RULES OF ORIGIN IN INTERNATIONAL TRADE TREATIES: TOWARDS THE FTAA

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I. INTRODUCTION AND SCOPE

Trade agreements traditionally establish preferential terms governing the relationships between two or more countries. The scope of these relationships may vary substantially, but the starting point is invariably centered in the free movement of goods. In a free trade area (FTA), tariffs and quotas are eliminated on goods originating in and traded between the member countries. In a customs union, the same principle applies, with the added ingredient of the determination of a common external tariff (CET) to be applied to goods originating from non-member countries.[1]

Which goods originate in member countries and which goods do not? This is the initial inquiry for establishing preferential treatment. This Article will attempt to analyze the concept of rules of origin; provide an overview of their treatment in some of the most relevant international trade agreements currently in force; and discuss the possibility of harmonization and how rules of origin should be dealt with in the future.

II. THE RULES OF ORIGIN GROUNDWORK

A. Originating Goods

Originating goods are those that meet the preferential rules of origin[2] applicable under a regional trade agreement (FTA, Customs Union, GSP, or multilateral agreement). This means that they have sufficient regional content to qualify for preferential treatment.

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1. *See* North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., Annex 308(A), 32 I.L.M. 289 (1993) [hereinafter NAFTA]. On the other hand, in a FTA each country retains its own tariff structure against non-members. Such is the case of the NAFTA, with only one exception so far: computers. *Id.*

2. The provisions or regulations under a treaty or agreement that establish which goods will benefit from the application of said agreement. *See* discussion *infra* Part II.B.

Criteria used to establish originating goods may vary in nature and complexity. At one extreme is the rather straightforward concept of goods wholly produced or obtained in a member country. At the other extreme is the more sophisticated notion of goods that have undergone a substantial transformation and/or a shift in their tariff classification. These procedures shall be examined in further detail under Part III of this Article.

B. Definition and Scope of Rules of Origin

Rules of origin are an essential component of any regional or preferential trading arrangement, as well as the basis for carrying out product determination for normal customs purposes (non-preferential rules of origin).[3] In a world with no trade barriers, rules of origin would be unnecessary. However, with differing trade policies and tariffs applied by different countries, rules of origin are necessary to determine appropriate treatment by tariff item.

The GATT[4] Agreement on Rules of Origin[5] defines rules of origin as:

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3. *See* JIMMIE V. REYNA, PASSPORT TO NORTH AMERICAN TRADE (1995). Differentiation of tariffs is the main objective of what we call preferential rules of origin. For example, those that establish which products may have access to the benefits granted under trade agreements. However, rules of origin may serve other non-preferential goals: the determination of the country of origin of the product for statistical purposes; the identification of products whereupon anti-dumping or countervailing duties have been imposed; and the compliance with marking requirements, to mention a few. *Id.* For instance, NAFTA art. 311 and its corresponding Annex establish marking requirements. *See* NAFTA, *supra* note 1, art. 311, 32 I.L.M. at 303. Country of origin marking requirements are special rules that allow consumers to know the origin of goods. REYNA, *supra* at 288. The NAFTA parties were unable to reach an agreement on marking rules. Instead, they adopted "minimum principles" and agreed that each party would apply its own national laws and regulations for purposes of NAFTA Annex 311. NAFTA, *supra* note 1, Annex 311, 32 I.L.M. at 303.

4. *See* General Agreement on Tariffs and Trade 1994 (Including Understandings and Marrakesh Protocol), Marakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1A, art. I, 33 I.L.M. 1145 (1994). The 1994 GATT consists of the 1947 GATT as amended plus the understandings and interpretations arising from the Uruguay Round Final Act. *Id.* The General Agreement on Tariffs and Trade was created in 1947 in Geneva to liberalize and to some extent regulate the international trading system. *See* General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. For an overview of the history of the GATT, see *GATT: A Look Back As the Ministerial Meeting Approaches*, BUS. AM., June 23, 1986, at 2.

5. Agreement on Rules of Origin, Apr. 15, 1994, Marakesh Agreement Establishing the World Trade Organization, *reprinted in* RAJ BHALA, INTERNATIONAL TRADE LAW 253 (1996) [hereinafter Agreement on Rules of Origin]. This was one of the Agreements resulting from the Uruguay Round of GATT which concluded on December 15, 1993 and resulted in the creation of the World Trade Organization

> [T]hose laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994.[6]

In defining rules of origin, one of the main objectives should be uniformity and simplicity in their administration. Unfortunately, as we shall see, this is not always the case. Currently, developing and developed countries have undertaken the arduous task of the simplification, harmonization, and liberalization of rules of origin. However, until this is achieved, the rules of origin remain fragmented.

