



## Rules of Origin for the 21st Century

— including services, digitalisation,  
sustainability and a more user-friendly  
approach

2020



# Foreword

**T**rade policy tends to change in times of crisis. When we face sudden and radical economic pressure, conditions for trade and production transform and new priorities emerge. For example, during the early stages of the COVID19-pandemic the most immediate policy-reactions were trade restricting. When conditions slowly settled, other suggestions took form, such as reductions of tariffs for medical products and supplies as well as trade facilitation measures to speed up border crossings.

This paper is not about COVID-19 or anything related to the pandemic. But it is about how trade policy can adjust and adapt to new realities, which the crisis forced us to do. The focus here is on Rules of Origin, a specific set of requirements used to determine the economic nationality of a product. Rules of Origin is also the key that unlocks the lower tariffs in a free trade agreement and can therefore have a large impact on production.

The production of goods has evolved significantly over the last two decades. Many argue we now have entered a Fourth Industrial Revolution. Servicification, digitalisation and sustainability shape how and where production takes place. This study presents ideas on how the Rules of Origin can adapt to this new reality. However, recognising that trade policy is more than just trade, the study also explores how the Rules of Origin can contribute to change, for example in the context of sustainability.

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Stockholm, May 2020



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**The National Board of Trade Sweden** is the government agency for international trade, the EU internal market and trade policy. Our mission is to facilitate free and open trade with transparent rules as well as free movement in the EU internal market.

Our goal is a well-functioning internal market, an external EU trade policy based on free trade and an open and strong multilateral trading system.

We provide the Swedish Government with analysis, reports and policy recommendations. We also participate in international meetings and negotiations.

The National Board of Trade, via SOLVIT, helps businesses and citizens encountering obstacles to free movement. We also host

several networks with business organisations and authorities which aims to facilitate trade.

As an expert agency in trade policy issues, we also provide assistance to developing countries through trade-related development cooperation. One example is Open Trade Gate Sweden, a one-stop information centre assisting exporters from developing countries in their trade with Sweden and the EU.

Our analysis and reports aim to increase the knowledge on the importance of trade for the international economy and for the global sustainable development. Publications issued by the National Board of Trade only reflects the views of the Board.

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# Summary

**G**lobalisation in the 21st century has had profound effects on production and trade. Materials are sourced from all over the world and production are often organised in complicated international networks, spread across both countries and continents. The next stage of development – often called the Fourth Industrial Revolution – will change the conditions again when new technology revamp business models and trade flows. In parallel to these changes, the demands for an increased focus on sustainable development will only get stronger and more urgent.

These developments challenge our trade rules. For the rules to continue to fit their purpose, they too need to evolve. Rules of origin are used more today than ever before, in part due to a growing number of free trade agreements in the world. However, changing conditions for production and trade challenge the function of the rules of origin. For example, physical goods today contain more services than before, often of the digital kind, and their contents are harder to trace. Traceability is in turn essential to establish origin.

This study presents thoughts and ideas on how the rules of origin can be modernised to meet the challenges of changing conditions for production and trade. The purpose is twofold; firstly, it is important for the rules of origin to match the current trade and production conditions in order for economic operators to be able to use free trade agreements. Second, rules of origin can be a part of a forward thinking trade policy that advances technological advancements and sustainable development across its three dimensions.

Four main pillars make out the foundation for the discussions in the study: i) services, ii) digitalisation, iii) sustainable development and iv) user-friendliness. Developments within these pillars affect how we view and establish origin in goods but also the role and function of the rules of origin.

Throughout this study, numerous thoughts and ideas are presented on how rules of origin can adapt, evolve and support developments within the four pillars. There are several examples where ideas cut across the different pillars, one such example is blockchain technology that potentially offers vastly improved traceability which in turn can be utilised to promote use of sustainable materials and goods.

Even if there is a need for the rules of origin to adapt and evolve, it does not mean that current methods have to be abandoned. On the contrary. It is in many ways more effective to use concepts that stakeholders are familiar with, but tweak them to promote sustainability or make it easier for SMEs to utilise trade agreements for example.

One of the main issues with rules of origin is their variety, countries prefer different methods and thresholds depending on their interests. The rules of origin themselves are also difficult to interpret, often considered opaque. While information about the rules is often plentiful, it is still a problem for many economic operators to find the information and fully understand it. Multi-lateral initiatives focused on transparency and harmonisation play a key role here.

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# 1 Introduction



It is not easy to say where the origin of a product is. Goods are made from materials from all over the world; they are processed in one place, incorporated into a product in the next, and later consumed in another. In fact, the issue is no longer only about physical materials. Much of a goods value comes from more intangible sources, such as services and intellectual property rights.

Considering how we produce and trade today, it is perhaps better to start with the following question: What defines “origin”? Is it the content of the good, or where the majority of the good is produced? Is the origin found in the brand of the product or perhaps in the nationality of those who made it? These questions come from the changes that international trade and production have experienced in the 21st century, and that is where this study has its starting point. The purpose of this paper is to analyse how these changes affect the concept of origin and the rules surrounding it: the rules of origin.

There was a time when the concept of origin was simple; countries specialised in different goods that they later traded. Goods were produced in their entirety in one country. This is not the case anymore. Globalisation has divided production into different stages, which are performed in separate countries by various economic operators. This change has only recently occurred and, already, trade is changing gears again. Trade is now speeding into the next stage of its development.

The National Board of Trade Sweden’s study *World Trade in the 21st Century* (2016) helped introduce the concepts of “servicification” and “digitalisation”. Now take these concepts, pair them with rapid technological advancements and add another layer on top – sustainable development. What emerges is a complicated picture of a new and different trade landscape. It could even be argued that we are facing a new industrial revolution, the fourth of its kind, such is the level of change to production and trade that some see coming.<sup>1</sup>


In facing this new landscape, how have the concept of and international rules regarding origin changed? Not a great deal, in all honesty. It can be argued that the only thing that has kept pace with the changing conditions, is the increased use of rules of origin. An increasing number of free trade agreements (FTA) has led to a web of overlapping preferential rules of origin. Additionally, the increased use of other trade policy measures that require the establishment of origin has contributed to a situation in which rules of origin are more relevant than ever.

It is easy to drown in all the details of rules of origin. Therefore, the ambition here is to stay clear of those waters and instead focus on what is beyond the horizon. Given how trade looks today and how it will develop in the future, how can we make sure that we have rules of origin that are fit for the purpose?

This report will present thoughts and ideas on how rules of origin can be modernised to better reflect the way we produce and trade today. Also included are possible ways that the rules of origin can facilitate change, primarily in relation to sustainable development. The approach will be “throw enough mud at the wall and some of it will stick”, meaning that a wide range of different ideas will be presented, which will hopefully act as building blocks for a deeper discussion further down the line. Work on the report started long

before the COVID-19 outbreak, but even if the ideas in the report is not connected to the pandemic per se, some of the concepts can still be relevant. Trade policy will play an important role in the economic recovery after the outbreak, including the rules of origin.

The text is structured into a discussion of four main concepts defining international trade today. All the chapters will have a short policy summary at the end. These summaries lay the foundation for the concluding remarks.



**Globalisation has divided production into different stages, which are performed in separate countries by various economic operators.**



# 2

## What are rules of origin, and why do they exist?

## Rules of Origin

How to decide the origin of goods

### Preferential RoO

- are essential in **all FTAs**, but still unique in every agreement.
- makes it possible to distinguish products that can access lower tariffs from all other products.

### Non-preferential RoO

- trade statistics
- "made in"-labelling
- anti-dumping, etc.



