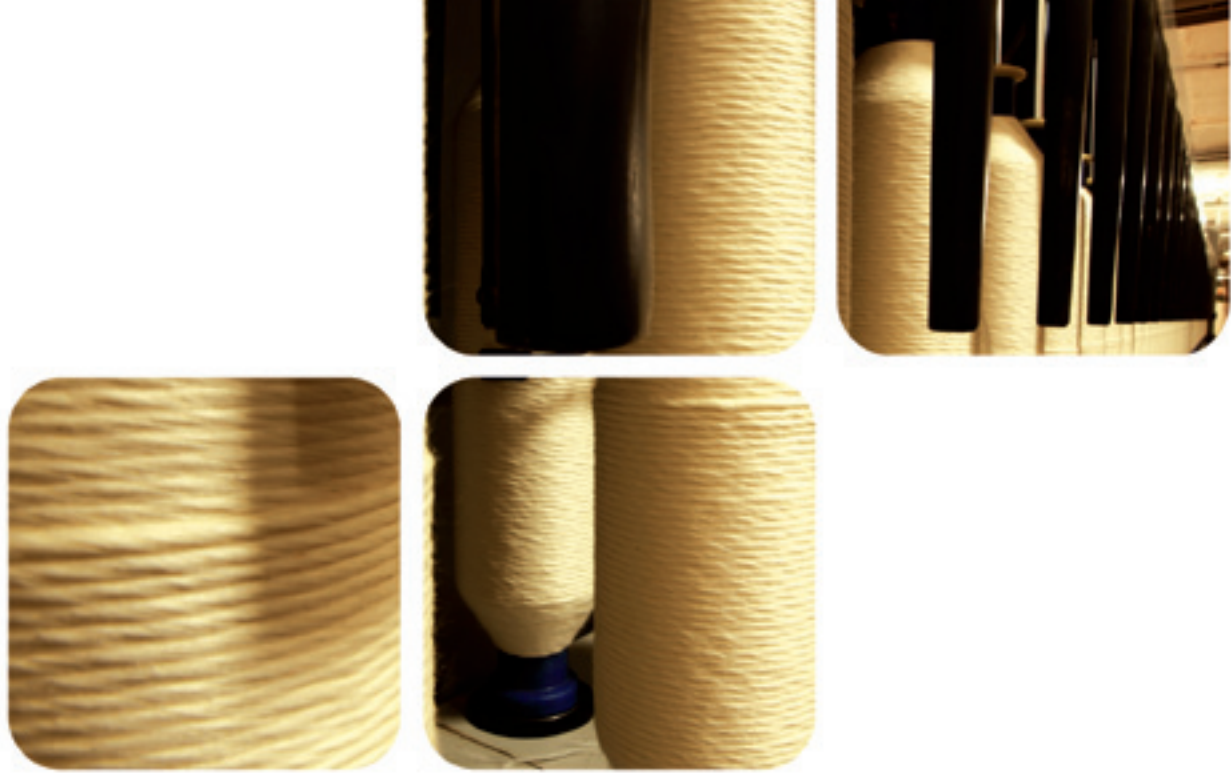
the less efficient, locally produced goods, instead of the more efficient, non-partner produced goods. The net welfare effect depends on the relative size of the different effects.³⁸ It should be noted that the rules of origin does not force a producer to change supply sources, but the rules can create incentive to change supply sources if the producer wants to obtain originating status of its products and, hence, be eligible for preferences. This is the core problem with rules of origin: they are an inevitable part of PTAs, and PTAs are aimed to stimulate trade, while rules of origin suppress trade.³⁹ Rules of origin are by default a barrier to trade, but depending on how they are design they can become a trade barrier in their own right by imposing an inordinate burden on producers and exporters.⁴⁰ Given this, the design of rules of origin are of critical importance.

In the absence of a common, harmonised set of preferential rules of origin, each PTA contains its own set of rules of origin, normally enshrined in an exhaustive protocol (between 50 – 300 pages long) annexed to the agreement. With currently approximately 300 PTAs in force⁴¹, an intricate flora of rules of origin has appeared commonly referred to as the “spaghetti bowl” or “noodle bowl” problem – *with preferences like noodles criss-crossing all over the place*.⁴²

Figure 3. The spaghetti bowl



Source: National Board of Trade



Each PTA normally includes a distinct set of rules of origin, meaning lack of compatibility between agreements and increased difficulties to harmonise between agreements. This reinforces the spaghetti bowl.⁴³ As discussed below, the rules of origin differ not only between different PTAs, but also between different sectors, which makes the system even more burdensome for traders. As La Nasa states:

“In a world where goods are produced from different parts around the world there is no single correct definition of origin”⁴⁴.

3.1. Production is increasingly global

The increase in economic fragmentation has added to the complexity of determining the economic origin of goods.⁴⁵ As discussed in the report “Made in Sweden?”⁴⁶ and the coming report “Business Reality and Trade Policy – Closing the Gap”⁴⁷, fragmented production processes and global sourcing networks are integral parts of the world economy, and integrated production structures within a single country no longer seem to be a viable option.

Several firms in different countries are in many cases involved in the production of a good. Thus, the opportunity to trade with intermediate goods is necessary for an efficient production chain. Restrictive rules of origin can reduce the ability of firms to integrate in global production chains, and this in turn may lead to sub-optimal outcomes economically: constrained access to efficient inputs can increase the production costs and damage the ability of local firms to compete in global markets⁴⁸. Firms have become increasingly specialised on a

limited part in the production chain, which imply that a product can pass through several countries before the production process is completed. The fragmentation of production allows smaller and less developed countries to take part in the production chain and utilise their comparative advantages.⁴⁹ Complicated rules of origin, and different rules in different agreements, can accordingly create increased costs for firms, and if the rules of origin are not designed in a way that reflects how firms organise their production, the rules will comprise ever-greater barriers to trade.

The European Commission highlights the relationship between open trade and competitive EU firms in the communication “Trade as a driver of prosperity”⁵⁰:

“Trade openness facilitates the integration of local companies in global production chains. It makes them more productive and competitive, and creates more employment. More than two thirds of EU imports are imports of intermediate goods, many of them much needed to ensure the competitiveness of EU companies both in Europe and abroad”.

The communication further points out the need to relax the rules of origin⁵¹:

“Global commerce is characterized by large and increasing volumes of trade in intermediate products. Producers take advantage of different costs in different locations to source the cheapest inputs possible. Allowing producers access to raw materials or intermediate products from low cost international sources through relaxed rules of origin (RoO) is therefore vital. This will generate economic activity in the beneficiary country and facilitate development. In developing countries, where labour is most often abundant and cheap, even simple manufacturing operations that provide only low levels of value added can create important job opportunities.”

Collier and Venables⁵² state that trade preferences have the opportunity to play an important role in catalysing manufacturing exports, and lead to export growth and employment opportunities. If this is to be reaped, the trade preferences need to be outlined as to comply with international trade in intermediate goods rather than international trade in complete products.

3.2. The theoretical discussion

When assessing the impact of rules of origin on trade flows the theoretical literature distinguishes between two types of compliance costs that arise from satisfying the origin requirements: *production costs* and *administrative costs*.⁵³ *Production costs* are costs caused by the change in production that is needed in order to comply with the technical criteria of the product-specific rules of origin, while the *administrative costs* are related to proving/certifying that the origin criteria have been met. In addition, there are other factors that may affect the impact of rules of origin on trade, such as the characteristics of the firm and of the sector/industry. Below follows a theoretical discussion about these costs and additional factors that are likely to affect the impact of rules of origin on trade.

3.2.1. Production costs

The *production costs* refer to the increased costs of production that follow from the technical criteria of the product-specific rules of origin. These costs can affect the investment and sourcing decisions of firms, and less efficient inputs may be used in order to fulfil the rules of origin. Hence, it is the increase in the cost caused by rules of origin that encourages the use of more expensive intra-PTA inputs at the expense of cheaper extra-PTA ones. Restrictive rules of origin are likely to constrain a firm's choices even more and encourage producers of intermediate goods to move production facilities within the region, even though it is not their producer of choice worldwide. Other terms used to describe this trade-distorting effect of rules of origin are the "supply-switching effects of rules of origin" or "industry-specific distortion cost".⁵⁴ In sectors where economies of scale are important, and the producer supplies trade partners under several trade arrangements, the negative effects will be aggravated. With different rules of origin in place for different trade partners, the producer may have to use a different input mix in production in order to achieve trade preferences.⁵⁵ In this way, potential economies of scale are undermined⁵⁶.

The production costs related to certain sets of rules of origin are however likely to change over time as reactions to rules of origin take time.⁵⁷ While in the short run, the response to rules of origin is primarily in terms of *trade flows*, in the long run it may take the form of *investment flows*, by encouraging a switch from non-regional inputs to regional inputs.⁵⁸

The majority of the theoretical literature concludes that more restrictive rules of origin distort trade and act as an instrument to protect intra-PTA trade.

Production costs are higher for developing countries

Satisfying strict origin criteria is often argued to be a concern, particularly for developing countries. Small countries and least developed countries (LDCs), where the possibilities for local sourcing are limited, are negatively affected by restrictive rules of origin. Producers in developing countries depend on supply sources outside their domestic market (and outside the PTA area) due to a lack of domestic supply of inputs and vertically integrated industries. Producers of the final product would rather import their inputs from the rest of the world and sell their output on their home market than produce it in the PTA party's market at higher production costs. Alternatively, they may use inputs from the rest of the world and export to the other PTA party by paying the MFN tariff and, hence, avoiding the costs of satisfying the rules of origin. As Naumann states:

*"Strict origin rules make compliance onerous, if not, indeed, impossible, especially for many developing countries with less developed infrastructure or domestic production capabilities."*⁵⁹

Brenton and Ozden argue that strict rules of origin are

"often supported by the argument that they are necessary to encourage substantial value-added activities in developing countries and as a mechanism for encouraging the development of integrated production structures within individual developing countries, or within regional groups of countries through cumulation mechanisms, to maximize the impact on employment and to ensure that it is not just low value-added activities that are undertaken in the developing countries (...). Such rules discriminate against small countries where the possibilities for local sourcing are limited or non-existent. Since most developing countries are small countries, they are particularly disadvantaged by restrictive rules of origin relative to larger countries. Second, there is no evidence that strict rules of origin over the past 30 years have done anything to stimulate the development of integrated production structures in developing countries".⁶⁰

3.2.2. Administrative costs

Administrative costs are the costs related to the necessary procedures that are required to prove compliance with the rules of origin. These costs include both the costs for the exporter to certify the origin prior to its export to a PTA member (bookkeeping costs) and the costs to the partner country customs to verify the origin of the product.⁶¹ The costs tend to be larger for less developed countries, with less developed customs authorities.⁶² Another term used for these kinds of costs is the “*transaction costs*” of rules of origin.⁶³ The costs vary, however, between agreements, with different rules of origin involving different certification mechanisms. In general, the administrative costs are higher when a country belongs to several PTAs with different types of rules of origin and administrative procedures.⁶⁴

Higher administrative costs for developing countries

The ability to certify origin often requires the use of accounting procedures that may be advanced and expensive for small firms in developing economies. Brenton and Imigawa argue that it is likely that the costs of proving origin are higher in countries where customs mechanisms are poor.⁶⁵ In LDCs, the increasing flora of rules of origin is diverting scarce customs resources that could have been used more effectively for other tasks, such as trade facilitation.⁶⁶

Self-certification diminishes the administrative costs

While most agreements request certificates to be verified and authorised by a recognised official body, such as the Custom Authority or the Ministry of Trade, the US agreements provide for self-certification by the exporter. The system with self-certification by the exporter means that the authorities of the exporting countries are not responsible for the accuracy of the information provided in the certificates. Brenton and Imigawa argue that this, in principle, should reduce the administrative burden of complying with the rules of origin.⁶⁷ On the other hand, some concern has been raised regarding the importer liability that in practice may lead to higher entry barriers for developing country exporters.⁶⁸ Currently, as part of the recently completed reform of the EU's GSP rules of origin, the EU has decided to apply a system of self-certification by the exporter.