Traditionally, rules of origin take into consideration different components, the main one being the *origin component*, which categorizes products according to where they were obtained.[7] Apart from the origin component, other standards may also be taken into consideration. These are the consignment standards and the documentary standards.[8] Compliance with consignment standards satisfies authorities that products shipped from beneficiary countries are the same at the port of disembarcation, i.e., that no manipulation, exchange, dilution, or third-country trade of products has taken place. The documentary standards require that adequate documentation of origin and consignment be submitted.[9] Traditionally, this duty is complied with through the presentation of a declaration and/or a certificate of origin.[10]

C. Purpose of Rules of Origin

With the multinationalization of certain industries and activities, origin questions have become increasingly complex.[11] In these cases the producer may source its components from different countries, or maybe manufacture the product in successive stages in different countries. Thus the problem arises of determining where the resulting products originated.

(WTO). The Agreement on Rules of Origin aims at the establishment of uniform non-preferential rules of origin between WTO member countries. *See id.*

6. *Id.* This Agreement is limited only to non-preferential rules of origin, as established under its definitions and coverage. *Id.*

7. Kele Onyejekwe, *International Law of Trade Preferences: Emanations from the European Union and the United States*, 26 ST. MARY'S L.J. 425, 462 (1995).

8. *Id.*

9. *Id.* at 465-66.

10. *Id*; *see infra* Part VII.C.

11. Gary H. Sampliner et al., *Rules of Origin for Foreign Acquisitions Under the Trade Agreements Act of 1979, NAFTA, and the New GATT Accords*, 23 PUB. CONT. L.J. 207, 231 (1994).

In international trade, origin rules are critical for the success of an agreement. They determine which products will benefit under the agreement, and which will not. As Jimmie V. Reyna states, they "discriminate between the goods of different countries."[12] The most fundamental purpose for determining the country of origin is the determination of the appropriate duty rate.[13]

Determining origin can become a rather complex task. Different approaches may be applied to the same category of product, depending on how sensitive the product is in the particular country or group of countries concerned.[14]

Rules of origin also play an essential role in ensuring that a trade agreement is not used as a vehicle for third countries to obtain otherwise unavailable tariff benefits. Thus rules of origin avoid what is called trade deflection: the preferential importation of goods from non-member countries through the member country that applies the lowest tariff.[15]

III. PROCEDURES USED TO DETERMINE THE ORIGIN OF GOODS

When the origin of goods cannot be immediately established, several procedures are implemented either in an independent or combined manner.

A. Substantial Transformation

For decades, this has been the principal approach for the determination of rules of origin by national regulations and under international frameworks, such as the Kyoto Convention.[16] In the U.S. the basis for this procedure is a 1908 decision of the U.S. Supreme Court, *Anheuser-Busch Brewing Association v. United States*.[17] The issue in this case was whether certain bottle corks from Spain that were cleaned, chemically treated, and dried in the U.S. were thereby "manufactured or produced" in the U.S. for the purposes of the customs drawback laws.[18] With relation to the term "manufacture," the Court held that:

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12. REYNA, *supra* note 3, at 5.

13. *Id.* at 5-6.

14. *See* Ralph H. Sheppard & Robert J. Leo, *NAFTA Rules of Origin—Improvement on Past Rules?* 6 INT'L L. PRACTICUM 24 (1993).

15. *Rules of Origin and Preferential Markets*, ORGANIZATION OF AMERICAN STATES (OAS) (visited Apr. 1, 1997) <http://www.oas.org/en/prog/trade/free62e.htm> [hereinafter OAS].

16. Convention Establishing a Customs Cooperation Council, Dec. 15, 1950, 22 U.S.T. 320, 347 U.N.T.S. 127, 171 U.N.T.S. 303 [hereinafter Kyoto Convention]; *see* Negotiating Rules Of Origin In Treaties *infra* Part IV.

17. Anheuser-Busch Brewing Ass'n. v. United States, 207 U.S. 556 (1908); *see also* Sampliner, *supra* note 11, at 214.

18. *Anheuser-Busch Brewing Ass'n.*, 207 U.S. at 558.