R&D

raw material



components



assembly



software



### HOW TO DETERMINE ORIGIN

#### Wholly obtained goods

- entirely from one country/region



#### Substantial transformation

- set of criterias:
  - value added (% of value added in the FTA)
  - change of tariff classification (materials change HS-code during production)
  - special technical requirement (specific production process)



### HOW TO PROVE IT

#### Certificate or declaration



# 3

## Rules of origin and services



- ‘Mode 5’ services
- Services included in RoO
- RoO for services

Rules of origin is a goods-regulation. It does not directly affect trade in services, data flows or the movement of people for example. But indirectly the rules of origin do. All these areas overlap, they interact and add value to each others activities. To view rules of origin as strictly connected to goods is functional, but insufficient in the long run.

What production and trade have experienced in the last 20 years is a continuous ‘servicification’. There is a need to start discussing the integration of services into the rules of origin. Perhaps even rules of origin for services.<sup>2</sup>

### Facts

#### Servicification<sup>3</sup>

Servicification refers to the ongoing integration of the production and consumption of goods and services. A company that produces goods also produces services, both of which can be exported later. For example, take a company that produces and exports machines of some sort. Maybe someone from the company must accompany the goods to install them or train workers in how to use them.

The same company also requires services in its production. Some of these services cannot be produced by the company itself and therefore must be imported.

### 3.1 ‘Mode 5’ services

The ‘mode 5’ concept sprang from the ‘servicification’ of production and trade. The WTO General Agreement on Trade in Services (GATS) has four established modes of supply. ‘Mode 5’ is not an addition to these four modes but rather a description of services that are not covered by them. ‘Mode 5’ services are either incorporated into goods or come along with a good. These services are often linked to innovation, design, R&D and IT services, which are all high-value added services.<sup>4</sup> Since the GATS does not cover ‘mode 5’ services, they are instead subject to regulations relating to goods, such as rules of origin.

Rules of origin in its current state are not very well equipped to include ‘mode 5’ services. However since services add value all along the production process of a good – from the research and design at the start, to providing IT-services at the end – there is a need to start looking at how rules of origin potentially can be expanded to include ‘mode 5’ services.

A good starting point would probably be in FTAs between high-income countries. These countries often have a high degree of ‘servicification’ and ‘mode 5’ services in their production. In addition high-income countries mostly trade variations of the same products between each other. Krugman, for example, argues that modern FTAs are more about protecting intellectual property rights (IPR) than anything else.<sup>6</sup> This

is in line with a ‘mode 5’ view of production and trade since services such as R&D, innovation and design all have a close connection to IPRs.

The next step would be to identify the sectors in which it would be most relevant to include a ‘mode 5’ component in the rules of origin. Logically starting with sectors that have a high degree of ‘servicification’. In the EU, the sector with the highest proportion of ‘mode 5’ services is the transport equipment sector, the second highest is textiles and the third is food products.<sup>7</sup> It is in these sectors where it would be most useful to

start exploring a new type of ‘mode 5’-friendly rules of origin.

Recently, some new trade agreements have begun to introduce rules of origin that better reflect ‘servicification’. One example is the new high-wage provisions in the United States-Mexico-Canada Agreement (USMCA). These new rules state that a certain amount of the content of a car must come from expenditures on research and development,<sup>8</sup> for example, testing, design and prototype development<sup>9</sup> – all ‘mode 5’-services.

### Facts

#### The WTO ‘modes’ of services<sup>5</sup>

The WTO has four definitions of trade in services, each of which is divided into a ‘mode’. These ‘modes’ represent where the consumer and the supplier are at the time of the trade.

**Mode 1** – Cross border trade: selling services from one country to another.

**Mode 2** – Consumption abroad: a person from one country buying services when visiting another country.

**Mode 3** – Commercial presence: a supplier from one country established in another country to sell services.

**Mode 4** – Presence of natural persons: a supplier from one country has an employee present in another country to sell services.



3.2 The problem with services (from a rules of origin perspective)

To some extent, services are already taken into the origin calculation. Labour costs for example.

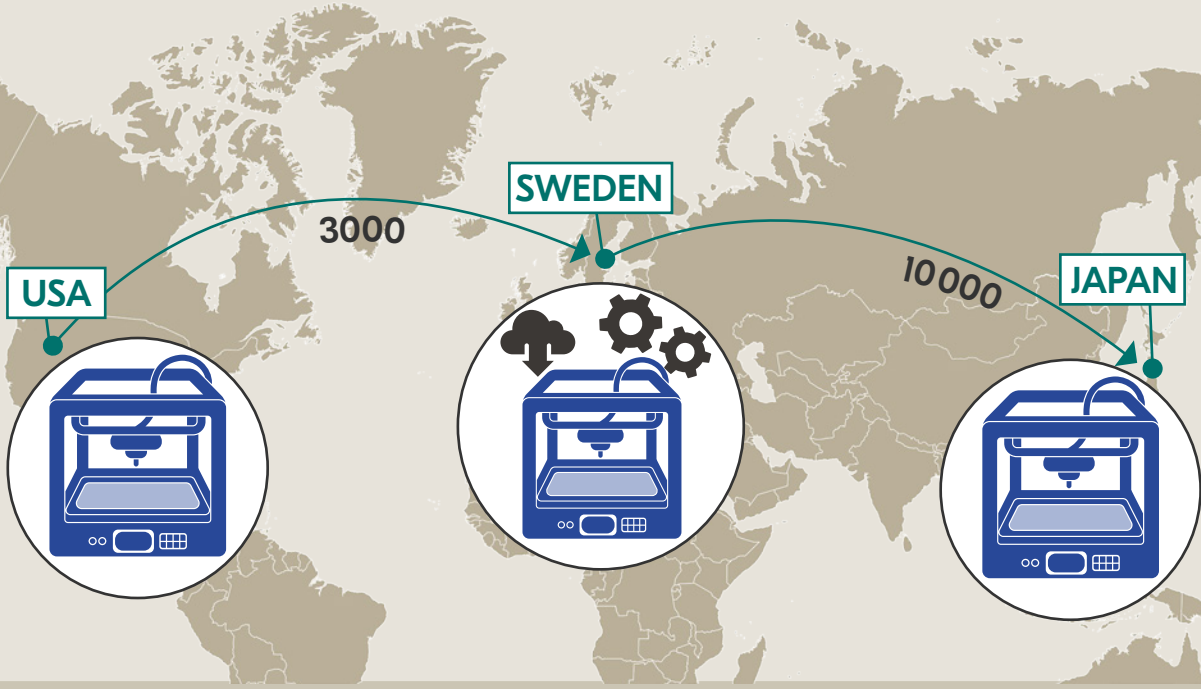
A manufacturer can add these costs onto the price of the product. The price is later the basis for determining whether the good has origin or not. But not all labour costs can be included. Take the company in the example below:

**Example**

**The 3D-printer company**

The company imports a 3D-printer to Sweden from USA. The Swedish company specialises in software development for 3D-printers and duly installs its own software into the 3D-printer. The Swedish company develops the software from scratch. The printer is then tested according to market standards, making it ready for export to Japan under the new EU-Japan economic partnership agreement. The 3D-printer cost 3000 to import. After installing the software plus overhead costs and profits, the finished product sells for 10 000.

HS code computer: 8477  
Origin rule: CTH or MaxNOM 50 %



It is highly doubtful that the 3D-printer in the example is originating in Sweden, regardless how much value the software adds to the final good. The Change of Tariff Heading (CTH) criterion cannot be fulfilled since the 3D-printer does not change tariff classification with the software installation. The actual software is not viewed as a material, so rules of origin cannot be applied to it. Installing the software is probably not enough to be considered a sufficient operation in itself.

Yet the 3D-printer cannot function without proper software. It is also beyond doubt that developing software requires significant resources and expertise. These two facts should merit a larger weight in the origin calculation. In the end, the 3D-printers origin is based on where the physical product is made, even if the main source of value comes from the software.