3.2.3. Factors affecting the impact

In addition to the above-mentioned costs of rules of origin, Gaisorek identifies some main characteristics of the firm and of the industry/sector that will affect the impact of rules of origin on trade.⁶⁹

Characteristics of the firm

- How easy it is for the firm to change the share of its value added in the production by changing underlying production technology. Gaisorek highlights how this is often difficult to change in the short run and may require substantial capital investments in the long run.
- How easy it is for the firm to source intermediates from domestic sources/partner country substitutes and how prices differ between domestic and imported sources.
- How easy it is for the firm to calculate the domestic content of its intermediate inputs and, thereby, prove origin.

Characteristics of the industry/sector

- The height of the preference margin (the tariff reduction). The firm can always choose between using imported intermediates which results in non-originating status of the product and having to pay the duty, or producing the product at a higher cost so that the origin rule is satisfied and the preferential tariff is obtained. For tariff preferences, the distortion arising from rules of origin tend to be reduced as MFN tariffs fall (as does the value of the preferences).
- The responsiveness of market demand for the final product to price changes. The establishment of rules of origin constrains firms' costs and, consequently, the price of the final product exported. If market demand is very sensitive to the change in price the impact on firms will be greater.

3.3. Empirical studies

While there is a broad theoretical debate about the impact of rules of origin on trade, the empirical evidence is more limited. Given the difficulty of translating the technical and intricate rules of origin into a measurable variable, it has been difficult to measure the effects of rules of origin on trade. Moreover, rules of origin may have indirect as well as direct effects on trade both between the PTA parties (intra-PTA trade) and between one of the PTA parties and the rest of the world (extra-PTA trade).

The empirical work has mainly focused on changes in trade between the PTA partners by using two main indicators: utilisation rates of trade preferences under different PTAs and changes in total aggregated trade flows between the PTA countries. In order to capture the restrictiveness of different types of rules of origin, a so-called “Restrictiveness index” has been created.⁷⁰



3.3.1. Restrictiveness index

In order to quantify the restrictiveness of rules of origin a so-called “Restrictiveness index” (R-index) was created by Estevadeordal in 2000. The index is intended to be an overall indicator of how costly or trade-inhibiting the rules of origin are. Many scholars have used it as a tool to measure the impact of rules of origin on trade flows.⁷¹ As a useful indicator of the trade-distorting effects of different types of rules of origin, it has been used in empirical studies examining trade preference utilisation rates, preference margins, and trade flows.

The index is based on a rating system where product-specific rules of origin are given a score between 1 and 7, where 7 corresponds to the most restrictive rules of origin.⁷² The underlying assumptions are that a CTC rule can be ranked in terms of its restrictiveness, where a change of chapter (CC) is more difficult to satisfy than a change at the heading level (CH), and so on. Furthermore, it is considered to be more restrictive when the CTC rule is combined with a VA or a SPT. Where the specific origin rules include alternative product-specific rules, the most restrictive rule is chosen. The R-index has been modified, for example by Cadot et al. who assigned the wholly obtained criterion and the VC rule to specific scores.⁷³

Flexibility in the application of the product-specific rules facilitates trade

Using the same R-index and applying it to trade statistics, a later study by Estevadeordal and Suominen indicates that PTAs with restrictive rules of origin discourage aggregated trade flows, both around the world and among PTA partners.⁷⁴ Moreover, the study points to the fact that *regime-wide* or *general* rules of origin that allow for flexibility in the

application of product-specific rules of origin (such as cumulation, tolerance rule and drawback) facilitate trade.⁷⁵ Since the restrictiveness of the rules of origin varies across sectors, the impact is not uniform across sectors.

High tariff rates connected to strict rules of origin

A study by Cadot et al.⁷⁶ captures the restrictiveness of the product-specific rules of origin in the EU’s and US’s PTAs. Estevadeordal’s index is used and compared with the tariff preferences. The study suggests that there is a positive correlation between high tariff rates and strict rules of origin, i.e. where preferences could be most valuable. One reason for the correlation between tariff peaks and restrictive rules of origin could be that protectionist interests influence the rules of origin.⁷⁷ Moreover, the study indicates that the tariff rates are in general higher for highly processed products. Since the preferences are usually known when the rules of origin are negotiated, Cadot et al. argue that this correlation indicates an incentive to make the product-specific rules of origin stricter in sectors where there is a higher tariff, hence undermining the benefits of the preferential treatment that is given. Cadot et al. conclude that this correlation reflects what they consider to be the perceived characteristics of product-specific rules of origin, namely that:

“they are tailor-made to fit the protectionist interest of lobby groups in the northern partner.”⁷⁸

In the Cadot et al. study it is also revealed that the utilisation rates of the trade preferences are lower when the rules of origin are strict.

In a study by Estevadeordal the R-index is used to analyse the rules of origin in the FTA between the US and Mexico. The study indicates that the rules of origin tend to be more restrictive in sectors where the difference between the US and Mexican tariffs are greater. Moreover, the study reveals a strong positive correlation between restrictive rules of origin and long phase-out periods for tariff liberalisation. This could be interpreted as an indication that rules of origin are used in protectionist manners.⁷⁹

Multiple product-specific criteria diminish trade preference utilisation rates

Cadot et al. combine the R-index values with the utilisation rates and preference margins to compute the total compliance cost of the rules of origin

within the EU's PANEURO regime and the US NAFTA regime. All estimates support the hypothesis that, when multiple product-specific criteria are used, trade preference utilisation rates are lower.⁸⁰

3.3.2. Trade preference utilisation rates

In order to empirically assess the effects of rules of origin on trade, the economic literature on rules of origin has mainly looked at the utilisation rates of trade preferences under different trade regimes. The utilisation rate of a given preferential regime is calculated as the value of imports receiving preferential treatment divided by the value of imports that are eligible for preferences. The compliance with the rules of origin is a condition for obtaining preferences. The utilisation rate of trade preferences is closely linked to the rules of origin and more restrictive rules of origin are associated with lower utilisation rates.⁸¹ Gibbon also describes that the clear link between restrictiveness in rules of origin and under-utilisation of preferences is subject to a growing consensus amongst trade economists.⁸²

The National Board of Trade has analysed reasons behind the low utilisation of the EBA preferences. The Board concluded that part of the explanation is that the rules of origin are too strict and hard to comply with for LDCs, and the preference margins of the EBA preferences have been too low.⁸³

High administrative costs and low utilisation rates of trade preferences

Some empirical studies on the costs related to rules of origin have been carried out. The compliance costs of fulfilling various rules of origin requirements in different PTAs has been estimated to range between 3–5 per cent of final product prices.⁸⁴ An often-cited empirical study of the effects of rules of origin on utilisation rates is a study by Herin⁸⁵. It indicates that a very large proportion of the trade between the European Free Trade Association (EFTA) and the EU paid the non-preferential tariff despite the EFTA-EC FTAs which allowed them to claim duty-free status if they satisfied the origin rules. The study also suggests that the costs of providing the appropriate documentation to prove origin (administrative costs) were approximately 2 to 3 per cent of the value of the export shipment. For African, Caribbean and Pacific (ACP) countries these costs are expected to be even higher, due to information disadvantages, institutional difficulties etc.⁸⁶

In a quantitative study of the utilisation of trade preferences from 2004, Inama found that while 62 per cent of the imports of the US, EU, Japan and Canada, from all GSP scheme beneficiaries, were covered by trade preferences, only 39 per cent of these imports were actually exported under such schemes (a fall from 55.1 per cent in 1995). With regard to the least developed countries (LDCs), 64 per cent of imports were covered by preferences but only 43 per cent of the eligible imports benefited from these schemes. Inama concludes:

*“all these findings point in the direction of rules of origin and related administrative procedures as the main reason for low utilisation”.*⁸⁷

Product-specific rules have negative impact on trade preference utilisation rates

The study by Cadot et al.⁸⁸ on NAFTA rules of origin shows that utilisation rates are positively related to preferential margins and negatively correlated to the presence of product-specific rules of origin. With regard to the EU, Brenton and Manchin indicate how only one third of EU imports from developing countries which were eligible for preferences actually entered the EU market with reduced duties in the year 1999.⁸⁹

Limitations

Poor utilisation rates of trade preferences cannot be solely explained by the rules of origin. The height of the preference margins (the relative cost of the MFN duty) is one of the most obvious factors that may affect the utilisation of preferences: the higher the margin, the greater the willingness to comply with the rules of origin. Although this is often taken into account when estimating the effects of rules of origin on utilisation rates, also taking into account the changes in the total trade volume might give a more accurate picture. The utilisation rates of various preferential schemes may also be misleading when a country is eligible to several preferential schemes (which is the case with developing countries' market access to the EU or the US market). The poor utilisation rate of one scheme can be explained by preferences already existing under another scheme, to which the exporter is already familiar.⁹⁰ Another difficulty of using utilisation rates of trade preferences is the inconsistency in the data that is likely to occur when using data of the requested, instead of effectively used, preferential regimes. It is likely that all exporters do not actu-

ally benefit from the regime they are requesting; hence, the utilisation rates might be overestimated.⁹¹ It could also be difficult to obtain data on trade preference utilisation rates, since this kind of data has been made freely available to the public only partially and recently (with regard to the EU and the US).⁹²

3.3.3. Total aggregated trade flows

Rules of origin may inhibit or deflect trade flows in general and not just the uptake of preferences. This has been indicated in studies that have assessed the impact of rules of origin on trade by looking at the value of the total aggregated trade flows (the total value of exports of one PTA country to another PTA country).⁹³

Rules of origin have a negative impact on trade flows

In a study, Estevadeordal and Suominen⁹⁴ construct a modified gravity model⁹⁵ to assess the impact of rules of origin on both the value of aggregated trade flows and trade in intermediate goods in five major economic sectors – chemicals, machinery, textiles, television and radio transmitters, and vehicles. Their sample covers 155 countries and nearly 100 PTAs around the world during 1981 – 2000. In order to capture the restrictiveness of different types of rules of origin they use the R-index.