> Manufacture implies a change, but every change is not a manufacture, and yet every change in an article is the result of treatment, manipulation. But something more is necessary. . . . There must be a transformation; a new and different article must emerge, "having a distinctive name, character or use." This cannot be said of the corks in question. A cork put through the claimant's process is still a cork.[19]

Thus, the question to be determined is whether the "change" (manufacturing or processing) is of such a substantial nature to justify the conclusion that the article is a product of the country where such change took place.

A change in name may well indicate a transformation, but it is not always a determinant factor to confer origin.[20] Consequently, a processing operation that converts "fresh broccoli" to "frozen broccoli" does not constitute substantial transformation, but an operation that converts "peanuts" into "peanut butter" does.

A change in the "character" of a product generally implies a change in the chemical composition, or shape of the article.[21] A "finishing" process, such as painting, polishing, sterilizing, or cleaning, though affecting the appearance of the product, may not be categorized as a change of origin.[22]

A change of use will usually be considered as a determinant factor if the process of manufacturing transforms the product from one that is suitable for one use to one applicable for another use or for multiple uses.[23] "A processing operation that merely completes an article for its intended use will not constitute a change in use sufficient to substantially transform the article."[24] For example, the Court of International Trade[25] has ruled that drawing steel wire from wire rod does not constitute a substantial transformation if the composition of the wire rod determines what uses the wire may have, and wire rod may be characterized as merely "different stages of the same product."[26]

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19. *Id.* at 560.
20. Sampliner, *supra* note 11, at 215.
21. *Id.*
22. *Id.*
23. *Id.* at 215-16.
24. *Id.*
25. Under U.S. law and applicable international treaties, there are multiple, overlapping, and often confusing remedies for dealing with trade disputes. The U.S. Court of International Trade, the successor to the U.S. Customs Court, has a wide range of legal powers and jurisdiction over trade matters, as established under 28 U.S.C. § 1581 (1988 & Supp. V 1993). *See* David A. Gantz, *A Post Uruguay Round Introduction to International Trade Law in the United States*, 12 ARIZ. J. INT'L & COMP. L. 7, 120 (1995).
26. Sampliner, *supra* note 11, at 216 (quoting Superior Wire v. United States, 669 F. Supp. 472, 479 (Ct. Int'l Trade 1987), *aff'd*, 867 F.2d 1409 (Fed. Cir. 1989)).

Should a change of name, use, or character not be enough to establish a change of origin, the customs authorities may resort to other factors. Sometimes the "substantial transformation" procedure has proved to be unpredictable in its application, depending ultimately on subjective considerations.[27] Additional factors to be considered include changes in the tariff classification of an article as a result of processing,[28] value added as a consequence of the processing, and the change of identity of the article from a "producer's good" to a "consumer's good," among others.[29] The U.S. Customs Service has strongly defended the notion of origin based on a change in tariff classification.[30]

B. Tariff-Shift Approach

1. Harmonized Tariff System

Under the tariff-shift procedure, nationality of a product is determined largely on the basis of a change in the product's tariff classification under the Harmonized Tariff System.[31]

At the international level, the Harmonized System sets forth a six-digit description for all products.[32] The first two digits are the "chapter" in which the

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27. Sheppard & Leo, *supra* note 14, at 25. Decisions have often relied on recourse to industry experts and have involved distinctions that were sometimes tenuous, sometimes well-founded, but generally unpredictable. *Id.*

28. Sampliner, *supra* note 11, at 216; *see* REYNA, *supra* note 3, at 8. The CUSFTA was the first U.S. preferential program that did not fully incorporate the substantial transformation test, but instead, just required that goods be "transformed" within a CUSFTA territory. The CUSFTA rules predominantly resorted to a tariff-shift for the determination of origin, with many exceptions wherein regional value must be demonstrated. *Id.*; *see* NAFTA, *supra* note 1, art. 401(b), (d), 32 I.L.M. at 349. Following the CUSFTA trend, in the NAFTA the word "transformed" was eliminated, and with it any reference to substantial transformation. Transformed was substituted with the general rule of change in tariff classification. *Id.*; *see also* MERCOSUR—CÓDIGO ADUANERO (CUSTOMS CODE) art. 20 (Uruguay 1994) [hereinafter MERCOSUR CUSTOMS CODE]. MERCOSUR provisions still make a reference to the need of a substantial transformation. *Id.*

29. Sampliner, *supra* note 11, at 216.

30. *Id.* at 232.