3.3 How to solve the problem

In such a situation as described above, one option can be to have the origin based on where the largest proportion of the product’s value was added. Current rules of origin focus on where it underwent its “substantial transformation”. However, if a large portion of the final value comes from a service, a “significant value addition” rule could be an option. Then, services, such as software, can feature in the origin calculation. A “significant value addition” rule would enable a new type of firm to use and benefit from trade agreements. This approach, for many goods and sectors, would be a better reflection of current production methods.

Another potential option could be to add the development and installation of software as a special technical requirement among the product specific rules. This special technical requirement could then be an option in addition to the traditional change of tariff classification and value added rules.

3.4 Rules of origin for services

Perhaps what we need is not a reformation of current rules of origin to incorporate services, but instead a way to design a completely new set of rules of origin for services.<sup>10</sup> The upside of this approach would be the possibility of capturing the increasing role of ‘servicification’ in production and trade. By establishing the origin of a service, it could be included in the calculation of the good’s origin in the same way that physical material is included.

Another area that would benefit from rules of origin for services is statistics. One of the main fields of application for non-preferential rules of origin is trade statistics.<sup>11</sup> Trade in services is notoriously difficult to measure statistically. A common method to determine the origin of services would make trade in services easier to track.

3.5 To sum things up...

When analysing the relation between rules of origin and services, it is clear that the discussion is still in its starting blocks, whether it is being examined from a ‘mode 5’ perspective or with a view toward establishing a separate set of rules of origin for services. The discussion is not only important in an FTA context, but also for the trade policy areas that rely on non-preferential rules of origin, such as better trade statistics. Another example is trade defence instruments (TDI), which depend on non-preferential rules for anti-dumping and anti-subsidy duties. TDI investigations would be more precise if there were a way to include services in the rules of origin.

The fact is that the relevance of the current rules of origin is losing ground as ‘servicification’ is speeding up. Today, many goods are just as much a service as a traditional good (in terms of value added). Rules of origin in modern trade agreements should reflect this.

**Recommendations**

- Start analysing how rules of origin can better incorporate ‘mode 5’ services; can a “significant value addition” or a special technical requirement for services, such as software, be a way forward?
- First, focus efforts on reforming the rules of origin on those sectors with a high degree of ‘servicification’
- Track developments in new and modern FTAs; do they contain ‘mode 5’-friendly rules of origin, and how are the rules working?
- Further investigate the potential positive and negatives of rules of origin for services.



# 4 Rules of origin and digitalisation

- 3D printing
- Blockchain
- Digital proof of origin



Production and trade are going digital. Without data transfers, nothing in a modern economy can be made or traded. Some companies have opted to leave the physical market altogether and instead operate entirely online in a digital value chain. With data flows becoming an integral part of trade and production, any disruption to international data transfers effectively acts as a barrier to trade.

## Facts

### Digitalisation<sup>12</sup>

The term 'digitalisation' refers to how information becomes digital and how people increasingly have access to computers and the internet. This trend has been rapid and has effectively reshaped the international economic climate.

'Digitalisation' has allowed companies to split their production networks into smaller parts and disperse them globally. For example, having a wide array of internet services allows us not only to communicate easily with all parts of the world but also to make purchases via secure payments.

As development has accelerated, the world has become smaller. A small firm can now access global markets via a digital marketplace, which was much more difficult before 'digitalisation'.

However, the effects of 'digitalisation' have yet to reshape the rules of origin. For example, how do you determine origin for a 100 per cent digital product? A digital product is categorised as a service, and as established in the previous chapter, there are no rules of origin for services.

## 4.1 Rules of origin for digital goods?

But what would happen if there are suddenly tariffs on digital trade? For example, what if you are forced to pay duties when buying music or a computer game online? There is currently a temporary agreement in the WTO to avoid tariffs on these types of products.<sup>13</sup> However, some countries are critical of this agreement and want to take a different path.<sup>14</sup> Could this potentially lead to a situation in which there are tariffs for digital products? And possibly also a need to determine origin? Let us hope not. The 12th WTO ministerial conference was postponed due to the corona pandemic but the agreement is still in force. Hopefully, the temporary agreement can be made permanent in the future. "Steps are also being taken in several FTAs to permanently exclude tariffs on digital goods.

Even if we do not have tariffs on digital goods, there are still situations in which there could be a need to establish origin on a digital good. If a country wants to block or hamper trade in digital goods from a certain country, there would have to be a way to determine origin. One such poten-

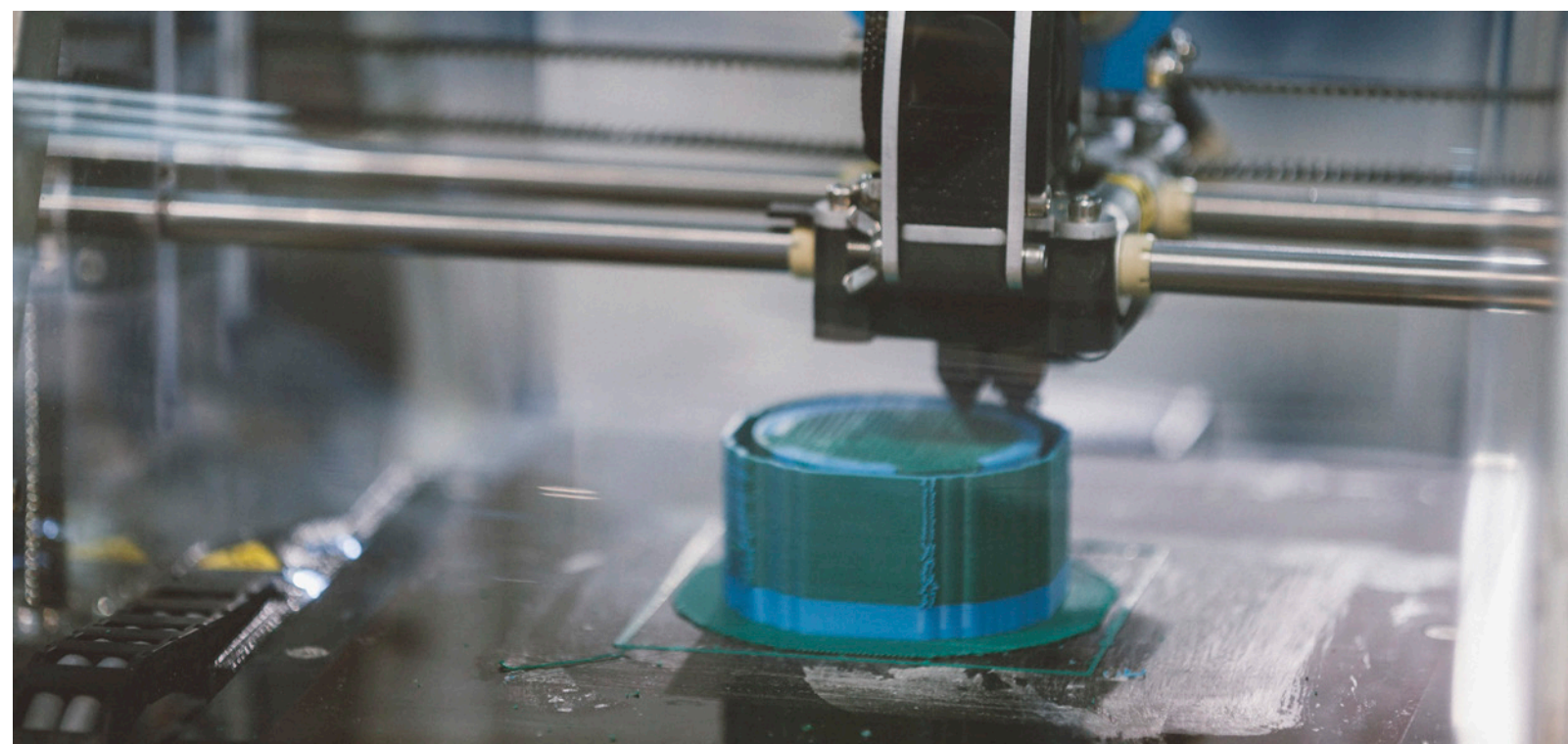
tial situation is the US executive order on information and communications technology and service supply chains<sup>15</sup> from foreign adversaries.

