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Addressing Origin Operational Challenges

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Think Piece



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Abbreviations and Acronyms

CETA	Comprehensive Economic and Trade Agreement
ERP	enterprise resource planning
EU	European Union
HS	Harmonized System
ISO	International Organization for Standardization
LDC	least-developed country
NAFTA	North American Free Trade Agreement
REX	Registered Exporter
RTA	regional trade agreement
SMEs	small and medium-sized enterprises
TPP	Trans-Pacific Partnership
WCO	World Customs Organization

| Abstract

This paper reviews reciprocal and unilateral preferential rules of origin, including the possibility of introducing expanded cumulation flexibilities to show why they are seemingly resistant to harmonisation and simplification efforts. It explains, from a practitioner's perspective, several of the main administrative and structural challenges faced by large and small producers, and in particular small and medium-sized enterprises, in both developing and developed economies. It then proposes some policy options and practical solutions to address these challenges.

1. Introduction

The proliferation of regional trade agreements (RTAs) and the strict, complex, and diverse rules of origin associated with them are both well studied and documented phenomena. The following paper will briefly review why both reciprocal and unilateral preferential rules of origin, including the possibility of introducing expanded cumulation flexibilities, are seemingly resistant to harmonisation and simplification efforts. The remainder of the paper will, from a practitioner's perspective, examine several of the main operational and origin knowledge challenges faced by all origin constituents in both developing and developed economies and propose some policy options and practical measures to face these challenges.

2. Origin Content

The form and content of any preferential rule of origin is determined by several factors, including the relative size and related negotiating strength of the parties to a particular RTA and the unique resource allocations and productive capabilities of each RTA partner. The limitless combination of these factors are the drivers behind rule of origin strictness and the complexity required to reflect countless resource and productive asymmetries between RTA partners. Consideration must also be given to the cultural dimension of origin content and origin administration, because different regions of the world come to RTA negotiations with distinct origin histories and heritages. These factors go a long way to explain why origin simplification and harmonisation have proven to be such difficult objectives to achieve.

Indeed, even in the so-called mega-regional and mega-bilateral agreements, it is not uncommon to see not so much anticipated elements of origin simplification and harmonisation, but rather the inclusion of multiple approaches to origin

determination. Outlined below are the regional value content provisions of the Canada-European Union (EU) Comprehensive Economic and Trade Agreement (CETA), which refers to both "transaction value" (a Canadian approach) and "ex-works price" (a more typical EU approach). The Trans-Pacific Partnership (TPP) provisions below introduce four different North American Free Trade Agreement (NAFTA) and post-NAFTA approaches to valuation.

2.1. CETA

"transaction value or ex-works price of the product means the price paid or payable to the producer of the product at the place where the last production was carried out, and must include the value of all materials. If there is no price paid or payable or if it does not include the value of all materials, the transaction value or ex-works price of the product:

1. must include the value of all materials and the cost of production employed in producing the product, calculated in accordance with generally accepted accounting principles; and

2. may include amounts for general expenses and profit to the producer that can be reasonably allocated to the product." (CETA)

2.2. TPP

"Article 3.5: Regional Value Content

1. Each Party shall provide that a regional value content requirement specified in this Chapter, including related Annexes, to determine whether a good is originating, is calculated as follows:

a) Focused Value Method: Based on the Value of Specified Non-Originating Materials

$$RVC = \text{Value of the Good} - FVNM \times 100 / \text{Value of the Good}$$

b) Build-down Method: Based on the Value of Non-Originating Materials

$RVC = \text{Value of the Good} - VNM \times 100 / \text{Value of the Good}$

c) Build-up Method: Based on the Value of Originating Materials

$RVC = VOM \times 100 / \text{Value of the Good}$

or

d) Net Cost Method (for Automotive Goods Only)

$RVC = NC - VNM \times 100 / NC$

where

- *RVC is the regional value content of a good, expressed as a percentage;*
- *VNM is the value of non-originating materials, including materials of undetermined origin, used in the production of the good;*
- *NC is the net cost of the good determined in accordance with Article 3.9 (Net Cost);*
- *FVNM is the value of non-originating materials, including materials of undetermined origin, specified in the applicable product-specific-rule (PSR) in Annex 3-D (Product-Specific Rules of Origin) and used in the production of the good. For greater certainty, non-originating materials that are not specified in the applicable PSR in Annex 3-D (Product-Specific Rules of Origin) are not taken into account for the purpose of determining FVNM; and*
- *VOM is the value of originating materials used in the production of the good in the territory of one or more of the Parties.” (TPP)*