31. *Id.* The Harmonized System was established under the International Convention on the Harmonized Commodity Description and Coding System, created under the auspices of the Customs Cooperation Council on June 1983. International Convention on the Harmonized Commodity Description and Coding System, June 14, 1983, pmbl., 1989 U.K.T.S. 15 (Cmnd. 695). For a historical overview of the Harmonized System, see Edwin A. Vermulst, *EC Customs Classification Rules: "Should Ice Cream Melt?,"* 15 MICH. J. INT'L L. 1241 (1994).

32. *See* Vermulst, *supra* note 31, at 1248. In contrast to its predecessor, the Brussels Nomenclature, which was a four digit system. *Id.*

product is contained. The first four digits taken together are called the "heading" and provide a more specific description of the product. The last two of the six digits provide a still more specific level of description. Individual countries may add more digits. In the U.S., two digits are added for tariff rate distinctions and two for statistical distinctions, making up a total of ten digits.

Despite the similarities of the respective tariff schedules among the countries that follow the Harmonized System, there are also significant differences due to the different nomenclatures adopted by each country or regional trade arrangement.[33] As a result, it is always necessary to resort to each country or region's particular tariff schedule and administrative practices to determine the applicable tariffs.[34]

2. Implementation of the Tariff-Shift Approach

As a rule, a change in the product's origin will take place in the country where, as a result of manufacturing or other processing, the tariff classification of the article changes from one category to another.[35] When the classification changes, then the product becomes a product of the country where the change occurred.

However, tariff-shift is not necessarily a final or clear criterion. Minor features of processing, such as simple assembly, can sometimes bring about a change in the tariff category. In such a case, a change of origin will not be acknowledged because the tariff change was not decisive.[36] Political considerations have also influenced this process, including the strength of domestic producers of particular products.[37] Where tariff-shift is not enough, additional criteria must also be furnished. Some alternative approaches are:

- Singling out a part or component that provides the article with its "essential character," and applying the origin of that component to the product (i.e. television sets under the NAFTA, where origin is determined by the origin of the color picture tube);
- Returning to the "substantial transformation" rule, which brings back the problem of subjectivity, and thus unpredictability; and
- Resorting to the "value-added" requirement (added regional value content).[38]

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33. Sheppard & Leo, *supra* note 14, at 25-26.
34. REYNA, *supra* note 3, at 52.
35. Sampliner, *supra* note 11, at 232.
36. *Id.* at 233-34.
37. *Id.*
38. *Id.*

C. Added Regional Value Content (RVC) as an Additional Criterion

This approach has generally been used in conjunction with either the "substantial transformation" or the "change in tariff classification" rule.[39] It may also be used solely as the basis for determining origin.[40]

Under this procedure, one must consider the extent of the manufacturing or processing undergone in a country based on the value it adds to the goods.[41] When this added value equals or exceeds the specified percentage, the goods acquire "origin" in the country where the manufacturing or processing was carried out.[42]

The NAFTA has centered its analysis on the tariff classification and in some instances on the value-added criteria,[43] trying to achieve a more objective approach, while protecting domestic industries. However, sometimes the determination of the added value has proved to be a rather complex process, and has even caused many to avoid special benefits programs.[44] For many people, the cost of compliance and even the consequences of inadvertent non-compliance outweigh the potential benefits of a special duty claim, particularly in low-tariff product categories and when the product incorporates multiple components, many of which are foreign.[45] On many occasions, the burden of tracking and certifying imported materials may outweigh the benefits of the trade agreement.[46]

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39. Sheppard & Leo, *supra* note 14, at 26.

40. *Id.*

41. Kyoto Convention, *supra* note 16, Annex D.1 § I.C, *amended by* International Convention of the Simplification and Harmonization of Customs Procedures, with Annexes and Reservations to those Annexes, Sept. 25, 1974, Message from the President of the United States Transmitting the International Convention on the Simplification and Harmonization of Customs Procedures, *reprinted in* S. TREATY DOC. No. 97-23, at 226, 228 (1982).

42. *Id.*

43. *See generally* REYNA, *supra* note 3. For instance, wooden furniture can qualify for NAFTA tariff preference under a tariff-shift approach or a combination of tariff-shift and the RVC requirement. The first option requires that all non-originating inputs be classified outside of HS Chapter 94 (furniture and bedding). If non-originating inputs are furniture parts, they fall under the same HS classification; thus, there is no tariff-shift. In that case, RVC may be analyzed both under the transaction-value or under the net-cost approaches at the choice of the exporter or producer of the good. *See* NAFTA, *supra* note 1, art. 402, 32 I.L.M. at 349. If the product qualifies under one of the two approaches, in this case, it will be granted NAFTA origin; *see NAFTA Rules of Origin—Regional Value Content* (visited Apr. 2, 1997) <http://sys1.tpusa.com/dir05/facts/5011.html> [hereinafter *NAFTA Rules of Origin*]. The transaction-value and net-cost approaches shall be further analyzed when examining the NAFTA provisions. *See* discussion *infra* Part V.A.3.