## 4.2 3D printing

Many products today often fall somewhere between a good and a service. 'Digitalisation' has accelerated this development; potentially, it will even turn it upside-down. Take 3D printing as an example. The technique prints a physical product from a suitable material using a digital blueprint. The majority of the products value is in the blueprint instead of the physical materials. The blueprint is the part that is traded, while the actual

good is just printed without at any point crossing a border.

The National Board of Trade Sweden laid out some of the regulatory challenges regarding 3D printing in the 2016 study *Trade Regulation in a 3D-printed World – a primer*, including how the technology can affect rules of origin. The study established that 3D printing would significantly alter the traditional production chain and, consequently, where the significant transformation of a product takes place. This would challenge the current rules of origin methods but not break them. Therefore, a large-scale use of 3D printing would require tweaks to the current methods rather than an entirely new way of establishing origin.<sup>16</sup>





### 4.3 Blockchain

‘Digitalisation’ does not only bring new challenges to the established trading system and the rules of origin. It also brings opportunities. For origin, the most promising development comes in the form of blockchain.

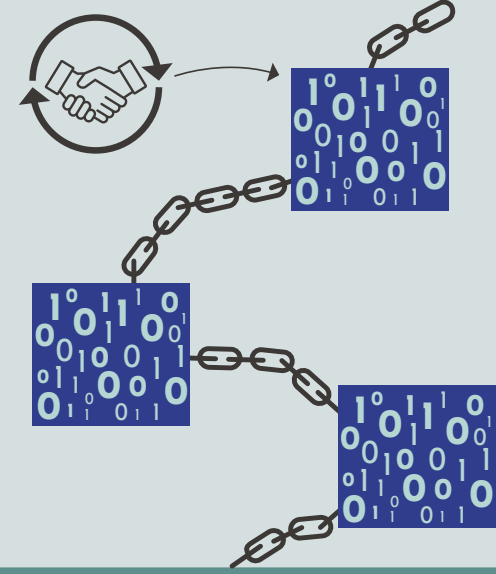
#### Facts

##### Blockchain<sup>17</sup>

What is blockchain? The simple answer is that blockchain is a kind of *distributed ledger*. Yet this definition probably raises even more questions.

Perhaps then, it is better to start with what blockchain can do. Blockchain effectively guarantees trust between trading partners. Lack of trust in a business transaction is a risk and therefore a cost. When a transaction is made, the details of it are recorded in a block of data. This data is then inserted into a chain of other data blocks. The blockchain of data belongs to a network that verifies every new transaction. Only a majority of the network’s members can agree to changes in the blockchain, which guarantees the transaction and making it trustworthy. For this reason, the technique has worked well for the digital currency Bitcoin.

A second benefit of establishing a blockchain of transactions is traceability. The chain is in itself storage for all the old transactions in the chain. In other words, it is possible to go back along the blockchain to verify old transactions, which, in the world of rules of origin, is significant.



The largest hurdle that companies’ face with rules of origin is rarely the actual origin criteria; it is often the administration surrounding them.<sup>18</sup> Without a proof of origin, it is not possible to claim preferential tariffs. The proof itself can take on several forms, which all have varying degrees of administration costs related to them. According to a recent survey by the European Commission, the process surrounding suppliers’ declarations is perceived as especially burdensome by European companies. Suppliers can face difficulties in understanding the rules of origin and therefore correctly completing the declaration. This can result in a lack of trust in the declaration from the exporters perspective, which in turn creates a risk. At the other end, the importer potentially faces a penalty if a preferential tariff is claimed for a good without origin. Is the lower FTA tariff worth the risk? Many firms do not think so and choose to pay a higher duty instead.<sup>19</sup>

#### 4.3.1 Traceability and digital certificates of origin

It is in this area that blockchain can make a difference. The risks and costs surrounding a supplier’s declaration boil down to traceability, a feature that is increasingly difficult to find in an economy defined by international production networks. However, with blockchain, every transaction can be traced and guaranteed. With guaranteed traceability the risk and cost of proving origin will decrease.

This approach sounds very promising, but is it feasible? In theory – yes. But does it work in the real world? In fact, a digital certificate of origin based on blockchain has already been issued by the Business West Chambers of Commerce in England<sup>20</sup>. Chambers of Commerce in Singapore<sup>21</sup> and Kenya<sup>22</sup> have also moved forward with similar projects.

Countries such as Israel, Norway, Switzerland and Turkey are also working on different ways to issue electronic certificates. The respective projects include printing certificates that are filled in, signed and stamped online or having a barcode that gives access to a digital version of the certificate.

A digital proof of origin is in itself a step forward in the era of ‘digitalisation’. Coupled with blockchain technology, this approach has the possibility to transform the way we prove origin.



### 4.4 To sum things up...

Moving to a more digital way of producing and doing businesses will raise many new questions regarding the current system of rules of origin, take 3D printing and its potential to completely transform production methods for example. However, ‘digitalisation’ potentially also offers a few answers. The blockchain technique is far from developed, and it could turn out to be nothing more than a faint hope. Nevertheless, its promise is hard to deny.

As new techniques and innovations continue to develop, it is important that the rules of origin legislation adapt. The concept of digital certificates of origin is one example. New and modern trade agreements should allow for this approach or at least include an enabling clause to keep the door open for it in the future.