Having regional value content choices is not necessarily a bad thing. Indeed, having choices is usually considered a good thing, but choices do not achieve simplification or harmonisation. Furthermore, although expanded cumulation has clear benefits, it is not clear that it is sufficient in and of itself to overcome the absence of origin harmonisation and simplification. This is especially true for least-developed countries (LDCs) and developing economies where resource diversity and trade intensity can be relatively rare, and as a result, there are limited inputs available from regional sources to take advantage of the benefits of expanded cumulation. In this developing country and LDC

context, what is required are simple, open, and non-restrictive rules of origin that allow global access to all competitive inputs and only require value-adding activities that are in line with current global value chains and the “trade in tasks” phenomena. However, even though reasonable and appropriate unilateral rules of origin could increase effective market access from a tariff perspective, they do not fully address other origin challenges, such as inadequate implementation support for origin or the vagaries of self-certification. These challenges are faced by both large and small producers in both developing and developed economies with the critical difference that small and medium-sized enterprises (SMEs) are much more sensitive to the fixed costs of origin management. The following sections of this paper will review some of these challenges and possible ways to address them.

3. Self-Certification

World Customs Organization (WCO) studies show the increasing trend toward various forms of self-certification of origin — approved exporter, importer certification, producer certification, exporter certification — versus certification by authorised entities. In fact, given the sheer volume in preferential trade, recent WCO Guidelines on Certification of Origin recommend self-certification:

“Guideline:

(FOSTERING THE USE OF SELF-CERTIFICATION OF ORIGIN)

4. Considering the increasing volume of preferential trade and recognizing the need for the facilitation of origin-related procedures, self-certification of origin by a producer, manufacturer, exporter and/or importer shall be utilized to the maximum extent possible while recognizing the specificities of domestic business environment.”

The TPP and the EU's Registered Exporter (REX) regime are examples of the trend toward self-certification: regimes designed to ensure strict importer accountability. This shift in origin procedures is presenting and will present serious challenges to all producers, large and small, that participate in RTAs that feature self-certification. The trend toward self-certification will see literally tens of thousands of exporters/producers having to determine and certify the origin of their products on their own without the support or analysis of certifying entities. Certifying entities usually perform some form of quality control on origin declarations in addition to providing technical feedback and origin training to domestic exporters and producers. Furthermore, trade law in nearly every country makes the importer of record responsible for all duty payments at the time of entry or subsequent reassessments for all customs-related obligations, including valuation, proper tariff classification under the Harmonized System (HS), and preferential origin. In light of this strict liability, importers are increasingly relying on private contract law to ensure that the suppliers, exporters, and producers provide them with properly completed and valid certificates of origin and are responsible for any subsequent duties and/or penalties should their certificate or declaration of origin be denied or successfully challenged. In other words, SME exporters and producers must be able to demonstrate to potential clients that they have the required origin literacy and skills to guarantee the originating status of their goods. Otherwise, potential purchasers will simply move to the next supplier or avoid preferences altogether.

The trend towards self-certification will require a variety of measures to support the effective participation of SMEs in preferential trade including:

THE HS – A CORE ORIGIN COMPETENCY

Although it is impossible to precisely identify the importance of proper classification of the HS in all preferential origin considerations, it is equally difficult to underestimate the role the HS plays in all matters related to preferential origin planning

and determinations. Increasingly, RTAs rely on tariff shift to define sufficient production or substantial transformation, which in turn requires the producer or exporter to accurately classify the finished product it intends to export and basically all the imported inputs used to make the finished product. Despite this crucial role in origin, HS confusion and ambiguity continue to plague the origin management process for nearly all origin stakeholders:

“Accurate product classification is one of the foundational components for moving product across borders. The survey revealed that 91 percent of respondents reported having a challenge with product classification. This is consistent across all industries and regions represented in the survey. An increasing trend in the area of classification is the use of shared service centres, or centres of excellence, that are able to support the classification of products across various countries. This model increases technical knowledge and efficiency while helping avoid duplication of efforts. Companies moving towards a centralized or regionalized structure often use automated tools to track, review, and document the classification workflow as well as centralized product databases and tools that facilitate the mapping of classifications across the harmonized tariff schedules of different countries.” (emphasis added: 2016 Global Trade Management Survey from Thomson Reuters and KPMG International).