44. Sheppard & Leo, *supra* note 14, at 26.

45. *Id.*

46. *Id.* at 27.

The value of the parts imported or of undetermined origin is generally established from the import value or the purchase price.[47] The value of the goods, when exported, is normally calculated using the cost of manufacture, the ex-works price, or the price at exportation.[48] This method provides a precise, if not simple, criterion. The value of the constituent materials might be established from commercial records or documents, which are not always available.[49] Often there are border-line cases in which a slight difference above or below the prescribed percentage causes a product to meet or fail to meet origin requirements.[50] Similarly, the origin attributed depends often on fluctuating world market prices and currencies.[51] Another major disadvantage is that such elements as the cost of manufacturing or the total cost of the products used are usually difficult to establish.[52] They may have different interpretations in the country of exportation and the country of importation.[53] Disputes may arise as to whether certain factors, particularly overhead, are to be allocated to manufacturing cost, or to sales and distribution, etc.[54] This is one of the instances where rules of origin become an obstacle to trade rather than a benefit.[55]

RVC rules are used extensively in international trade agreements for automotive goods, chemicals, and other sensitive products, but are quite limited in other product areas.[56] As we shall discuss later when looking at particular treaty provisions, this regional content may be calculated using two methods: transaction-value[57] or net-cost.

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47. Kyoto Convention, *supra* note 16, Annex D.1, *amended by* International Convention of the Simplification and Harmonization of Customs Procedures, with Annexes and Reservations to those Annexes, Sept. 25, 1974, Message from the President of the United States Transmitting the International Convention on the Simplification and Harmonization of Customs Procedures, *reprinted in* S. TREATY DOC. No. 97-23, at 226, 228 (1982).

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *See* REYNA, *supra* note 3, at 73. Under the NAFTA, it was quite difficult to achieve an agreement regarding the percentage of RVC to be required. It was necessary to balance the need for content rules which would require a level of production "sufficient" to reduce the incentive for export-platform operations and yet would not discourage foreign investment. The resulting compromise was that a NAFTA content of 50% or 60% would apply to the most heavily traded goods, and specific content regulations would apply to sensitive sectors (such as automobiles). *Id.*

57. *Id.*

IV. NEGOTIATING RULES OF ORIGIN IN TREATIES

Until the adoption of the WTO Agreement on Rules of Origin, the Kyoto Convention's rules of origin, which became effective on September 25, 1974, represented the most ambitious multilateral undertaking on this subject.[58] The GATT Customs Cooperation Council (CCC) approved this convention in May 1973.[59]

The Kyoto Convention contains general understandings and GATT-like principles, such as transparency, most-favored nation, and national treatment.[60] In addition, the Kyoto Convention has thirty annexes, three of which specifically pertain to rules of origin.[61] To become a signatory to the Kyoto Convention, a country must accept the main body of the Convention and at least one annex.[62] Origin under Annex D.1 (rules of origin requirements, which became effective on December 6, 1977) is established on the basis of two general rules: wholly produced goods and substantial transformation.[63] These concepts, as we have already seen, were not new to some national and regional trade regimes.

The needs of international trade have led to inevitable complexity, which, as we have seen, has made the mere notion of substantial transformation obsolete. Products are rarely wholly produced in one country.[64] Parts, components, and manufacturing processes originate in different countries, with different levels of participation.[65] The challenge in international treaties is making a determination for each of those cases. But the final challenge goes even further, and involves establishing rules that are practical yet clear and easy to apply.

Political considerations, sectorial interests, and protectionism have proven to be a restraint on the achievement of this goal.[66] Overly detailed rules of origin are often criticized for obstructing rather than facilitating trade.[67] Yet oversimplification may lead to ineffective rules.[68]

In the next Part we will analyze different types of rules of origin, as currently applied, and later we shall examine the efforts presently under way to attain harmonization.