With regard to aggregated trade flows, the results indicate that while a PTA has a positive effect on aggregated trade flows, the rules of origin have a negative impact, and hence constrain the liberalising impact potentials of PTAs. Moreover, it shows that while restrictive product-specific rules of origin undermine aggregated trade flows, general/regime-wide rules of origin that allow for flexibility in the application of the product-specific rules of origin facilitate trade.⁹⁶ *General* rules of origin, such as *de minimis*/the tolerance rule, full cumulation, allowances of duty drawback and self-certification, all prove to have a positive effect on aggregated trade flows. Full cumulation and self-certification proves to have the greatest positive impact on trade flows. When further testing for variation in the product-specific rules of origin between different sectors, the results suggest that greater sectoral selectivity (a wider range of differentiations in the rules across the sectors) in the rules of origin regime undermines aggregated trade flows. In addition to this, it shows that the regimes with the most restrictive rules of origin (here NAFTA and PANEURO) also have the highest sec-

toral selectivity. Hence, according to this analysis, an across-the-board criterion⁹⁷ is likely to minimize the trade-distorting effect of the product-specific rules of origin. On the other hand, there are difficulties in applying an across-the-board criterion, since different sectors, with different characteristics, prefer different criteria.

Restrictiveness in final goods encourages trade in intermediate goods

With regard to the impact of rules of origin on imports in intermediate goods, restrictiveness of rules of origin in final goods encourages trade in intermediate goods among PTA partners.⁹⁸ This result supports the theoretical hypothesis that rules of origin divert trade in intermediates from the rest of the world to the PTA area. Moreover, the empirical tests show how the trade-distorting effect of rules of origin has diminished over time. Estevadeordal and Suominen put forward three explanations for this finding. First, that exporters have learned to comply with rules of origin and potentially also altered their production strategies to better meet these. Another explanation is that the lowering of preferential tariffs has increased exporters' incentives to qualify for preferences. The third explanation is that exporters avoid, or circumvent, the rules of origin by paying the declining MFN tariff to enter the PTA member's market.⁹⁹

Cumulation reduces the negative impact of overlapping rules of origin

A study by Augier et al., indirectly investigates the impact of rules of origin on trade flows by looking at the changes in trade flows following the introduction of the diagonal cumulation in the Pan-European Cumulation System (PECS) in 1997. The study shows how diagonal cumulation has stimulated trade flows between the countries in the area and reduced the negative effect of overlapping rules of origin without undermining their ability to prevent circumvention.¹⁰⁰

Limitations

A difficulty in estimating the impact of rules of origin on trade flows lies in separating the classic effects of tariff preferences (trade creation between partners and trade diversion with third nations) with the specific impact caused by the rules of origin. However, as Augier et al. argue, while trade diversion arising from trade preferences will affect final and intermediate goods equally, rules of origin have a much greater impact on intermediate goods than they do on final goods.¹⁰¹



Summary

Different rules in different agreements create difficulties

In the absence of a common harmonised set of preferential rules of origin, each PTA contains its own set of rules of origin, normally in an exhaustive protocol annexed to the agreement. With currently around 300 PTAs in force, an intricate flora of rules of origin has appeared, commonly referred to as the “spaghetti bowl” problem. With different rules of origin in different PTAs, traders face a cumbersome system.

Costs stemming from rules of origin

The costs arising from satisfying the rules of origin can be divided into production costs and administrative costs. Production costs arise from changes in production that are dictated by the rules of origin. Administrative costs arise from the administrative procedures required to prove compliance with the rules of origin.

Stricter rules of origin connected to lower utilisation rates

Two commonly used indicators for measuring the impact of rules of origin on trade are trade preference utilisation rates and total aggregated trade flows, as well as the R-index that is used to capture the restrictiveness of the rules. Studies that have assessed the impact of rules of origin on trade by using these indicators find that rules of origin regimes with multiple product-specific criteria in general have a more negative effect on trade than regimes with an across-the-board criterion for the majority of products. There is often a positive correlation between high tariff rates and strict rules of origin. Furthermore, the utilisation rates of the trade preferences are lower in trade regimes and in product groups where the rules of origin are stricter.

Restrictive product-specific rules undermine aggregated trade flows

Studies that have examined total aggregated trade flows between PTA parties indicate that while restrictive product-specific rules of origin undermine aggregated trade flows, general rules of origin that allow for flexibility in the application of the product-specific rules can limit the trade-distorting effect of the rules of origin. Full cumulation and self-certification seem to have the greatest positive impact in this respect.

How to minimise the trade distorting effect of rules of origin

According to the empirical evidence, ways to minimise the trade-distorting effect of the rules of origin are allowing for greater flexibility in the rules; avoiding multiple product-specific criteria; allowing for greater relaxation in the product-specific rules and providing for self-certification.

4. The Example of the Textile and Clothing Sector

Among sectors that qualify for trade preferences, the textile and clothing sector is one of the most important sectors for many developing countries. It represents a large proportion of the exports from developing countries to industrialised countries, such as the EU countries and the US. Moreover, it is a sector that remains subject to relatively high tariff barriers, making the value of tariff preferences compared with other sectors relatively higher. Consequently, the existence of well-designed rules of origin that enable traders to actually make use of these tariff preferences in various PTAs is crucial.

In this section the rules of origin for textile and clothing products under the EU's and the US's preferential trading arrangements with developing countries are described and compared by analysing existing empirical data on utilisation rates of trade preferences and total aggregated trade flows. Based on this comparison, conclusions are drawn with regard to the impact of these rules on trade.

In order to better understand the background against which the EU's and US's rules of origin for textile and clothing products have been designed, this chapter begins with a brief description of the trading environment for textile and clothing products over the past 50 years and the main characteristics of the sector.

4.1. Background and sector characteristics

4.1.1. The global trading environment for textiles and clothing

Over the past 50 years, the textile and clothing sector has been subject to various protectionist trade policy measures, both through tariffs and so-called non-tariff barriers to trade. In the 1950s, the US had already signed a bilateral agreement with textile exporters in South East Asia to limit imports from these countries. In the 1960s, growing competition from an increasing number of developing countries, able to offer much lower prices, started to compete with textile manufacturers in the industrialised countries. This resulted in the introduction of quantitative restrictions on textile and clothing imports and to the establishment of the MFA in 1974. For 30 years the MFA quota system governed the world trade in the textile and sector clothing. By restricting the output from the most competitive countries it is argued to have artificially overstated

the number of countries manufacturing garments for export.¹⁰² The MFA came to an end on 1 January 2005, eliminating all textile and garment import quotas for WTO member countries.¹⁰³

Although the textile and garment quotas have been eliminated, the sector remains subject to relatively high tariff barriers. In the Organisation for Economic Co-operation and Development (OECD) countries, tariffs ranged from 13 – 19 per cent in 1995, but were reduced to an average of 12 per cent by 2005. In 2001, the EU MFN average tariff rate for textile and clothing products was 10.1 per cent compared with 11.7 per cent for the US.¹⁰⁴ These relatively high MFN tariffs imply greater potential advantages through the use of preferences. Hence, well-designed rules of origin that enable exporters to benefit from these preferences became imperative. However, alongside the MFA phase-out, there has been a proliferation of preferential trading arrangements, which has resulted in an increased number of different and difficult rules of origin for textile and clothing products.

4.1.2. Sector characteristics

The textile and clothing sector is characterised by some specific features. The textile and yarn industry is generally a capital-intensive sector, while the garment/clothing industry is traditionally a labour-intensive sector, but neither requires advanced technology nor large investments. Associated with low labour costs, developing countries have a potential comparative advantage in the production of clothing products.¹⁰⁵ The sector is also of great importance to developing countries exporting to the EU and the US markets. Some economists argue that the textile and clothing sector offers a base for industrialisation and participation in the global economy as well as an opportunity to diversify into manufactured products.¹⁰⁶ However, most developing countries do not have the industrial infrastructure required to manage every stage of production: from producing the thread and weaving the cloth, to sewing the finished garment. Yet, the use of originating fabric (from one of the PTA parties) in the production of clothing is often required in order for the beneficiary country to qualify for origin and, thereby, benefit from preferential market access to the EU's and the US's markets.¹⁰⁷ The highly capital-intensive textile and yarn industry is still of vital trade and economic interest to industrialised countries such as the EU and the US. Some



scholars argue that various trade policy measures are taken to sustain “the top end” of the garment/clothing industry in these countries.¹⁰⁸

In the international classification of goods (the HS), textile and clothing products are classified under Chapters 50 – 63. As discussed in this report, the product-specific rules of origin are specified according to this classification system. A division can be made between textile products (intermediate products) in Chapters 50 – 60 and clothing products (end products) in Chapters 61 – 63.¹⁰⁹

4.2. The EU's preferential rules of origin for textiles and clothing

Trade preference schemes consist of two primary components acting in opposite direction. These are trade preferences – the granting of market access by reduced tariff rates and/or less restrictive quotas, and constraints – eligible countries, products and the rules of origin.¹¹⁰ The current main preferential trade arrangements that regulate trade between the EU and developing countries are the EU's GSP and the Market Access Regulation (MAR) or the interim agreements within the Economic Partnership Agreements (EPA). In addition, the EU is currently negotiating FTAs with a number of developing countries.¹¹¹

4.2.1. The EU's Generalised System of Preferences (GSP)

The Generalised System of Preferences (GSP) constitutes three separate arrangements:

- The standard GSP, providing autonomous preferences to 176 developing countries and territories on approximately 6,300 tariff lines. There are limi-

tations in the tariff reductions for so-called sensitive products, primarily textile and agricultural products:

- The Special Incentive Arrangement for Sustainable Development and Good Governance, or GSP+, an arrangement promoting sustainable development by offering additional preferences to some (at present 14) vulnerable developing countries that have ratified and effectively implemented 27 specific international conventions, for example regarding labour rights and environmental protection or by combating drugs;
- Everything But Arms (EBA), an arrangement providing duty-free and quota-free access to LDCs, at present 48 countries, for all goods except arms.¹¹²

A new GSP scheme is currently being negotiated among EU member states and the European Parliament, based on a proposal by the Commission. The major change proposed by the Commission is a substantial reduction in the number of beneficiary countries. There is no change proposed to the product coverage or duty reduction rates. No changes are foreseen to the rules of origin, which are regulated by a separate legal act: Commission Regulation (EU) No 2454/93, as amended by Regulation No 1063/2010.