In light of the above, significantly increased HS training for SMEs is critical as is additional research into existing “automated” HS tools, including those that use advanced artificial intelligence, not simple key word searches, to properly classify goods.¹

¹ See 3CE Technologies, 2017. Commodity Classification Begins Here. Accessed January 29, 2017. <http://www.3ce.com/> as one example.

ORIGIN “STANDARDS” + ORIGIN “INSURANCE”

Given the dramatic rise in the number of RTAs, it is not surprising that the private sector has begun to design and develop e-commerce and e-origin solutions. Naturally, many of these solutions are directed to the largest participants in RTAs and global value chains.² Although there is increasing interest in the SME e-origin market, most SME producers and exporters are left to their own devices when designing origin management systems. In these circumstances, it would be worthwhile to investigate whether the development of an International Organization for Standardization (ISO) origin data standard could be developed to support SME producers and exporters in their efforts to utilize RTAs. An ISO origin data standard could provide a voluntary standard or template that SMEs could adopt as opposed to designing one-off remedies. After all, the difficulties associated with product and data standards (certified once here – accepted everywhere) reflect the challenges associated with the importer liability for preferential information and certifications “originating” in another country. Alternatively, the WCO, in collaboration with the private sector, could develop some standardised origin management guidelines for SMEs. Such WCO standards could, in turn, become the basis of more detailed ISO standards if required. Another area of potential research could be to see if a SME producer or exporter that did follow the management procedures required by an ISO or WCO origin data standard could combine its preferential origin claim with a form of origin “insurance” to purchasers. Could RTA utilisation rates be increased if there are systems in place to encourage producer/exporter accountability and reduce importer liability?

² See Reuters, Thomson. nd. OneSource for Free Trade Agreements. Accessed January 29, 2017. <https://tax.thomsonreuters.com/onesource/global-trade-management/free-trade-agreement> as one example

COMPREHENSIVE SME SUPPORT

Notwithstanding web links that contain the complete text of RTAs and their related rules of origin (that can run hundreds of pages long), most developed and developing countries do not do a good job of providing meaningful, comprehensive, and understandable origin support to their SME producers and exporters. A clear exception is the various RTA support programmes offered by Korea to SMEs. These programmes are ideal candidates for additional “best practices” research or a related benchmarking exercise, so other countries could adapt them to their own unique needs (please refer to the Annex). What is particularly interesting about the Korean FTA-Pass system is that it links SMEs into the enterprise resource planning (ERP) style e-origin solutions for larger entities outlined above.

4. Inadequate Implementation + “Customs Sovereignty”

Despite the presence of numerous origin committees under the NAFTA and various RTAs, there is no real independent way to resolve origin disputes and asymmetries in most RTAs effectively.

RTAs do not generally feature any “meta-national” administration, tribunals, or regulations (other than vague undertakings to discuss and communicate issues when RTA origin administrations differ on the same set of facts). What these lacunae imply is that the authorities – usually the customs authorities – in the country of import can and do act independently from the customs in the country of export in a phenomenon that I call “customs sovereignty.” “Customs sovereignty” can result in the customs authorities in the same RTA classifying identical goods in different ways and/or deeming that operations that confer origin in the territory of one RTA partner do not confer origin in another. This

is a serious issue and usually comes up in any RTA compliance discussion with the private sector; thus, customs authorities effectively erode the economic integration and expansion that RTAs are designed to encourage. The objective here is not to “blame” customs authorities for this phenomenon, because they are often under explicit instructions to maximise revenue and pursue maximum enforcement goals. The objective is to encourage the inclusion of origin dispute and dissent remedies in RTAs that are not resolved by consensus alone or the relative power of one RTA partner over another. The following outlines a few suggestions and examples of regulatory mechanisms that blunt the full effect of “customs sovereignty.”