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58. *Id.* at 311.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.* at 312; *see* Kyoto Convention, *supra* note 16, 22 U.S.T. at 320.
64. Sampliner, *supra* note 11, at 231.
65. *Id.*
66. OAS, *supra* note 15.
67. *Id.*
68. *Id.*

V. RESULTS ACHIEVED: A COMPARATIVE ANALYSIS OF THE TREATMENT OF RULES OF ORIGIN—FTAS AND CUSTOMS UNIONS

As discussed earlier, the basic difference between a FTA and a customs union is that, in addition to the elimination of tariffs and quotas, a customs union adds a uniform system regarding the external world, the common external tariff or CET.[69]

The difference in practice is significant. The general notion is that if the external treatment is uniform, then it does not matter from where the foreign goods enter the region, as they will always face the same tariff.[70] On the contrary, if there are differences in the tariffs from country to country, then the preferred place of entry will be the one that affords the lower tariff, from which products will be distributed throughout the region.[71] To deal with this problem, a FTA must have rules of origin.[72] The same applies to a customs union with an extensive list of exceptions to the CET, as is the case currently with MERCOSUR.[73] Rules of origin are also important in agreements entered into between a customs union and other individual countries or regional arrangements.

In the EU there are almost no rules of origin, with some exceptions.[74] Rather, there exists the principle of "free circulation."[75] Once a good leaps over the uniform tariff wall, it clears customs once, pays the duty once,[76] and it can then move freely throughout the region without any further tariff or hindrance of any kind.[77] Most of the EU now has no internal checks or customs stations.[78]

There is a general assumption that where there is a customs union, transshipment is irrelevant, and thus so are rules of origin.[79] For many reasons

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69. *Id.*

70. R. Jeffrey Kelleher, *NAFTA and the European Union, Comparison and Contrast,* 2 SAN DIEGO JUST. J. 19, 22 (1994). This is particularly true if dealing with finished goods. For parts or components, the situation is not so clear. Even if the common tariff has been paid, additional requirements still may have to be met, like special processing or regional content, and therefore, an origin determination for the final product will still be necessary. *Id.*

71. *Id.*

72. *Id.*

73. Thomas Andrew O'Keefe, *MERCOSUR at the Nine Month Mark: What's Happening and What is Not,* LATIN AM. L. & BUS. REP., Sept. 30, 1995; *see* discussion *infra* Part V.B. and note 146.

74. Kelleher, *supra* note 70, at 23.

75. *Id.*

76. *Id.* This has been one of the drawbacks of MERCOSUR, that a centralized system of collection of the CET has not yet been implemented. O'Keefe, *supra* note 73.

77. Kelleher, *supra* note 70, at 23.

78. *Id.*

79. *Id.* at 22-23.

this statement is not completely true. Although the existence of a CET does eliminate or minimize the need for internal customs controls, rules of origin still apply to a certain extent. First, as we have seen, customs unions still relate to third countries by virtue of trade agreements (such as FTAs) or by granting tariff preferences. Rules of origin thus remain necessary in these relationships. Additionally, within the customs union, they are necessary to establish whether a product originates in a member state, and consequently if it can freely circulate throughout the union. Questions are certain to arise when the product is merely assembled or even manufactured in the customs union, yet the components originate in a third country.

Finally, non-preferential rules of origin also apply within the customs union, in order to determine when a product is subject to special duties, such as anti-dumping duties or other trade restrictions.[80]

A. The NAFTA

The North American Free Trade Agreement (NAFTA) became effective between the U.S., Canada, and Mexico on January 1, 1994, establishing among its goals that of defining clear and advantageous rules governing the trade between these countries.[81] This is to be accomplished by eliminating barriers to trade and facilitating the cross-border movement of goods and services between the parties.[82] The NAFTA is governed by general principles including national treatment, most favored nation treatment, and transparency.[83]

The goal of facilitation of cross-border movement of goods becomes somewhat blurred when analyzing the complexity and intricacy of the NAFTA rules of origin.[84] Simplicity seems to have been dimmed by politics and protectionist interests seeking to ensure that Mexico would not be used as an "export platform" for Asian products, parts, or components.[85]

The issue of non-compliance with GATT provisions in establishing these rules has also been raised in the past, threatening the possibility that NAFTA provisions—and particularly, those pertaining to rules of origin—will be extended to an agreement covering hemispheric trade.[86]

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80. GEORGE A. BERMANN ET AL., CASES AND MATERIALS ON EUROPEAN COMMUNITY LAW 979 (1993).

81. NAFTA, *supra* note 1, pmbl., 32 I.L.M. at 297.

82. *Id.* art. 102(1), 32 I.L.M. at 297.

83. *Id.*

84. David A. Gantz, *Implementing the NAFTA Rules of Origin: Are the Parties Helping or Hurting Free Trade?*, 12 ARIZ. J. INT'L & COMP. L. 367, 377 (1995).