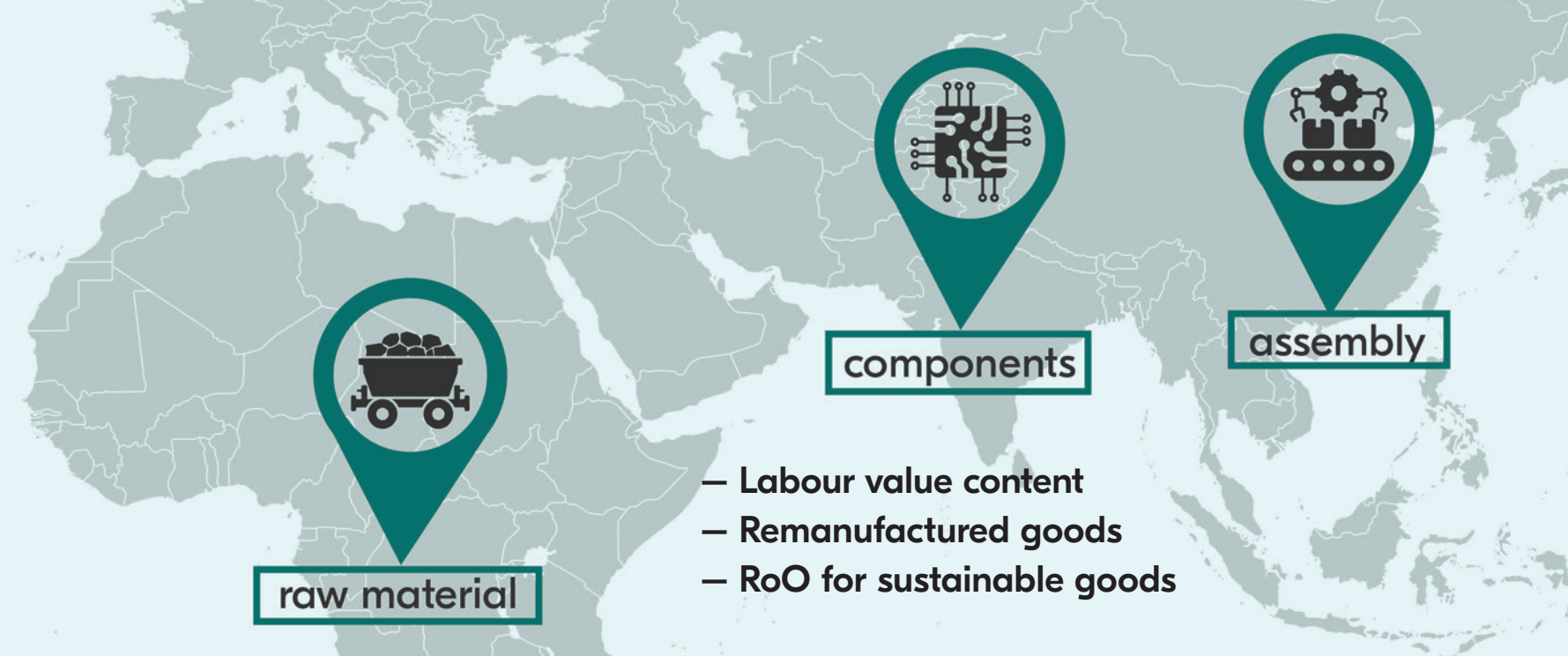
#### Recommendations

- Start looking at ways to allow electronic certificates of origin in modern trade agreements.
- Continue to explore how blockchain can be used in a rules of origin context, potentially as a basis for origin certificates.
- Further explore and analyse the potential effects of 3D printing on production and trade from the viewpoint of rules of origin.



# 5

## Rules of origin and sustainable development



'Servicification' and 'digitalisation' have revolutionised how we produce and trade goods. Parallel to these processes, sustainable development is changing how we view trade. Previous chapters focused on how rules of origin can adapt to changing conditions in world trade. This chapter will cover this aspect through the lens of sustainable development.

Economic growth, increased output and higher volumes were the only parameters that we used to measure the success of trade. But not anymore.

### Facts

#### Sustainability and trade in three dimensions

**Economic:** how trade generates economic wealth and how it is distributed among stakeholders, including areas such as technological advancements, corruption and competitiveness.<sup>23</sup>

**Environmental:** addresses the effects of trade and production on the environment, both in negative and positive terms. It can cover how increased production and trade can harm the environment, but also how trade can make environmentally friendly technology more available for example.<sup>24</sup>

**Social:** includes human rights, working conditions and gender equality, for example, and is often intertwined with economic sustainability in such areas as poverty reduction and labour market issues.<sup>25</sup>

We are now also talking about how trade impacts jobs, the environment, economic opportunities and gender equality. The fact that trade is now considered a tool to reach the goals in Agenda 2030 is proof of this change.<sup>26</sup>

### 5.1 The economic and social dimensions

The most obvious connection between rules of origin and economic sustainability is through access to trade agreements. Better market access promotes economic opportunity and, in the long run, economic development. A good example of this fact is the Everything But Arms (EBA) agreement which gives tariff-free-quota-free access to the EU market at very generous rules of origin-terms. The EBA agreement is only for the least developed countries (LDC). Lowering the origin criteria for LDCs is a way to help firms from these countries export to the EU. This approach is in itself not enough to generate a sustained positive economic development; many other factors matter. Nevertheless, the EBA example highlights how rules of origin can play a part.

#### 5.1.1 The EU-Jordan Compact

Looking at social sustainability, there is a recent initiative that shows how rules of origin can be a useful tool – the EU-Jordan Compact.

### Example

#### EU-Jordan Compact

The purpose of the agreement is to better the conditions for the large number of Syrian refugees currently living in Jordan. To promote investment, jobs and economic opportunity, the rules of origin in the EU-Jordan Association Agreement have been significantly relaxed for producers that employ a substantial number of Syrian refugees (15 per cent rising to 25 per cent). The producers also have to be located in one of the specific economic zones in Jordan.

Jordan committed to simplifying the process of obtaining work permits for Syrian refugees<sup>27</sup>. The target was set at 200,000 new permits by 2026.

So far, the initiative has not lived up to expectations, and therefore, the conditions of the agreement have been further relaxed. It remains to be seen whether the initiative can have a significant effect, but it is still an interesting example of how trade policy (and rules of origin specifically) can have an expanded purpose.

#### 5.1.2 The Labour Value Content

The newly introduced Labour Value Content (LVC) in the USMCA also deserves mentioning. The LVC rule says that a certain portion of a vehicle must be produced by a worker earning at least 16 US dollar per hour. This amount is approximately twice what a Mexican worker earns today.<sup>28</sup> From a social sustainability point of view, the rule could be very positive for Mexican workers. The LVC could force car manufacturers to double their pay to use the USMCA. However, there are no guarantees. A manufacturer can instead choose not to use the USMCA (and export at a higher tariff rate) and pay the same salary as before. Not using the USMCA will lead to more expensive exports (due to the higher tariff rate) and probably a loss of competitiveness, which will in turn have a negative impact on jobs and economic opportunity. The effects of the LVC rule are, in other words, difficult to predict.

In light of the overall discussion about jobs, factories and the localisation of production in the USCMA, it is difficult to view the LVC rule as a pure social sustainability provision. Nevertheless, the rule is still an interesting example of how to connect rules of origin and social sustainability.

## 5.2 The environmental dimension

The connection between environmental sustainability and rules of origin is not obvious. Trade agreements with rules of origin provisions that strengthen environmental sustainability are rare. Time for policymakers to get creative.

### 5.2.1 Remanufactured goods

One way to decrease the negative environmental effects of production is to recover materials to a higher degree. These recovered materials can then be used to remanufacture goods. Such a process is a move towards a more circular economy.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) led the way in this area with an article that allows recovered materials to count as originating from a country if they are incorporated into a remanufactured good<sup>29</sup>. The same provision is also in the USMCA.<sup>30</sup> This approach creates opportunity for more remanufactured goods to obtain origin.

Hopefully more FTAs can follow the CPTPP and USMCA and establish similar provisions for remanufactured goods. But why stop there? A recovered material is not the same as a recycled material. Recycling means collecting and processing waste into a new material.<sup>31</sup>

To make an even greater environmental impact, rules of origin could consider certain recycled materials as originating from a country. This idea has recently started to appear in the literature.<sup>32</sup>

### Facts

#### Remanufacturing

“Returning a product to at least its original performance with a warranty that is equivalent or better than that of the newly manufactured product.”

This is the definition of remanufacturing according to the European Remanufacturing Network (ERN). The practice is most common in the aerospace, automotive, heavy duty and off-road equipment, electronic equipment, machinery, furniture and marine industries. Remanufacturing activities employ approximately 190,000 people in the EU.<sup>33</sup>

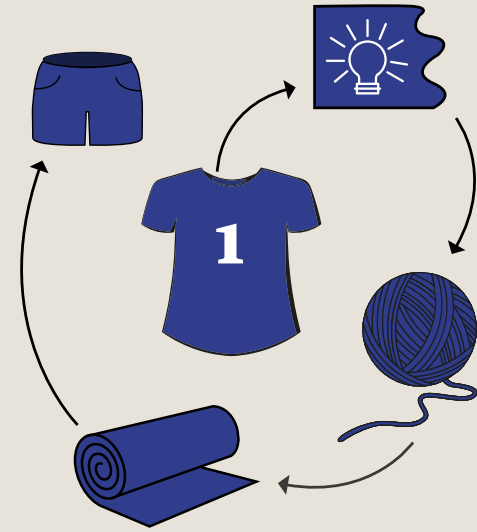
## 5.3 How can rules of origin promote sustainability?