In order to obtain tariff preferences, the GSP rules of origin need to be fulfilled. The rules of origin within the GSP have been subject for reform since 2005. On 18 November 2010, the European Commission adopted a revised regulation of rules of origin for products imported under the GSP. The new rules of origin apply from 1 January 2011.¹¹³ The former rules of origin within the GSP have long been criticised for being too complex, strict and

outdated. An argument behind this critique is that there are low utilisation rates of the GSP.¹¹⁴

Under the standard GSP scheme, beneficiary countries are granted duty-free access for non-sensitive products while products considered to be “sensitive” obtain a duty reduction of 3.5 percentage points of the MFN rate for ad valorem duties and 30 per cent for specific duties. Textile and clothing products are considered as sensitive products and furthermore have a special reduction formula – the MFN duty rate minus 20 per cent applies. In the former EU GSP scheme (from 2002) the preferences for textile and clothing products granted a 35 per cent tariff reduction of the MFN rate. Duty-free market access for textile and clothing products is granted to the countries benefiting from the GSP +scheme, at present 15 beneficiary countries¹¹⁵, as well as to the LDCs that benefit from the EBA initiative.

The rules of origin for textile and clothing products under the EU’s GSP scheme, as well as under the EU’s other PTAs, have been criticised for being too difficult and strict. In the reformed GSP rules of origin, some relaxations have been made.¹¹⁶ The main difference in the textile and clothing sector is that a distinction between LDCs and non-LDCs has been made in the product-specific rules. For non-LDCs, the former requirement of double transformation still applies. The double transformation rule dictates that textile or clothing products have to be made out of a two-stage transformation process: stage one being the yarn woven into fabric and stage two the fabric made into clothing. It implies that beneficiary countries are not allowed to import fabric and then make it into clothing. This origin rule is dominant in the EU’s origin protocols. For LDCs, the new rules imply that textile and clothing products can be made of imported fabric, i.e. a single transformation rule. The rules of origin for textile and clothing products are generally more complex than for most other sectors, consisting of a combination of product-specific criteria. In the EU’s GSP scheme, textile and clothing products are not covered by the general tolerance that allows for relaxations from the product-specific rules.¹¹⁷

All of the EU’s preferential agreements provide for bilateral cumulation of origin with the EU. The EU’s reformed GSP rules of origin provide for regional cumulation between countries within four specific regional groupings¹¹⁸. The former value condition for regional cumulation has been removed

on the basis of being “complex and too stringent”.¹¹⁹ Upon request, and under certain conditions, cumulation between groups of countries in the EU’s GSP is possible. However, the condition that the working or processing carried out in the beneficiary country where the materials are further processed or incorporated goes beyond “minimal” operations remain, and, in the case of textile products, also beyond the operations set out in Annex 16 of Regulation No 1063/2010. There is a possibility for a new type of cumulation (extended cumulation) under certain conditions, namely between countries of different regions and between GSP beneficiary countries and EU FTA partner countries.

There is also a possibility to apply for a time- and quantitative-limited derogation from the GSP rules of origin, where the development of existing industries or the creation of new ones justifies it. With regard to textiles, such derogations have been granted to Laos, Cambodia and Nepal, however the derogations expired on 31 December 2010. This expiration was motivated by these derogations being redundant as the reformed rules of origin are simpler and more development friendly.¹²⁰

4.2.2. The Cotonou Agreement and the Market Access Regulation (EPA)

Until 1 January 2008, the EU granted special unilateral preferences to 77 African, Caribbean and Pacific states under the so-called Cotonou Agreement.¹²¹ Under this regime, textile and clothing products could be exported duty free to the EU. The origin rule for textile and clothing products was identical to the former rules under the GSP (double transformation rule). However, the cumulation rules under the Cotonou Agreement were considerably more generous than in the GSP, by allowing full cumulation between all ACP states.¹²²

On 1 January 2008, the trade provisions under the Cotonou Agreement (including the rules of origin) expired.¹²³ By this date the EPAs, reciprocal trade agreements between the EU and the 77 ACP states, were supposed to have entered into force. However, these agreements were not finalised by this date. A temporary solution was therefore applied through the adoption of the Market Access Regulation (MAR). Under this regulation, duty-free and quota-free market access for trade in goods (and the rules of origin connected thereto) was granted unilaterally from the EU to those ACP states that have initiated WTO-compatible EPA



agreements on trade in goods with the EU. The rules of origin are based on the Cotonou rules of origin but are made more relaxed with regard to sectors that are particularly sensitive to the ACP states (textiles, fisheries and special agricultural products). Instead of the so-called double transformation rule, the MAR rules of origin for clothing products (chapters 61 and 62, chapter rule) stipulate: “*manufacture from fabric*”. This means that imported fabric can be used in the production of clothing and that just a single transformation is required in order to obtain origin status, similar to the reformed GSP rules of origin for LDCs for the textile and clothing sector. The ACP countries that benefit from duty-free market access under the MAR and, at the same time, are GSP beneficiaries, can currently choose under which regime (and hence rules of origin) they want to export.

4.2.3. The US’s preferential rules of origin for textiles and clothing

Unlike the EU, there is much more variation across rules of origin regimes in the US. On the one hand there are the NAFTA rules that are mainly based on a wide range of product-specific rules with a broad application of the change of tariff classification criteria for determining origin. These rules are the reference point for the US Mexico and Canada FTAs as well as for the US bilateral rules with Singapore, Chile and South Korea. On the other hand, there are the rules of origin within the US bilateral FTAs with Jordan and Israel that employ a general rule across-the-board for all tariff systems based on the value content criteria.

The US has a number of autonomous trade regimes that provide preferential treatment to goods of developing countries. Just like the EU, the US has its own GSP scheme that grants unilateral

preferences to selected goods of qualifying developing countries, with special provisions for LDCs. The product coverage is, however, much more limited than the EU’s GSP, covering only 53 per cent of dutiable imports from developing countries.¹²⁴ Moreover, the *Caribbean Basin Economic Recovery Act* (CRERA) and the *United States Caribbean Basin Trade Partnerships Act* (CBTPA) grant preferential treatment to selected goods of certain Caribbean countries. The *Andean Trade Preference Act* (ATPA) provides preferential treatment to selected goods in certain countries in South America. Since 2001, the AGOA grants temporary custom relief for importation from a group of African countries into the USA.¹²⁵

4.2.4. The US’s Generalised System of Preferences (GSP)

Under the US’s GSP system, textile and clothing products are, just like under the EU’s GSP, considered to be “sensitive products”. The US general GSP scheme applies to 4,600 items. However, in the US GSP scheme, only 6 per cent of the textile and clothing products from non-LDCs are eligible for preferences.¹²⁶ LDCs enjoy somewhat greater product coverage. The rules of origin in the US GSP scheme have been described as being much simpler than the EU GSP rules of origin.¹²⁷ The origin rule for the eligible textile and clothing products within the US GSP system, as well as in the CRERA and the ATPA, is based on a value-added requirement (of 35 per cent of local value-added content) in combination with a substantially transformed rule that varies on a case-by-case basis.¹²⁸ These rules have been interpreted under US law as requiring a dual substantial transformation.¹²⁹ Under the US GSP scheme, cumulation is only allowed between members of the same association of countries that are treated as “one country”.¹³⁰ Material of US



origin is also cumulable. Both the CRERA and the APTA allow cumulation between all beneficiary countries in these regimes. The APTA Agreement also allows cumulation with the beneficiary countries of the CRERA.

While only a few textile and clothing products are eligible for preferences under the US GSP, the CRERA, the APTA, the AGOA and the CBTPA contain provisions specifically designed to encourage trade in goods in the textile and clothing sector between the US and the developing countries benefiting from these agreements.

4.2.5. The African Growth and Opportunity Act (AGOA)

The African Growth and Opportunity Act (AGOA) was signed in 2000. The AGOA has been extended and amended at several occasions, for example, the preferential market access was extended to 2015 by AGOA III, signed 2004.¹³¹ Eligible AGOA countries must be GSP eligible, and must fulfil certain conditions, for example making continual progress toward establishing the following: market-based economies; the rule of law and political pluralism; elimination of barriers to US trade and investment; protection of intellectual property; and efforts to combat corruption, amongst others. At the moment, 40 countries are AGOA beneficiaries.

Under the AGOA, the tariff preferences for eligible Sub-Saharan African countries applies to more than 6,400 tariff items, including a large proportion of textile and clothing products. The AGOA thus extends the US GSP scheme by 1,800 products. In addition, there are special rules of origin which grant temporary custom relief for importation of clothing products from a group of African countries into the USA. Distinctions are made between

“lesser developed countries” and other AGOA countries. The so-called lesser developed countries (currently 24 out of the 40 eligible AGOA countries) are subject to more generous rules of origin and may source fabric and yarn from anywhere in the world and still qualify for duty-free access when exporting their final clothing product to the US market. This rule is often referred to as a single transformation or “*third country fabric rule*”.¹³² Other eligible AGOA countries face stricter rules of origin. These origin rules basically require that the yarn and fabric are sourced from any of the AGOA beneficiary countries or from the US, in order to enjoy the duty-free access to the US market. This rule is often referred to as “the yarn forward rule” or “mandatory cumulation rule”.¹³³ The AGOA limits imports of clothing made with regional or third-country fabric to a fixed percentage of aggregated clothing imported into the US. For the lesser developed countries the cap is defined in terms of square meter equivalent and not in monetary terms, which is argued to encourage exporting higher-quality clothing with more value.¹³⁴ Moreover, the AGOA has a negative list with textile products that are excluded from the more generous rules of origin (table 4.6.7 p.78 of the Act) that restricts the export of competitive textile products from Africa to the US.¹³⁵

For non-clothing products, the main rule is a value-added requirement of 35 per cent. This value addition can also be met by counting production or materials from other beneficiary countries or the US.¹³⁶

The CBTPA’s provisions for textile and clothing products is based on the same model as the AGOA, with similar rules of origin, designed to encourage trade in textile products.