85. *Id.* at 375.

86. *Id.* at 377; *see* discussion *infra* Part VII.C.

1. Origin Criteria

When products meet the rules of origin and therefore qualify for NAFTA tariff benefits, they are said to "originate."[87] NAFTA Chapter 4 sets out most of the principles governing the origin determination. There are three categories of rules of origin under the NAFTA: general, specific, and special rules.[88]

General rules are the ones that apply to all goods, and are contained under NAFTA Article 401. Under the general rules, there are four main origin criteria, i.e. four ways in which goods generally meet the NAFTA rules of origin: [89]

a. Goods *"wholly produced or obtained"* in the NAFTA region (no non-NAFTA parts or materials). "Obtained" does not mean "purchased." This criterion typically applies to raw materials ("natural products" such as minerals, agricultural goods, etc.) or goods made directly from raw materials.[90] Further manufactured goods do not fall into this category unless the producer can trace all inputs back to raw materials originating in North America.[91]

b. Goods containing non-originating inputs, but meeting the Annex 401 rules of origin. Goods made from non-originating materials may also qualify for NAFTA treatment as long as each non-NAFTA input undergoes a tariff classification change as specified in NAFTA Annex 401, and meets other requirements that may apply.[92] Under Annex 401 (Specific Rules of Origin) rules of origin may be based on a change in tariff classification, a RVC requirement, or a combination of both approaches, following the criteria presented in this Article.[93]

Example of a tariff shift:

Products: Breads, pastries, cakes, biscuits (HS 1905.90).
Non-North American input: flour (classified in HS Chapter 11).
Rule of origin: change to heading 1902 through 1905 from any other chapter.

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87. *NAFTA Rules of Origin—Regional Value Content* (visited Apr. 2, 1997) <http://sys1.tpusa.com/dir05/facts/5001.html> [hereinafter *NAFTA Rules of Origin*].
88. REYNA, *supra* note 3, at 56.
89. *Id.*
90. *NAFTA Rules of Origin*, *supra* note 87.
91. *Id.*; NAFTA, *supra* note 1, art. 415, 32 I.L.M. at 354. Article 415 defines "wholly produced or obtained" and the products comprised thereunder. *Id.* Cases include mineral goods, vegetable goods, live animals born and raised in the territory of one of the member parties, fish, shellfish and other marine life existing in said territories. *Id.*
92. NAFTA, *supra* note 1, art. 401(b), 32 I.L.M. at 349.
93. *See* discussion *infra* Part III.B. & C.

Application:

For all products classified in HS headings 1902 through 1905, all non-North American inputs must be classified in an HS chapter other than HS Chapter 19 in order for the product to obtain the NAFTA tariff preference. These baked goods would qualify for the NAFTA tariff preference because the non-originating ingredient (flour) is classified under Chapter 11, not 19.

If, however, these products were produced with non-originating mixes, then these products would not qualify because mixes are classified in HS Chapter 19, the same chapter as baked goods.[94]

c. Goods produced in the NAFTA region wholly from originating materials, i.e., produced from materials that may contain non-NAFTA materials, but meet the NAFTA rules of origin.[95]

Example:

A wine press made in California of all originating parts could qualify, even if the parts contain non-North American metals. In this case the foreign materials have been transformed in North America to such an extent that new, originating parts have been created. These originating components are then used to produce the originating wine press. All parts originate so, therefore, the goods made from them also originate.

d. Unassembled goods and goods classified in the same HS category as their parts, which do not meet the Annex 401 rule of origin, but contain sufficient North American content.[96]

Under two limited circumstances, if a product fails to qualify under a product-specific tariff-shift rule of origin, it may qualify under a RVC requirement.[97] This is the case even if the product-specific rule of origin in Annex 401 does not contain a RVC provision.[98] These provisions never apply to products classified in HS Chapters 61-63 (apparel and other made-up textiles items such as blankets, linens, and bags).[99]

These two circumstances apply when the good is produced entirely in the territory of one or more of the NAFTA countries, but one or more of the non-originating materials do not undergo a change in tariff classification because: 1) the good was imported into North America in an unassembled or disassembled

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94. For other examples, see *NAFTA Rules of Origin*, *supra* note 87.
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*

form, but was classified as an assembled good under the HS system; or 2) parts and the final product are classified under the same heading or subheading.[100]

In these two situations, no tariff-shift is possible because of how the goods are classified. However, goods in this situation may obtain the NAFTA tariff preference if they have 50% or 60% North American value content, depending on the method used (net-cost or transaction-value).[101]

Other provisions refer to specific and special rules of origin.[102] *Specific rules* are those that apply to specific products, and are used to correct situations in which the application of the general rule might lead to unwanted or unreasonable results.[103] They are extremely comprehensive and detailed.[104] They include as determination criteria the change in tariff classification, RVC, a combination of both, or other specific requirements.[105]

Special rules are those designed for a particular sector, such as the textiles or automotive sectors.[106] Special rules are contained in Chapters 3 (textiles) and 4 (autos), and Annexes 300B and 401 (computers).