### Example

#### Old clothes into new fabric

Recycling old products to create materials is often easier said than done. Take the textile industry as an example. Second-hand clothes are one way to promote better sustainability in the industry. Collecting old clothes to remake them into new ones is another option. Now there is a third option.

Re:newcell is a Swedish company that has managed to create a new material from old clothes that can be spun into yarn and later made into fabric and new clothes. The technique was first created at the Royal Institute of Technology in Stockholm.<sup>34</sup> In this way, a garment can get new life after it has been worn out, creating a circle from production to consumption to the production of a new product.



The example shows how a recycling process can look and how new technology play a major role in finding more sustainable production methods. Rules of origin could act as a carrot, encouraging these types of sustainable materials. The most common origin rule for textiles is double transformation – requiring two steps of transformation in the same country to achieve origin. One way to encourage the producer to choose

environmentally sustainable materials, such as recycled fabrics or organically grown cotton, would be to offer a less strict origin rule – a single transformation rule for example – on condition that sustainable materials are used..

Environmental goods<sup>35</sup> are another area that may be considered through the same line of reasoning. At a 2016 OECD workshop on how to optimise global value chains for environmental goods and services, rules of origin were mentioned as one of the main obstacles to value chain participation.<sup>36</sup> One way to facilitate the trade in environmental goods could be via specific rules of origin criteria for these types of goods.

This thinking can be extended to other products and areas of sustainability. Take gender equality for example; could rules of origin be more lenient if the producer is a company owned or led by women? Or where an overwhelming part of the workforce are women? Measures do not have to be permanent either; rules of origin can offer temporary relief for a limited time. Rules of origin are used as a trade policy tool all the time, so why not use them to promote sustainability.

There are numerous ways to use rules of origin. The suggestions above mainly have a product-specific focus. There are other options available though. One example is a sustainable tolerance rule<sup>37</sup> where a set percentage of a good can be non-originating if the inputs are certifiably “sustainable”. Another idea could be a kind of sustainable extended cumulation<sup>38</sup>; if specific inputs can be verified as “sustainable”, they can be sourced from countries outside the FTA. Both of these ideas open up the possibility for non-originating materials to be considered originating if they can be verified as sustainable. This approach, in turn, gives producers more options to choose from when sourcing materials.

A ‘sustainable’ input in this context can be an input that has an internationally accepted standard or an eco-label. One issue here would be the verification of the labelling, something which blockchain could help with. The technology has been tested as a method to guarantee sustainability claims, for example, in the tuna fishing industry, where the results have been encouraging.<sup>39</sup>

## 5.4 To sum things up...

Sustainable development has now firmly taken its place at the trade policy table. What we have yet to see is this fact translating into specific measures in individual trade policy areas, such as rules of origin.

Sustainable development in rules of origin are mostly uncharted waters, but there is little reason not to start considering what the two policy areas can gain from a closer relation. Across all dimensions of ‘sustainability’ – economic, social and environmental – rules of origin can have an impact. Some of the ideas presented here are new and very much untested. Others fit within the current tried and tested methods, such as tolerance rules or cumulation. Most of these rules are incentives to change behaviour – carrots rather than sticks – to encourage a more sustainable production and consumption of goods.

Rules of origin on their own will not make production and trade more sustainable. Other policy areas need to follow suit. Rules and regulations need to complement each other for meaningful change to take place.

### Recommendations

- Take inspiration from the CPTPP and USMCA regarding provisions for remanufactured goods in EU agreements.
- Further analyse how rules of origin can be used as incentives to increase the use of recycled and other ‘sustainable’ goods and materials.
- Continue to follow up the results of the EU-Jordan Compact and see if the initiative can be used in other similar situations.



# 6

## Accessible rules of origin

- Harmonisation
- RoO waiver
- RoO for SMEs



The previous chapters have discussed the need for rules of origin to evolve to reflect the changing conditions in the 21st century. In this chapter, the focus will shift slightly from how to design future rules of origin to what we can do to improve the functionality of the current rules. The fact is that many FTAs today are not fully utilised. Much economic potential therefore remains unfulfilled,<sup>40</sup> in part due to rules of origin.

Rules of origin can be a problem for all companies regardless of size. It does not matter if you are a global producer that exports to different markets or a small-scale business selling to a neighbouring country, rules of origin present the same type of challenge: the need for substantial transformation and proof of origin.

That said, depending on the size of the company and the product it exports, rules of origin pose different kinds of problems with different ways to tackle them. First, any producer must keep track of the origin of all its materials. This becomes harder with larger numbers of inputs and countries involved. Additionally, keep in mind that rules of origin differ across FTAs.

Many large firms have separate departments that keep track of everything and perhaps even a specific software to manage the price and origin of materials. A luxury small and medium-sized enterprise (SME) often cannot afford. On the other hand, an SME probably exports to fewer markets and has a smaller range of products that contain less imported materials.

### 6.1 3 ways to improve access

All trading firms, regardless of size, want a harmonised and predictable regulatory environment. However, the very nature of a trade negotiation makes this an almost impossible target to reach. Every negotiation is unique and therefore churns out different rules of origin every time.

#### 6.1.1 Harmonisation

Nevertheless, there are ways to achieve some level of harmonisation among rules of origin. Mega-regional trade agreements, for example the CPTPP, connect several countries to the same set of rules. Instead of all the members having bilateral FTAs, they now have one agreement with the same rules of origin.

#### Facts

##### Pan-Euro-Med (PEM)

The PEM system connects the EU, the EFTA, Turkey, the countries of the Barcelona Declaration, the Western Balkans and the Faroe Islands to a single origin protocol, called the PEM convention. All the individual FTAs between these parties create a link in their respective agreements to the convention. This approach makes diagonal cumulation possible; meaning that materials from other PEM parties are all considered as originating.<sup>41</sup>

The convention is currently being modernised to update the rules of origin. The work is expected to be finished in 2019.

Another option is the PEM model in which individual FTAs are all linked to the same rules of origin protocol. This model not only creates a level of harmonisation but also a common input pool to source from (via diagonal cumulation). In substance, the rules of origin in the CPTPP and PEM are very complicated, a result of the large number of interests involved in the negotiations. However, the two agreements can still serve as models for increased harmonisation due to the number of countries involved.

Would it not be better to harmonise rules of origin on a multilateral level? Undoubtedly, it would be the optimal solution. There are ongoing efforts to harmonise non-preferential rules of origin in the WTO, but the process is at a standstill. Currently, there is nothing indicating that the situation will change in the near future. Therefore, there needs to be other ways forward. One idea that has surfaced is to try a plurilateral alternative.<sup>42</sup> Plurilateral alternatives seems to be in fashion currently at the WTO, largely due to the inability of all members to come to an agreement.

Another option could be to move away from substance and instead focus on appearance. One aspect of rules of origin that can be confusing for business and customs authorities alike is how they are written. The exact same rules of origin (in substance) in two separate agreements can be worded in two different ways. What if the language of rules of origin can be harmonised? Having a common way to draft rules of origin would make life easier for those trying to utilise and implement them. This type of initiative could be proposed at the multilateral level.

Continuing on the same theme it could be useful to explore the harmonisation of language and the appearance of proofs of origin, possibly at the multilateral level. A standard template for origin certificates or a standard phrase for origin declarations would increase predictability for all stakeholders.