Summary

The textile and clothing sector represents a large proportion of the exports from many developing countries to the US and the EU. Moreover, it is a sector that remains subject to relatively high tariff barriers, increasing the value of tariff preferences compared to other sectors. Consequently, the existence of well-designed rules of origin that enable traders to actually make use of these tariff preferences in various PTAs is crucial. Most developing countries do not have the industrial infrastructure required to manage every stage of production; from producing the thread and weaving the cloth, to sewing the finished garment. Yet, the use of originating fabric in the production of clothing is often required in order for the beneficiary country to qualify for origin and thereby benefit from preferential market access to the EU's and US's markets.

EU's preferential arrangements

One of the main preferential trade arrangements that regulate trade between the EU and developing countries is the EU's Generalised System for Preferences (GSP). The rules of origin for textile and clothing products under the EU's GSP scheme has been criticised for being too complex. The rules of origin for textile and clothing products are generally more difficult than for most other sectors, consisting of a combination of product-specific criteria. In the EU's GSP scheme, textiles and clothing products are not covered by the general tolerance that allows for relaxations from the product-specific rules. The rules of origin in the EU GSP were revised 2010 with some relaxations in the rules as a result. The main difference in the textile and clothing sector is that a distinction between Least Developed Countries (LDCs) and non-LDCs has been made.

US's preferential arrangements

In the US's GSP, only few textile and clothing products are eligible for preferences. The AGOA extends the tariff preferences to more than 1,800 products, including a large proportion of the textiles and clothing products. In addition, there are special rules of origin which grant temporary custom relief for importation of clothing products from a group of African countries into the USA. The lesser developed countries are subject to more generous rules of origin and may source fabric and yarn from anywhere in the world and still qualify for duty-free access when exporting their final clothing product to the US market.

5. Comparison of the Impact of the Rules of Origin on Trade in Textile and Clothing

The impact of the EU's and the US's preferential rules of origin for textile and clothing products on trade is examined in this chapter. Data on trade preference utilisation rates and total aggregated trade flows from various empirical studies is presented and compared.

5.1. Trade preference utilisation rates

5.1.1. Studies on the utilisation of the EU's and US's trade preferences for textile and clothing products

The impact assessment of the EU's rules of origin for the GSP, conducted by the EU Commission in 2007, points out that the clothing industry is the sector with the lowest utilisation of trade preferences of all sectors, varying between 0 and 50 per cent.¹³⁷ Data on utilisation rates of preferences under different trade regimes reveal relatively low utilisation rates of the EU's preferences for textile and clothing products, varying between 30–50 per cent (EU's GSP and Cotonou).¹³⁸ Candau and Jean examine the value of the EU's trade preferences for developing countries.¹³⁹ They find that the utilisation of the EU's GSP preferences is low for textile and clothing products and conclude that the constraints imposed by onerous rules of origin on textiles and clothing are the main reason for low utilisation. In a study by Brenton and Manchin, data from 1999 indicates that while textiles and clothing accounted for over 70 per cent of the EU's imports from developing countries, the utilisation rate of the trade preferences for these products was only 31 per cent.¹⁴⁰

The National Board of Trade has analysed the trade effects of the introduction of the EBA initiative (granting duty-free and quota-free market access to LDCs) under the EU's GSP scheme. With regard to textile and clothing products, the study shows that the utilisation rates of the trade preferences granted under the GSP increased from 20 per cent in 1998 to 57 per cent in 2004.¹⁴¹ From this data it is interesting to note that three of the four countries representing the greatest increase in utilisation rates of preferences for textile products were the countries that were granted special derogations from the GSP rules of origin for textile and clothing products (Laos, Nepal and Cambodia)¹⁴². With regard to textiles, such derogation was granted to Laos in 1997. Between 1997 and 2004 Laos experienced an increase in its utilisation rate of the EU's

GSP preferences for textiles and clothing from 6 per cent in 1997 to 96 per cent in 2004. Considering the phase-out of the quotas on textiles and clothing during this period, it is, however, difficult to tell how much of the increase in preference utilisation rates can be explained by the granting of a derogation. Still, since the other two countries benefiting from derogations also experienced relatively higher trade preference utilisation rates than other LDCs, the derogations may have had a positive effect on the utilisation rate of the preferences.

A study by Cadot et al.¹⁴³ indicates further that the utilisation rate for clothing in the EU's GSP scheme is only 14 per cent.¹⁴⁴ For the whole textile and clothing sector, the utilisation rates vary between 0 and 50 per cent. For AGOA, the lesser developed beneficiary countries' utilisation rates for clothing products was 92.3 per cent (for chapter 61) and 96.4 per cent (for chapter 62) in 2002 according to a study by Inama¹⁴⁵. The corresponding utilisation rates for 2001 was 47.7 per cent (chapter 61) and 62.1 per cent (chapter 62). Moreover, the volume of exports also increased in 2002. This suggests that there was a "learning by doing" effect, and that relaxed rules of origin allowing third country fabric has a large impact on both utilisation rates and export volumes. Cambodia and Bangladesh are scrutinised more closely and Inama suggests that the low utilisation of preferences are due to the fact that the rules of origin requirements did not permit the use of imported fabrics.

In a study conducted by Portugal-Perez¹⁴⁶, data on the utilisation of preferences for 22 sub-Saharan African countries benefiting from both the US AGOA and from the EU's GSP and/or Cotonou Agreement in 2004 is compared. The data indicates that the utilisation rates of preferences for clothing imported by these 22 countries were 97.4 per cent for the US AGOA and 91.2 per cent for the EU's GSP EBA arrangement for LDCs. Cadot and de Melo find similar utilisation rates for clothing in 2004: 97.36 per cent for AGOA and 94.9 per cent for EBA. Both Portugal-Perez and Cadot and de Melo point out that the export volumes evolved in different ways after the rules of origin in AGOA were relaxed, with a boost in exports under AGOA. Cadot and de Melo conclude that if developing countries are to effectively benefit from preferential market access the rules of origin should be simplified.¹⁴⁷

In the Inama study, expected trade effects from full preference coverage and full utilisation of pref-

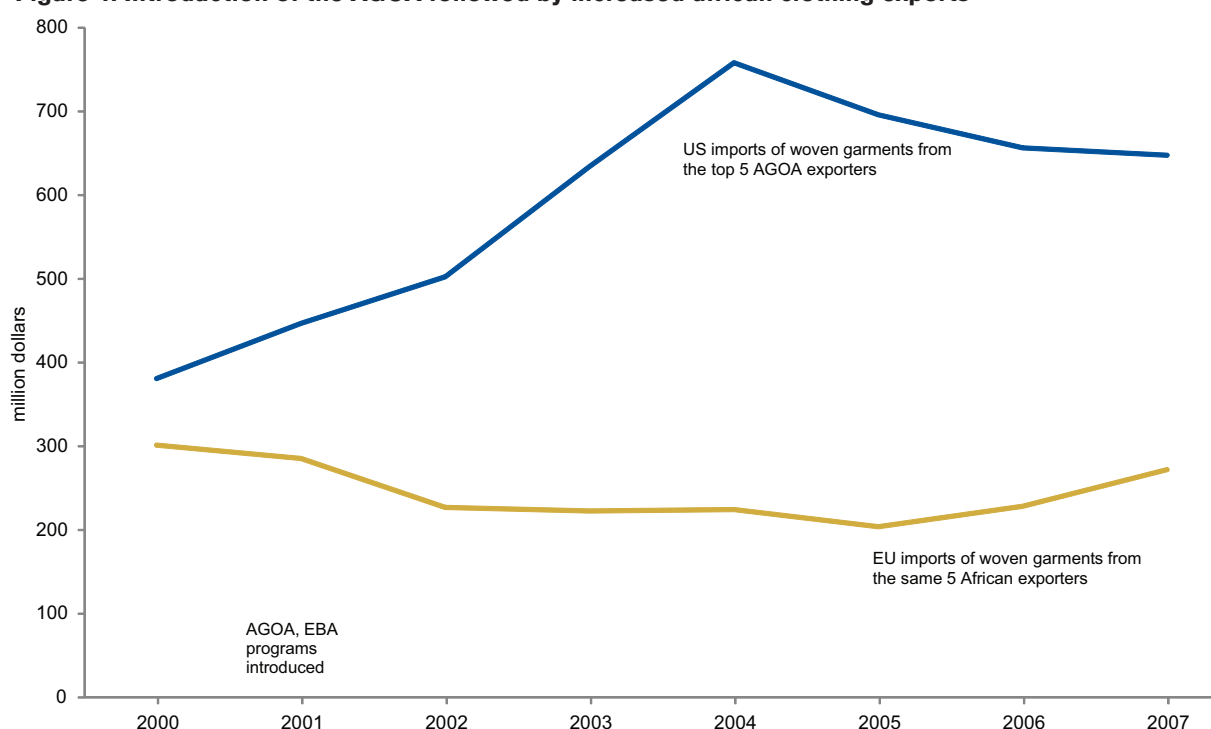
erences (subsequent to a liberalisation of the rules of origin) of the EU's and the US's preferential schemes are being estimated and compared. The estimation indicates that the preferences given for textile and clothing chapters under the US preferential trading arrangement amount to almost 96 per cent of the total benefit from the full coverage. With regard to the EU's preferential trading agreements a distinction is made between the non-ACP LDCs (Asian LDCs benefiting only from the GSP scheme) and the ACP LDCs (LDCs benefiting from both the GSP scheme and Cotonou Agreement). The estimated trade effect in the textile and clothing sector for the non-ACP LDCs is 97 per cent, largely due to chapters 61 and 62. For the ACP countries, textiles and clothing represent 41 per cent of the total trade benefits from full product coverage. Hence, according to this data, the benefits of liberalised rules of origin and complete product coverage of preferences in the textile and clothing sector in the preferential schemes appear to be significant, and substantial trade potential in the textile and clothing chapters have been untapped. Moreover, they appear to be considerably greater for the non-ACP countries.

5.2. Total aggregated trade flows

5.2.1. Studies on exports from developing countries to the EU and the US

In the Portugal-Perez study, the impact of different rules of origin on exports of a selection of African LDC's is examined. The development of total export volumes to the EU and the US from the specific 22 countries benefiting from the single transformation rule under the AGOA is analysed. The data indicates that the paths of African clothing exports to the EU and the US are similar prior to 2000 but that after 2000, when the AGOA entered into force, the clothing export to the US increased substantially while the clothing export to the EU declined. Portugal-Perez found that the AGOA, with relaxed rules of origin, raised the clothing exports from the seven main exporters by about 300 per cent during a five year period (2000 – 2005).¹⁴⁸ An analysis at the product level also revealed that less restrictive rules of origin are associated with an expansion of the range of exported clothing products. Hence, these results support the theory that less restrictive rules of origin diminish the costs for exporters and encourage export diversification.