“UNIFORM REGULATIONS”

In an effort to encourage regulatory and administrative standardisation and convergence, the three NAFTA parties spent a year negotiating the NAFTA “Uniform Regulations,” which outline how specific treaty provisions are to be administered by all three parties in painstaking detail, with complete illustrative examples.³ In addition to supporting RTA uniformity in all three languages, the examples provided are very useful in explaining rules of origin to producers and exporters. Although these regulations are particularly focused on automotive issues, which might not necessarily be of interest to all origin parties, they do provide a general template for consideration by all existing and emerging RTA partners. Section 15 of the NAFTA Rules of Origin Regulations (Inability to Supply Sufficient Information) are of particular interest. In very general terms, what Section 15 states is that if an origin determination/certification made by a producer is confirmed by an independent auditor, this confirmation must be taken into consideration by the customs authorities while

performing a verification of that origin claim under certain specialised conditions (the verification process cannot be completed because of situations beyond the producer’s or exporter’s control, such as supplier bankruptcy or accidental destruction of records). What is interesting about Section 15 is that it recognises the benefit of having origin declarations confirmed at or around the time of origin determination by the producer or exporter. In light of the destabilising factors mentioned above that are introduced by the combination of self-certification and importer liability, origin confirmation could be a mechanism to facilitate and encourage RTA utilization – especially for SMEs. In this light, why restrict origin confirmation to independent auditors? Why not include other trusted third parties, such as licenced customs brokers, authorised chambers of commerce or lawyers from the trade bar? Why not include the implementation of standardised origin management procedures as established by the WCO and/or by ISO as a legitimate form of origin confirmation?

RELATED MECHANISMS – NAFTA ARTICLE 506

It is clear how the provisions below provide some level of protection to importers when customs authorities disagree on the origin of goods and how these provisions encourage the use of Advance Rulings opportunities:

“11. Each Party shall provide that where it determines that a certain good imported into its territory does not qualify as an originating good based on a tariff classification or a value applied by the Party to one or more materials used in the production of the good, which differs from the tariff classification or value applied to the materials by the Party from whose territory the good was exported, the Party’s determination shall not become effective until it notifies in writing both the importer of the good and the person that completed and signed the Certificate of Origin for the good of its determination.

³ See Canadian Minister of Justice, NAFTA Rules of Origin Regulations. Accessed January 29, 2017. <http://laws-lois.justice.gc.ca/PDF/SOR-94-14.pdf> wherein the NAFTA regulations are incorporated into Canadian law

12. A Party shall not apply a determination made under paragraph 11 to an importation made before the effective date of the determination where:

a) the customs administration of the Party from whose territory the good was exported has issued an advance ruling under Article 509 or any other ruling on the tariff classification or on the value of such materials, or has given consistent treatment to the entry of the materials under the tariff classification or value at issue, on which a person is entitled to rely; and

b) the advance ruling or consistent treatment was given prior to notification of the determination.

13. If a Party denies preferential tariff treatment to a good pursuant to a determination made under paragraph 11, it shall postpone the effective date of the denial for a period not exceeding 90 days where the importer of the good, or the person who completed and signed the Certificate of Origin for the good, demonstrates that it has relied in good faith to its detriment on the tariff classification or value applied to such materials by the customs administration of the Party from whose territory the good was exported.”(NAFTA Article 506)

BIG DATA SOLUTIONS

Increasingly large importers in developed and developing countries are investing in systems that provide them “end-to-end” supply chain visibility. These systems are required for various reasons, including but not limited to the ability to react quickly to supply chain interruptions, the measurement of logistics performance, and the need to satisfy product traceability standards imposed in the country of import. These systems reach far beyond first-tier suppliers and often reach all the way back to the origin of the raw materials that are eventually used to make the finished imported product. There have been calls for the use of the “big data” these systems produce by customs authorities, especially for origin determination purposes. These calls envision a regime

wherein customs authorities get access to such “big data” in exchange for the elimination of most forms of importer origin liabilities for duty in the absence of fraud. Such regimes would facilitate legitimate trade by using commercially organised data and lessen the contractual liabilities of producers and exporters for technical and formal origin violations.

5. Expanded Cumulation: Possible Complications & Solutions

The benefits of goods and process or full cumulation within an RTA are clear and well established. Likewise, it is widely agreed that the main benefit of expanded or full cross-cumulation provisions, which build linkages between RTAs that would otherwise operate independently, is to provide producers with more options for sourcing input materials in the production of originating and duty free goods.