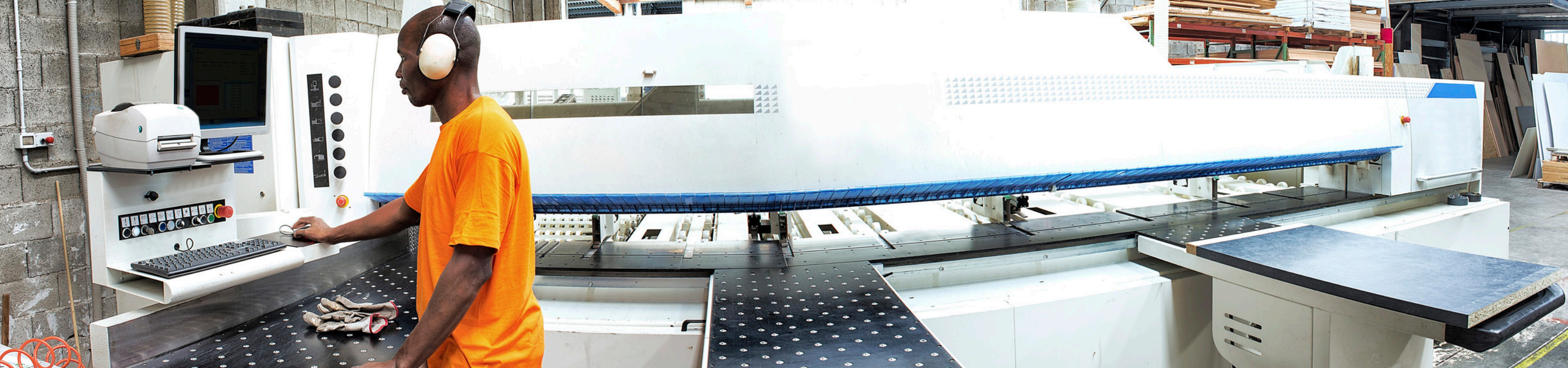
Finally, a recent initiative by Switzerland has been proposed to the Committee on Rules of Origin at the WTO. The initiative calls for increased transparency regarding the non-preferential rules of origin. Countries today are free to set their own non-preferential rules of origin.<sup>43</sup> The aim of the initiative is to improve notification procedures on non-preferential rules of origin and have countries establish an enquiry point to answer questions.

#### 6.1.2 Better information

Better information is a key antidote to the ever-increasing complexity of rules of origin. It has traditionally proven difficult to collect and present information on rules of origin across different trade agreements in the same place. However, there are encouraging signs that this difficulty is about to change, for example, through the Rules of Origin Facilitator<sup>44</sup>. The webpage is a project managed by the International Trade Centre (ITC) with the help of the World Customs Organization (WCO).

In 2018, the EU Commission launched a survey of the rules of origin along with a test version of an online tool designed to help firms obtain origin.<sup>45</sup> If designed correctly, an online tool to





help calculate origin could be of great help, especially to SMEs.

### 6.1.3 A rules of origin waiver

Is it worth the trouble? That is the big question that many companies face when encountering rules of origin. Do the duty savings from using an FTA cover the cost of obtaining and proving origin? For the answer to be ‘yes’, the duty savings have to outweigh the costs. This depends in part on the tariff rate. There must be a significant difference between the normal tariff rate and the lower FTA rate. The other variable is the trade volume. A low volume together with a low tariff difference will not lead to significant duty savings.

One possible option to lower the costs is a rules of origin waiver. A waiver could be used for goods where the tariff difference between the two FTA parties is small, maybe 1–2 per cent, and where the goods have undergone their last step of transformation within the FTA (like the current EU non-preferential rules of origin). If there is only a small difference between the two parties’ tariffs, there is a lower risk of transshipment<sup>46</sup> (since the extra cost of transshipment from third countries is not covered by the tariff difference).<sup>47</sup> This approach would create a semi-customs union type of situation. One of the prime purposes of rules of origin is to prevent transshipment, so if there is a lower risk of this happening, there is also less need for rules of origin.

## 6.2 SME-friendly rules of origin

It is not unusual to hear that “SMEs are the backbone of the economy”. Which is true. In the EU, 99 per cent of all businesses are SMEs. SMEs create the majority of all new jobs in the union and are vital to economic development in Europe.<sup>48</sup> Not all SMEs export though, far from it. Approximately 25 per cent of SMEs export to the EU, but only a small fraction export to outside countries.<sup>49</sup>

Rules of origin are not an issue for all SMEs that trade internationally. Recent data, for example, suggest that SMEs utilise the EU-Korea FTA to a very high degree.<sup>50</sup> For others, rules of origin can be a major barrier. Regardless, rules of origin lead to increased trade costs. It is also a fact that SMEs have less capacity to effectively manage all the different aspects of rules of origin. This lower capacity makes it harder for SMEs to use an FTA,

### Facts

#### Small and medium-sized enterprises (SME)

The definition of an SME depends on two factors: the number of employees and the balance sheet total. The factors count for each individual company. If a firm is part of a larger group, the number of employees and the balance sheet total for the whole group is considered.

The EU definition of SME sets a limit for a medium-sized company at fewer than 250 employees and a maximum of 50 million euro turnover (43 million euro balance sheet total). A small business has fewer than 50 employees and a max of 10 million euro turnover.<sup>51</sup>

potentially even shutting them out of the market. With SMEs being such an integral part of the economy, there is much to gain if they can obtain better access to foreign markets.

One potential way to achieve better market access can be via specific rules of origin for SMEs, in the same way that LDCs have special rules in the EU Generalised Scheme of Preferences (GSP) for example. For instance, if a firm can show that it is an SME, it can apply a more lenient origin criterion that offers broader sourcing options for materials.

Another option to look at is raising the limit for when a company can use an invoice declaration without being a registered exporter in the EU. This limit is currently set at 6 000 euro per consignment.<sup>52</sup> The rule is presumably aimed at SMEs with the purpose to decrease the administration in cases where the value of the shipment is low. Significantly raising the limit from 6 000 euro would make it easier for many companies to start trading. The goods still have to meet the rules of origin and can be subject to verification.

## 6.3 To sum things up...

As discussed here, there are many ways to help companies improve their ability to comply with rules of origin. Some initiatives are ongoing, others more of a longshot.

It is important to keep in mind that negotiating an FTA is only half of the job. If economic operators do not use the agreement or the local authorities have difficulties implementing it, it is a loss of economic potential. Successful implementa-

tion depends on the contents of the agreement, but also on measures and infrastructure to make the contents accessible to all stakeholders.

Recent studies show that trade agreements are being used to a high degree. To not only maintain a high degree of utilisation but also improve it, more resources must be set aside for implementation. Rules of origin need to feel like less of a barrier to those firms that are starting to trade. A helping hand can be offered in the shape of more harmonised rules, both with regard to language and substance, or better information. For those firms with the least resources, maybe more generous rules of origin can give them a push to enter the international market.

### Recommendations

- Continue initiatives to provide better information on rules of origin, such as the development of online tools and databases.
- Consider specific SME-friendly rules of origin in FTAs.
- Keep pushing for initiatives on a multi-lateral level, including better notifications, transparency, and more ambitious projects on common language and standardised templates.
- Continue to work towards lower tariffs on a multilateral level and consider if and how a rules of origin waiver could work.



# 7

## Concluding remarks



Trade and production have changed fundamentally in recent decades. Policy and legislation lag behind, playing catch-up with changing conditions. The purpose of this report is to present a smorgasbord of different ways that rules of origin can adapt to a new reality shaped by ‘servicification’, ‘digitalisation’, sustainable development and the ever-growing spaghetti bowl of FTAs. Hopefully, the ideas presented here create an appetite for further research and analysis.

It is clear that we cannot view these 21st century developments in isolation. These developments affect each other, interact and sometimes inter-depend, as do some of the proposals in this report. Take blockchain as an example. Born out of technology advancements and overall digitalisation, blockchain has the potential to revolutionise how we trace materials and transactions, with large potential ramifications for rules of origin and stakeholders. However, blockchain could also be a catalyst. If we can trace sustainable products with greater certainty, would it be more feasible to design origin provisions that promote sustainable trade? Probably.