Figure 4. Introduction of the AGOA followed by increased african clothing exports



Source: Center for Global Development



Olarreaga and Ozden¹⁴⁹ have analysed the effects of the rules of origin in the AGOA and found that countries for which rules of origin have been relaxed have greatly expanded textiles export to the US. The AGOA beneficiaries that remained subject to the general US GSP rules of origin did not register as high export growth rates as did the countries where the rules of origin were relaxed. Olarreaga and Ozden conclude that:

*“this alone proves how stifling rules of origin requirements can be and diminish potential benefits of preferential market access”.*¹⁵⁰

A working paper from the Danish Institute for International Studies (DIIS) illustrates how the AGOA, with its relaxed rules of origin for clothing products, managed to create supply side responses. While the exports to EU basically stayed at the same level between 2000 and 2007, the exports to the US increased substantially. The entire increase comes from non-traditional producers. A strong connection between neutral rules of origin, trade creation and export diversification emerges from this.¹⁵¹

A study by the International Monetary Fund (IMF) concludes clothing exports to the US substantially increased after the AGOA was implemented, and the lesser developed beneficiary countries have gained the most. Another conclusion is that exports from the AGOA countries to the US would have been even greater if the producers of the exporting countries not considered to be lesser developed countries could source materials outside the US and still satisfy the origin rules.¹⁵²

In a study by Scheffer, data indicates that during the years 2000–2005 there has been a decline in the EU’s imports of intermediate textile products (Chapter 50 – 56 and 58 – 60) by 21 per cent and a growth in imports of end products (Chapter 56 and 61 – 63) by 25 per cent.¹⁵³ However, the growth in

imports has been captured by China, India and Turkey together (countries not benefiting from the EU’s preferential schemes with developing countries). Hence, according to this, developing countries have experienced a decline in exports to the EU over the years 2000 – 2005. The decline from the African states is 60 per cent in value and 50 per cent in volume. A limited number of developing countries under the EU’s preferential schemes stand out as exceptions by having experienced an increase in its export to the EU. Bangladesh, Cambodia and Myanmar have all experienced an increase in their exports to the EU market. It is interesting to note that these countries also benefit from the regional cumulation granted under the EU’s GSP scheme.

Augier et al. have carried out a more in-depth study on how cumulation possibilities impact trade with the EU. Regarding textile and clothing products, the results indicate that the lack of cumulation possibilities is likely to have reduced the trade between non-cumulating countries by 73 per cent in 1995 and 81 per cent in 1999.¹⁵⁴

From the existing research, the accumulated picture is that more generous rules of origin are needed if the utilisation of preferences and the trade flows are to increase. The export diversification effect stemming from less restrictive rules of origin is interesting to note from a development perspective. Both the EU’s and the US’s preferential arrangements can be improved in their layout in terms of rules of origin if developing countries are to increase their exports to the EU and the US. The positive effects seem to follow from the introduction of a single transformation rule, the granting of derogations from the origin rules in the textile and clothing sector, and generous cumulation possibilities. The revised rules of origin in the EU’s GSP are in this perspective positive, but there is room for further improvements.



Summary

Lower utilisation rates when stricter rules of origin in EU's preferential arrangements

The textile and clothing sector stands out as one of the sectors with the lowest utilisation rate of trade preferences granted by the EU to developing countries, varying between 0 and 50 per cent. However, when looking at the more generous preferences granted to the LDCs under the EBA initiative the utilisation rates are substantially higher. The countries that have recently benefited from derogations from the EU's rules of origin appear to have increased their utilisation rates of the EU's preferences for textile and clothing products.

Higher utilisation rates of the US's preferences for textiles and clothing

With regard to the US preferential schemes for developing countries, trade preference utilisation rates for textile and clothing products appear to be higher than the EU's. The utilisation rates of the trade preferences for clothing products among LDCs (granted the more generous rules of origin under the US AGOA) amount to more than 90 per cent.

Higher preference margins under the EU's preferential regimes

Higher preference margins are likely to lead to higher utilisation rates. Despite higher preference margins, the utilisation rates of the EU's preferences for textile and clothing products are lower than those for the US's preferential schemes.

Substantial increase in exports following the introduction of the AGOA

When the AGOA entered into force, the clothing exports from Africa to the US increased substantially while the exports to the EU declined during the same period. Cambodia, Myanmar and Bangladesh which experienced the highest increase in textile exports to the EU, all belong to one of the regional groups benefiting from regional cumulation possibilities under the EU's GSP. Moreover, Cambodia is one of the three developing countries that have been granted derogations from the EU's rules of origin for certain textile products.

More generous rules of origin increase preference utilisation rates and trade flows

Hence, a comparison of the EU's and the US's trade preference utilisation rates and total aggregated trade flows in textile and clothing products from developing countries suggests that the introduction of more generous rules of origin is likely to have a positive (less distorting) impact on trade.

6. Conclusions

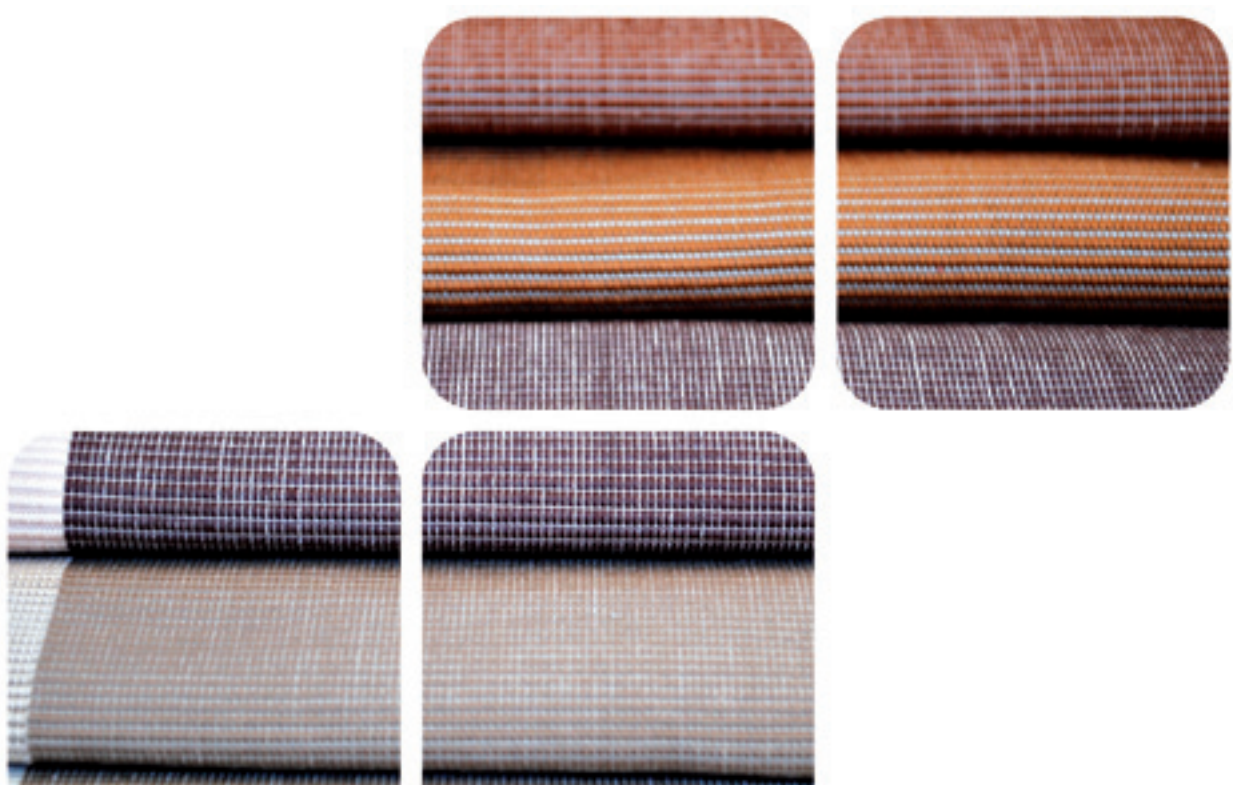
Strict rules of origin have a negative effect on both utilisation rates of preferences and total aggregated trade flows, exemplified by the textile and clothing sector. High tariff rates are related to strict rules of origin in the EU's preferential trade arrangements with developing countries. The US's AGOA regime has previously been more generous when it comes to the rules of origin than the EU's GSP, leading to higher utilisation rates of trade preferences as well as to a large increase in developing countries' exports to the US. These findings clearly indicate that the rules of origin within PTAs, designed to support developing countries, have a negative effect on trade flows. Consequently, the full potential of the preferences designed to benefit these countries is not being realised.

Hence, these findings support the theory that more generous rules of origin encourage specialisation and sourcing of inputs from the most competitive suppliers, thereby facilitating trade.

The recently reformed rules of origin in the EU's GSP have taken some steps in this direction. Never-

theless, the improvement of the rules of origin could have been more progressive and trade facilitating. For future reformation of rules of origin in different schemes, and the rules of origin in upcoming agreements, the trade facilitating effects of more relaxed rules of origin should be considered.

Some general conclusions emerge on how to diminish the negative effects of rules of origin and to embrace the development policy ambition of trade schemes such as the GSP. Rules of origin should allow greater flexibility by allowing greater relaxation in the product-specific rules by e.g. the introduction of a single transformation rule for all beneficiary countries instead of the strict double transformation rule; avoid multiple product-specific criteria, e.g. by the introduction of general across-the-board criteria; include provisions on full cumulation and generous tolerance rules; allow duty drawback; allow for self-certification that limits the administrative costs linked to proving the origin; and generously grant derogations to LDCs from the origin rules in certain sectors.



Appendix 1: Frequency and Implications of Different Product-specific Criteria

With regard to the product-specific criteria, the most commonly applied criteria vary between trade regimes as well as sectors. Most regimes use a combination of all three. Estevadeordal and Suominen have summarised the frequency of the various product-specific criteria in 87 PTAs around the world.¹⁵⁵ Their findings show that the change of heading requirement is being used in 83 PTAs and is the most commonly applied method to determining sufficient processing or working. The second most commonly applied rule is the specific technical requirement, used by 74 PTAs. Sixty-eight PTAs use the value-added rule calculated on the basis of import content (MC), with a threshold allowing 30 – 60 per cent of the value of the total inputs to be imported. Only seven PTAs use the

value-added rule calculated on the basis of the value that must be added in the country (VA) with a threshold of between 25 – 65 per cent.