However, there are several administrative and structural challenges associated with expanded cumulation. Outlined below are some of these difficulties and possible ways to lessen their impact.

ORIGIN VERIFICATION

Expanded cumulation requires at least three parties: parties A, B, and C that all have bilateral RTAs with each other. Broadly speaking, expanded cumulation envisages a situation wherein inputs sourced from A by country B can be used to support the originating status of B’s finished exports to C. The input supplied by A to B may have been imported into A from country X and further processed in A prior to shipping to B. For the customs authorities in country C that are performing an origin verification of the product shipped from B to C, this scenario can be a challenge: their authority to verify the origin of goods between B and C most likely does not include the authority to verify transactions between A and B. Under these

circumstances, if there is any doubt by the authorities in C about the accuracy of A's claims, normally origin would be denied. In light of the above, it is critical that expanded cumulation agreements address the issue of multi-party verifications by way of allowing verifications of A by C under specially defined circumstances and/or the identification of ways for A to certify information to authorities in A in such a way that the authorities in C (and B) can be confident of their accuracy. In this regard, it might be interesting to perform some research on if and how Blockchain technology could be used to resolve this and other origin challenges. Blockchain solutions appear to have several desirable origin features including but not limited to:

- data interoperability without monopoly
- data transparency
- they do not require the imposition of any third-party data platform but can adapt to work with such platforms
- if required, the ability to cover the challenging "first mile" in any traceability regime without the use of high technology (i.e., with a basic smart phone) and
- the ability to connect easily with ERP systems at the other end of the supply chain⁴

STRUCTURAL DIFFICULTIES

Canada has been a supporter of expanded cumulation or what is called full cross-cumulation in Canada. Despite its enthusiasm, it has been a challenge to implement the existing expanded cumulation provisions in Canadian RTAs. The reason for this is that expanded cumulation implementation inevitably leads to larger RTA networks that might not feature pre-existing provisions for expanded cumulation. In other words, in the separate RTAs between A and

B and C there could be the possibility of initiating expanded cumulation, but activating expanded cumulation between A, B, and C could impact their RTAs with RTA parties other than each other. This has proven to be a difficult issue that other conference participants will address in detail, but specific notice should be given to Jeremy Harris's suggestion of some form of stand-alone expanded cumulation "treaty" or undertaking that willing parties would sign.

⁴ Provenance. 2017. From shore to plate: Tracking tuna on the blockchain. Accessed January 28, 2017. https://www.provenance.org/tracking_tuna_on_the_blockchain

Annex

FTA-PASS System⁵

OVERVIEW

A system for making preparations even for the determination of origin and any origin verification to be conducted by the FTA partner country as an origin management program developed by the Korea Customs Service and being distributed free of charge (since Sep. 2010) for small and medium-sized enterprises which have much difficulty utilizing FTAs because of the burden of dealing with manpower and costs

DOWNLOAD

Search for "FTA-PASS" in a search portal system > get connected to the FTA-PASS Website > join as a member > use the Web services or download the program for personal computers

FTA-PASS Website: <http://www.ftapass.or.kr>

How to use

- (1) Common: Get connected to the FTA-PASS Website, join as a member and attach a copy of your business registration certificate > obtain approval of your membership.
- (2) Log-in (Web-based): Account for joining the Website (common).
- (3) Program installation: (Web-based) Use the Website directly / (PC-based) download and install the program.
- (4) Education: Familiarize yourself with how to fill in basic information through the educational materials and examples.
- (5) Starting to use: Start to enter your basic information after registering yourself as a user/person authorized to sign.

⁵ Korea Customs Service. Accessed 27 February 2017. http://english.customs.go.kr/kcshome/cop/bbs/selectBoardList.do?bbsId=BBSMSTR_1777&layoutMenuNo=32092&siteId=english&-searchCtgry=&searchWrd=&recordCountPerPage=10¤tPageNo=5#a2

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the Inter-American Development Bank (IDB), the RTA Exchange works in the interest of the sharing of ideas, experiences to date and best practices to harvest innovation from RTAs and leverage lessons learned towards progress at the multilateral level. Conceived in the context of the E15 Initiative, the RTA Exchange creates a space where stakeholders can access the collective international knowledge on RTAs and engage in dialogue on RTA-related policy issues.