Rules of origin do not have to be reinvented to better fit production and trade in the 21st century. An update is enough in many cases. We can use the structures, methods and concepts within rules of origin today to tackle future challenges. For example, consider the special provisions for in place LDCs; the same concept can be applied to SMEs. Another option is the cumulation and tolerance rules that are in all rules of origin pro-

ocols today; why not add a sustainability dimension to these two horizontal provisions?

Still there are challenges that are difficult to take on with only a tweak of the current rules of origin system. The increasing ‘servicification’ for example. In order for the rules of origin to reflect modern production methods services needs to be taken into account to a greater degree than today.

Where should these changes be made? Many changes have to take place within the framework of preferential trade agreements. Modern FTAs contain chapters on services, e-commerce and sustainable development to reflect the current conditions of international trade. However, these chapters are negotiated as stand-alone chapters. The negotiations on rules of origin are always connected to discussions on market access, but never to other policy areas. Services, digitalisation and sustainability should be reflected in the rules of origin in the same way they are integrated into trade and production today.

While much can be achieved in a preferential context, the biggest potential still lies in multi-lateral cooperation. Initiatives on better information, transparency and harmonisation could lead to significant improvements in quality of life for companies and customs authorities when dealing with rules of origin. The rules of origin would still be there though, costing time and money. To get in front of the problem, there is only one solution to the problem: zero tariffs. If the WTO could manage to negotiate tariffs down to zero, rules of origin would become irrelevant.

Lastly, a word on the current COVID19-pandemic. As mentioned in the introduction this report was written well before the outbreak. The need for rules of origin to be in line with the current conditions run through this report like a mantra. The extreme effects of the pandemic on production and trade require creative and fast-footed trade policy responses. Rules of origin can contribute here. Perhaps through more generous sourcing options for producers of protective equipment, medical devices or medicine. Another option could be relaxed requirements regarding proofs of origin. Measures can be temporary or permanent, restricted via quotas or entirely unlimited. There are many options to consider.

### Further research

The reasoning in this report can be taken one step further. Both ‘servicification’ and ‘digitalisation’ are two important drivers of what can be described as the Fourth Industrial Revolution. Exactly what the revolution will entail is hard to pin down, but it will likely include re-shoring or changing the locations of production, greater customisation of products and the increasing importance of software in production and trade.

Many envisage that the Fourth Industrial Revolution will turn production, trade and communication on their heads and fundamentally change the current conditions. ‘Servicification’ and ‘digitalisation’ have been discussed here but mainly from the perspective of the changes that

these two processes bring to production and trade today. To truly stay ahead, we need to take one step further and look at future changes. What will these changes mean for the current rules that govern international trade? Will the laws and regulations of today still be relevant tomorrow, including the rules of origin?

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45. European Commission (2018), *Results of the Survey on Rules of Origin*.
46. One of the main purposes of rules of origin is to prevent transshipment/free-riding. Without rules of origin, a country outside of the FTA could transport its goods via an FTA to gain access to a market at a lower tariff rate.
47. Productivity Commission (2004), p.27
48. European Commission, *Entrepreneurship and Small and medium-sized enterprises (SMEs)*
49. European Commission, SMEs' access to markets.
50. Forthcoming Kommerskollegium study
51. European Commission. What is an SME?
52. European Commission (2019), *Preferential Rules of Origin*.

## Svensk sammanfattning

### Swedish summary

Globaliseringen i det 21:a århundradet har haft stora effekter på tillverkning och handel. Material köps numera in från hela världen och tillverkningen är ofta uppdelad i internationella nätverk spridda över både länder och kontinenter. Nästa steg i utvecklingen – ofta kallad den fjärde industrirevolutionen – kommer att förändra villkoren återigen, ny teknik kommer att omforma både affärsmodeller och handelsflöden. I tandem med dessa förändringar kommer kraven på en hållbar utveckling att bli både starkare och mer brådskande.

Denna utveckling utmanar även vårt handelsregelverk. För att reglerna fortfarande ska vara användbara, behöver de utvecklas. Ursprungsregler används mer än någonsin idag, inte minst på grund av det växande antalet frihandelsavtal världen över. Men förändrade handelsvillkor utmanar ursprungsreglernas funktion. Exempelvis innehåller varor idag en högre andel tjänster än förut, inte sällan digitala, vilka är betydligt svårare att spåra. Spårbarhet är i sin tur centralt för att kunna bestämma en varas ursprung.

Den här studien presenterar tankar och idéer om hur ursprungsreglerna kan moderniseras för att möta de förändrade villkor som tillverkning och handel står inför. Syftet är tudelat; för det första är det viktigt att ursprungsreglerna matchar dagens villkor för att näringslivet ska kunna använda internationella handelsavtal. För det andra kan ursprungsregler vara en del av en framtidsblickande handelspolitik som underlättar för teknologiska framsteg och hållbar utveckling i alla dess tre dimensioner.

Diskussionerna i studien vilar på fyra ben: i) tjänster, ii), digitalisering, iii) hållbar utveckling

och iv) användarvänlighet. Utvecklingen inom dessa respektive ben påverkar hur vi betraktar och etablerar ursprung men även vilken roll och funktion som ursprungsreglerna spelar.

Genomgående i studien presenteras olika tankar och idéer kring hur ursprungsreglerna kan anpassas, utvecklas och understödja utvecklingen inom de fyra benen. Men diskussionen är inte avgränsad till varje enskilt ben. Det finns flera exempel där idéer korsar gränserna. Ett exempel är diskussionen om blockchain, en teknik som potentiellt erbjuder väsentligt förbättrad spårbarhet genom en tillverkningskedja, något som i sin tur kan användas för att främja användningen av hållbara material och varor.

Även om det finns ett behov för ursprungsreglerna att anpassas och utvecklas, betyder inte det att nuvarande metoder helt behöver överges. Tvärtom. På flera sätt är det mer effektivt att använda de koncept som olika intressenter redan är vana vid, med den skillnaden att innehållet stöps om för att tjäna ett specifikt syfte, exempelvis underlätta för små och medelstora företag att använda ett frihandelsavtal.

Ett av de huvudsakliga problemen med ursprungsregler är den stora variationen, länder föredrar olika metoder och tröskelvärden beroende på deras egna intressen. Ursprungsreglerna är dessutom svåra att tolka, ofta anses de vara icke-transparenta. Att hitta rätt information om ursprungsreglerna och fullt förstå dem är också ett problem för många företag som ska använda regelverket. Multilaterala initiativ som fokuserar på harmonisering och transparens kan här spela en nyckelroll för att förbättra användarvänligheten.

# Ursprungsregler

Att bestämma en varas ursprung

## Preferentiella ursprungsregler

- är nödvändiga i varje frihandelsavtal och samtidigt unika för varje enskilt avtal;
- gör det möjligt att urskilja varor som har rätt till nedsatt tull från alla andra varor som handlas.



FoU

råmaterial

komponenter

montering

mjukvara

## SÅ BESTÄMS EN VARAS URSPRUNG

### Helt framställd

- från ett land/en region

### Betydande bearbetning

- ett antal olika kriterier:

- värderregel (% av varans värde adderas i FTA)
- nummerväxlingsregel (material byter HS-kod under bearbetning)
- särskilt tekniskt bearbetningskrav (utgår från en specifik bearbetningsprocess)

## ATT BEVISA URSPRUNGET

Ett ursprungscertifikat eller en deklaration

## Allmänna ursprungsregler

- handelsstatistik
- "made in"-märkning
- anti-dumping, tullkvoter eller andra liknande policyinstrument