Both the US's NAFTA and the EU's PANEURO system has a long list of product-specific rules where all the three criteria are represented. In general, the NAFTA agreement relies more heavily on the change of tariff criteria while the PANEURO model relies mostly on value content criteria and the wholly obtained criteria.¹⁵⁶

Research shows that there is no consensus as to which of the three criteria for determining sufficiently processed products that is the most trade facilitating. Each of these rules has its advantages and disadvantages.

Summary of the different approaches to determining origin

Rule	Advantages	Disadvantages	Key Issues
Change of Tariff Classification	- Consistency with non-preferential rules of origin. - Once defined, the rule is clear, unambiguous and easy to understand by both operators and enforcers. - Relatively straightforward to implement. - Largely immune to exogenous influences (exchange rate movements, commodity cycles etc.).	- Harmonised System not designed for conferring origin, as a result, there are often many individual product-specific rule, which can be influenced by domestic industries. Also, this method imposes different burdens on different products. - Documentary requirements may be difficult to comply with. - Can be conflicts over the classification of goods, which can introduce uncertainty over market access.	- Level of classification at which change is required – the higher the level the more restrictive. - Can be a positive (which imported inputs can be used) or negative (defining cases where change of classification will not confer origin) test – a negative test is more restrictive.
Value-added	- Clear, simple to specify and unambiguous. - Allows for general rather than product-specific rules. - Could be tailored to specific countries and sectors.	- Difficult to apply – requires firms to have sophisticated accounting systems. - Uncertainty due to sensitivity to changes in exchange rates, wages, commodity prices etc. - May act as a disincentive against efficiency improvements in production processes.	- The level of value-added required to confer origin. - The valuation method for imported materials – methods which assign a higher value (e.g. CIF) will be more restrictive on the use of imported inputs.
Specific Manufacturing Process	- Once defined, clear and unambiguous. - Provides for certainty if rules can be complied with. - Could be tailored to specific countries and sectors.	- Consume great negotiating time and resources. - Documentary requirements can be burdensome and difficult to comply with. - Leads to product-specific rules. - Domestic industries can influence the specification of the rules.	- The formulation of the specific processes required – the more procedures required the more restrictive. - The test can be negative (processes or inputs which cannot be used) or positive (what can be used) – a negative test is more restrictive.

Source: EU COM (2005), Naumann (2011).

The table above is based on a document produced by the European Commission and communicated to its Member States.

Appendix 2: The EU's Preferential Rules of Origin

The EU's preferential rules of origin date back to the 1970s and are found in a separate annex to the respective PTA. The EU rules of origin are highly uniform across the different protocols. Since the beginning of the 1990s, the EU Commission has tried to harmonise the preferential rules of origin in order to facilitate for European exporters operating on many different markets and to enable cumulation (which requires identical rules of origin). The harmonisation efforts resulted in the creation of the Pan-European (PANEURO) cumulation system in 1997. The PANEURO system is currently being extended to mainly the Mediterranean countries, and is often referred to as the Pan-Euro-Mediterranean cumulation system, or the Pan-Euro-Med system. It operates between the EU, EFTA, Turkey, Faroe Islands, and the countries that signed the Barcelona Declaration (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and the Palestinian Authority of the West Bank and the Gaza Strip).¹⁵⁷ The rules of origin in the PANEURO system have, since 1997, been incorporated into the EU's more recent FTAs and are often referred to as the EU's "standard rules".¹⁵⁸

Efforts to reform (initially to simplify) the EU's preferential rules was presented by the EU Commission in 2003. In 2005 the EU Commission adopted a communication outlining the orientations for the future reform with three main objectives: 1) *Simpler and more development-friendly rules for the determination of preferential origin* 2) *More efficient procedures based on better balance of responsibilities between trade and customs* 3) *Secured environment for legitimate trade through enforced rules*. The communication stipulated that the reformed rules should first apply to development-orientated arrangements such as the GSP and later to the EU's other preferential agreements.

Three impact assessments were commissioned to assess the effect on trade in general and with regard to fish and textiles in particular. Based on these assessments, the EU Commission presented a proposal for new rules of origins for the GSP in October 2007. The two main features of the proposal were: 1) a single across-the-board value-added criterion for the determination of origin for most products (exceptions for, e.g. agricultural products, fisheries and textiles and clothing) and 2) a new system with origin certification carried out by registered exporters (REX) in the beneficiary countries.

According to the initial roadmap the new rules for the GSP were planned to enter into force on 1 January 2009, together with the new GSP Regulation. However, due to criticism from European experts and industries, the process was delayed. On 18 November 2010, the European Commission adopted a regulation revising rules of origin for products imported under the GSP. The new rules of origin came into effect on 1 January 2011. These reformed rules of origin are intended to form a basis for the EU's future FTAs.

The main changes in the reformed rules of origin within the GSP are liberalisations of value thresholds, a higher general tolerance rule (from former 10 per cent to 15 per cent), changes in sector specific rules regarding the textile and clothing sector and the fisheries sector, improved possibilities for cumulation between certain groups of countries and a possibility for extended cumulation. With regard to cumulation, a new cumulation region is added, in which Mercosur member countries are introduced. A new type of cumulation is provided for under certain conditions, namely between countries of different regions and between GSP beneficiary countries and EU FTA countries. Some red tape reductions are also found in the new GSP rules of origin: the new system of self-certification by registered exporters (REX) where exporters give evidence of origin themselves is a liberalisation from administrative burdens. The adjustment in the direct transport rule, where a "non-manipulation certificate" is no longer compulsory, is also positive from a red-tape perspective. The main difference in the textile and clothing sector is that a distinction between LDCs and non-LDCs has been made, granting LDCs easier access to the EU market by less restrictive rules of origin. For most textile and clothing products, a double transformation is no longer required for LDCs. This implies that LDCs can import fabric and make it into clothes and still fulfill the rules of origin, similar to the rules for lesser-developed countries in the US's AGOA.

Unfortunately, the updated rules are still stringent and difficult. Many exceptions from the rules remain, which creates complexity and uncertainty which do not promote user-friendliness. In the beginning of the reformation process, a single method for determining origin, based on local value added was proposed to replace the long list of product-specific rules. However, this method was not possible to achieve in the negotiations.

The recently reformed rules of origin do not reflect the original objectives of the reform, which were not only to modernise the rules, but also to make them more development-friendly as well as user-friendly. In order to increase the utilisation rate of the GSP and to increase the development-friendliness and user-friendliness of the rules, further improvement is needed.

A set of rules of origin that do not follow the EU's so-called "standard rules" is the rules within the MAR governing the ACP countries having agreed to initiate EPAs. These rules entered into force 1 January 2008 when the trade provisions of the Cotonou Agreement expired. The rules are, to a large extent, based on the rules of origin under the Cotonou Agreement (with a combination of product-specific and general rules similar to the EU's standard rules), but with more generous rules for fish and fish products, textiles and clothing, cumulation and derogations. With regard to the rules of origin for textile and clothing products, a single transformation rule has been introduced.



Appendix 3: Rules of Origin Concepts

Rules of origin

Rules of origin are rules that are used to determine the economic nationality of goods.

Preferential rules of origin

Preferential rules of origin are necessary in PTAs. In order to apply trade preferences under a PTA, it has to be determined if a traded good originates in one of the partner countries.

Non-preferential rules of origin

Non-preferential rules of origin distinguish foreign from domestic goods in non-preferential trade, or so-called Most Favoured Nation (MFN) trade, where all countries face the same tariff.

Trade deflection

Trade deflection means transshipment of goods from non-preference countries through a low-tariff PTA partner to a higher tariff one. Preferential rules of origin aim to prevent trade deflection.

Product-specific rules of origin

Product-specific rules of origin are specific rules based on the Harmonised System. These rules stipulate the required working or processing that needs to be carried out in order for the product to obtain originating status. The product-specific rules differ between different sectors/products.

Multiple product-specific criteria

If more than one product-specific rule applies for a good, there are multiple product-specific criteria.

Special technical requirement

This criterion prescribes for each product or product group certain manufacturing or processing operations that define origin or that do not confer origin. A special technical requirement is a form of a product-specific rule, common for textile and clothing products.

General across-the-board criterion

A general rule applicable for all tariff items i.e. no product-specific rules.

General rules of origin

General rules of origin normally apply to all sectors, irrespective of product.

Cumulation

Cumulation allows imported materials to be used in the production of a good. It means that a product can be originating in one country in a preferential area by adding together processing done in different countries in the preferential area. There are different types of cumulation: bilateral, regional, diagonal and full, where bilateral cumulation is the most restrictive.

Self-certification

The system with self-certification means that the exporter certifies the origin of the product. The administrative costs for the exporter and authorities in the exporting country are reduced.

Duty drawback

Duty drawback means that the customs duties paid for intermediate goods used in the production of a final product, which is exported, is refunded.

General tolerance rule

The general tolerance rule stipulates a maximum percentage of non-originating materials that can be used in production without affecting the defined origin of the final product.

Single and double transformation

Single transformation is a form of a special technical requirement normally applying to textile and clothing products. A single transformation means that imported fabric can be used in the production of clothing and that just a single transformation is required in order to obtain origin status.

A double transformation means that textile or clothing products have to be made out of a two-stage transformation process: stage one being the yarn woven into fabric and stage two the fabric made into clothing. Double transformation implies that beneficiary countries are not allowed to import fabric and then make it into clothing.

Notes

- 1 See for example Inama (2003), or the National Board of Trade (2006).
- 2 Non-preferential rules of origin are used when applying basic trade policy measures and for surveillance and statistical purposes (see further discussion in Chapter 2 below).
- 3 Estevadeordal and Suominen (2005).
- 4 See e.g. Carrere and de Melo (2006), Brenton and Manchin (2002).
- 5 See e.g. Bhagwati and Mayer (2003), Baldwin, Evenett and Low (2007).
- 6 Green Book by the EU Commission on the revision on the preferential rules of origin (2003) p. 7, see: http://eur-lex.europa.eu/LexUriServ/site/en/com/2003/com2003_0787en01.pdf
- 7 Communication by the EU Commission (2005).
- 8 The MFA expired on 1 January, 2005.
- 9 OECD (2002).
- 10 See e.g. Gibbon (2008).
- 11 Gibbon (2008).
- 12 Naumann (2011).
- 13 Which in turn is annexed to the Marrakesh Agreement Establishing the World Trade Organization, from 1995.
- 14 Brenton and Imigawa (2005).
- 15 Estevadeordal and Suominen (2005), Estevadeordal and Suominen (2003), Cadot, de Melo and Portugal– Perez (2006).
- 16 In general it is called “substantial transformed” when it is dealing with non-preferential rules of origin and “sufficiently processing or working” when it is dealing with preferential rules of origin.
- 17 The Revised Kyoto Convention (1999) Annex D 1 - the Kyoto Convention is an international instrument adopted by the World Custom Organization (WCO) to standardise and harmonise custom policies and procedures around the world. The WCO adopted the original Convention in 1974. The revised version was adopted in 1999.
- 18 The HS contains 96 chapters (two-digit level), 1, 241 headings (four-digit level) and approximately 5,000 subheadings (six-digit level).
- 19 For more information see “Incoterms” at the International Chambers of Commerce <http://www.iccwbo.org/incoterms/id3045/index.html>
- 20 Many scholars highlight how the problem of correctly setting a threshold that must be reached to acquire originating status for a product has deepened as the division of production has become more and more international. Processes that used to be undertaken within the same factory (or at least the same country) are now distributed all over the world. Yet origin rules are rarely amended fundamentally. See further discussion on fragmented production chains in chapter 3.
- 21 Estevadeordal and Suominen (2003).
- 22 See e.g. Brenton and Imigawa (2005).
- 23 Brenton and Imigawa (2005).
- 24 See Appendix 2 for the PANEURO system.
- 25 Augier et al., (2005).
- 26 2001.
- 27 Augier et al., (2005).
- 28 Naumann (2011).
- 29 Estevadeordal and Suominen (2003b).
- 30 Estevadeordal and Suominen (2003).
- 31 The tolerance rule cannot be used in combination with the value-added rule of a product.
- 32 Estevadeordal and Suominen (2003).
- 33 There is, however, a special tolerance rule of 8 or 10 per cent prevailing for certain textiles.
- 34 See e.g. Estevadeordal and Suominen (2005).
- 35 Estevadeordal and Suominen (2003).
- 36 Brenton and Imigawa (2005).
- 37 The WTO compatibility is not a topic which is scrutinised more closely in this report, however the NBT intend to come back to this topic in future studies.
- 38 De La Torre and Kelly (1992).
- 39 Gasiorsek et al (2007).
- 40 Naumann (2011).
- 41 As of August 2011, WTO webpage: http://www.wto.org/english/tratop_e/region_e/region_e.htm
- 42 Bhagwati and Mayer (2003).
- 43 Gasiorsek et al., 2007.
- 44 La Nasa (1995).
- 45 See for example Harris (2009), or Cadot and de Melo (2007).
- 46 National Board of Trade (2010).
- 47 National Board of Trade (2012).
- 48 Brenton and Imigawa (2005).
- 49 Harris (2009).
- 50 EC: Trade as a driver of prosperity (2010), p. 14.
- 51 EC: Trade as a driver of prosperity (2010), p. 59.
- 52 Collier and Venables (2007).
- 53 Estevadeordal and Suominen (2003).
- 54 Cadot, Melo and Pondrad (2006), Aguer et al. (2005).
- 55 Brenton (2003).
- 56 Naumann (2011).
- 57 Krishna (2006).

- 58 Krishna (2006).
- 59 Naumann (2005b), p.3.
- 60 Brenton and Ozden (2006).
- 61 Estevadeordal and Suominen (2003).
- 62 Naumann (2011).
- 63 Augier et al. (2005).
- 64 Estevadeordal and Suominen (2003).
- 65 Brenton and Imagawa (2005).
- 66 Cadot and de Melo (2007).
- 67 Brenton and Imagawa (2005).
- 68 Gibbon (2008).
- 69 Gaisorek (2007).
- 70 Estevadeordal (2000).
- 71 E.g. Cadot et al. (2005).
- 72 This method have also been referred to by the EU Commission in a staff working document "Rules of Origin for the Textile and Clothing Sector", an accompanying document to the proposal of the Commission for the improvements of the current rules of origin of the Cotonou Agreement, dated 20th of July 2007.
- 73 Cadot et.al. (2005).
- 74 Estevadeordal and Suominen (2005).
- 75 Ibid.
- 76 Cadot et al. (2005).
- 77 Cadot and de Melo (2007).
- 78 Cadot, Carrère, de Melo and Tumurchudur (2005), p.19.
- 79 Estevadeordal (2000).
- 80 Cadot, Carrère, de Melo and Tumurchudur (2005).
- 81 Cadot and de Melo (2007).
- 82 Gibbon (2008).
- 83 National Board of Trade (2006).
- 84 Cadot and de Melo (2007).
- 85 Herin (1986).
- 86 Herin (1986), Inama (2003).
- 87 Inama (2003), p. 41.
- 88 Cadot et al. (2005).
- 89 Brenton and Manchin (2002).
- 90 Canadau and Jean (2005).
- 91 See Candau, Fontage and Jean (2004) discussing these possible limitations with the trade preferences utilisation rates.
- 92 Cadot and de Melo (2007).
- 93 Import data can be obtained from the International Monetary Fund's Direction for Trade Statistics and deflated with e.g. US consumer price index.
- 94 Estevadeordal and Suominen (2005).
- 95 The gravity model has been widely used to predict bilateral trade flows between countries and to examine regional integration. In its barest form, it assumes that trade between two regions increases as bilateral trade barriers falls.
- 96 Estevadeordal and Suominen (2005).
- 97 An across-the-board criterion is a general rule applicable for all tariff items, i.e. no product-specific rules.
- 98 Estevadeordal and Suominen (2005).
- 99 Estevadeordal and Suominen (2005).
- 100 Augier et al. (2005).
- 101 Augier et al. (2005).
- 102 De Vylder (2007).
- 103 Safeguard measures against China continued throughout the end of 2008.
- 104 Cadot and Melo (2007).
- 105 In 2005 study by Grynberg, the cost of unskilled labour costs in the textile industry in a selection of countries was summarised, indicating that while the cost of unskilled labour (per hour) is \$ 25 in Germany, \$13 in the UK and \$14 in the US it is only \$0.55 in China, \$0.65 in India and \$0.50 in Zimbabwe and \$ 0.95 in Mauritius.
- 106 Brenton and Manchin (2002).
- 107 In the reformed rules of origin in the EU's GSP, the rules have been somewhat relaxed for LDCs.
- 108 Grynberg (2005).
- 109 Chapters 50 – 53 cover cotton and other vegetable fibres, silk, wool, yarns and fabric. Chapter 54-55 cover man-made filaments and man-made staple fibres and yarns and fabric made from these materials. Chapters 56 – 60 cover various other textile products such as wadding, felt, carpet and other textile floor coverings, special yarns and fabrics and knitted and crocheted fabric. Chapters 61 and 62 cover articles of clothing and clothing accessories and Chapter 63 covers various other made-up textile articles.
- 110 Collier and Venables (2007).
- 111 For example with India, Malaysia and Mercosur.
- 112 European Commission (2011); <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/>
- 113 See Annex 2 for more information on the reformed GSP rules of origin.
- 114 See, for example, Manchin (2006).
- 115 Cape Verde is the 15th country as of 1 January 2012.
- 116 See Annex 2 for further information about the EU's preferential rules of origin.
- 117 The general tolerance rule in the EU's GSP scheme allows non-originating (10 – 15 per cent of the EXW of the product, or expressed in weight for products in Chapter 16) to be used even if the product-specific rules are not met. This does not apply to textile and clothing products, although there is a special tolerance rule of 8-10 per cent of either weight or value prevailing for certain textile products (see footnote 6 and 7 in Annex 13a to the GSP rules of origin).
- 118 Group I : ASEAN: Brunei-Darussalam, Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand and Vietnam.

- Group II: CAMC+Andean Community: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru and Venezuela.
- Group III: SAARC: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.
- Group IV: Mercosur: Argentina, Brazil, Paraguay and Uruguay.
- 119 Commission Regulation (EU) No 1063/2010.
- 120 Commission Regulation (EU) No. 1063/2010
- 121 National Board of Trade (2006).
- 122 Manchin (2006).
- 123 The unilateral trade provisions under the Cotonou agreement was declared incompatible with the WTO framework already in 1995. EU was however granted a WTO waiver until the end of 2007.
- 124 Brenton and Manchin (2002).
- 125 Grynberg (2005).
- 126 Grynberg (2005).
- 127 Harris (2009). Note that this comparison involves the former EU GSP rules of origin.
- 128 While the value-added rule of 35 per cent appears relatively low it is restricted to materials and direct processing costs.
- 129 Grynberg (2005).
- 130 Caribbean Common Market (CARICOM): Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, and Trinidad and Tobago.
- West African Economic and Monetary Union (WAEMU): Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.
- Southern African Development Community (SADC) – Botswana, Mauritius, and Tanzania.
- Cartagena Agreement (Andean Group): Bolivia, Colombia, Ecuador, and Venezuela.
- Association of South East Asian Nations (ASEAN): Cambodia, Indonesia, Philippines, and Thailand.
- South Asian Association for Regional Cooperation (SAARC): Afghanistan, Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka.
- 131 See the AGOA website for more information on AGOA: www.agoa.gov
- 132 In order to benefit from this less strict rule the countries must fulfil various requirements, such as having an effective visa system in place to prevent illegal trans-shipment and the use of counterfeit documentation, as well as effective enforcement and verification procedures. The third country fabric provision was extended until 2012 by AGOA IV, signed in 2006.
- 133 Grynberg (2005).
- 134 Ozden (2006), Portugal-Perez (2008).
- 135 For more information about the AGOA, see <http://www.agoa.gov/index.html>
- 136 Mattoo et. al (2002).
- 137 The EU Commission (2007).
- 138 Cadot and de Melo (2007); Cadot, de Melo and Portugal-Perez (2006); Brenton and Manchin (2002).
- 139 Candau and Jean (2005).
- 140 Brenton and Manchin (2002).
- 141 National Board of Trade (2006).
- 142 Bangladesh was the forth country with the highest increase in utilisation rate of trade preferences for textile and clothing products in exports to the EU.
- 143 Cadot et al. (2006b).
- 144 Note: with a standard deviation of 31 per cent.
- 145 Inama (2003).
- 146 Portugal-Perez (2008).
- 147 Cadot and de Melo. (2007).
- 148 The exchange rate effect is controlled for, with no evidence found that real exchange movements are related to this development. The US dollar also depreciated against the euro during this period.
- 149 Olarreaga and Ozden (2004).
- 150 Olarreaga and Ozden (2004), p. 15.
- 151 Gibbon (2008).
- 152 Mattoo et al (2002).
- 153 Scheffer (2007).
- 154 Augier et al (2005).
- 155 Estevaderaol and Suominen (2003b).
- 156 Cadot and de Melo (2007).
- 157 European Commission (2011) http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_783_en.htm
- 158 Lazaro and Medalla (2006).

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