2. Change in Tariff Classification

Although the NAFTA does not specifically incorporate the notion of "substantial transformation," the application of the tariff-shift approach many times has an equivalent effect.[107] As we have seen, tariff-shift grants origin when all inputs undergo a change, although under the de minimis rule a certain percentage need not undergo the tariff change for the product to still be considered as originating.[108]

When no tariff change takes place, a product may nevertheless originate if RVC requirements are met.[109]

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100. *Id.*
101. *Id.*
102. REYNA, *supra* note 3, at 56-57.
103. *Id.*
104. For specific rules of origin, see NAFTA, *supra* note 1, Annex 401, 32 I.L.M. at 397.
105. *Id.* For instance, percentage of weight of a component in the final product is taken into consideration for determining origin when dealing with cocoa powder. *Id.*
106. REYNA, *supra* note 3, at 57.
107. David A. Gantz, *Maximizing the Regional Benefits of North American Economic Integration: Rules of Origin Under NAFTA* (visited Apr. 2, 1997) <http://www.natlaw.com/pubs/gantz1.htm>.
108. REYNA, *supra* note 3, at 114; *see* NAFTA, *supra* note 1, art. 405, 32 I.L.M. at 352; *see also* De Minimus Rule, *infra* Part V.A.5.
109. NAFTA, *supra* note 1, art. 402, 32 I.L.M. at 349.

3. Regional Value Content (RVC)

RVC is used in lieu of, and for some products in addition to, the requirement of tariff-shift.[110]

Two methods are established under NAFTA Article 402 for the calculation of the RVC: transaction-value and net-cost.[111]

The transaction-value is based on the Customs Valuation Code of GATT.[112] The transaction-value generally means the price actually paid or payable for a good.[113] The price paid or payable for the good is subject to certain adjustments that tend to adapt the price to a free on board (FOB) price basis.[114]

The formula is as follows:

RVC=[(TV-VNM)/TV]x100, where: TV = transaction value of the goods adjusted to a FOB basis; and VNM = the value of non-originating materials used by the producer in the production of the good.[115]

In the net-cost method, on the other hand, you remove the costs of sales promotion, marketing and after-sales service, royalties, shipping, packing, and some interest (usually, the costs incurred outside the factory gate).[116] The formula for the net-cost method is as follows:

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110. REYNA, *supra* note 3, at 68.

111. NAFTA, *supra* note 1, art. 402, 32 I.L.M. at 349.

112. General Agreement on Tariffs and Trade Implementation of Aricle VII-Customs Valuation, Apr. 12, 1979, 34 U.S.T. 1151(1), T.I.A.S. No. 10,402 [hereinafter Customs Valuation Agreement]. The Agreement on Implementation of Article VII of the GATT was one of the GATT Codes produced by the Tokyo Round. *See id.* Even countries that were not originally signatories to this Code have ratified it by means of regional trade agreements. Such is the case with the NAFTA, MERCOSUR, and the EU—all of which include provisions that refer to this Code. *See* discussion *infra* Part V.A-C.

113. NAFTA, *supra* note 1, art. 415, 32 I.L.M. at 354-55.

114. *NAFTA Rules of Origin*, *supra* note 87. Free on board price (FOB) is adapted, regardless of the mode of transportation, at the point of direct shipment, for example, at the factory or by the seller to the buyer. NAFTA, *supra* note 1, art. 415, 32 I.L.M. at 354-55. According to INCOTERMS, FOB presupposes that the seller must provide the goods and the commercial invoice or its equivalent electronic message in conformity with the contract of sale, and the buyer must pay the price as specified under said contract. International Chamber of Commerce INCOTERMS (an acronym for International Commercial Terms) are prepared by the Commission on International Commercial Practice. *See* International Chamber of Commerce INCOTERMS, *available in* LEXIS, 2 B.D.I.E.L. 711 (1980) [hereinafter INCOTERMS].

115. *NAFTA Rules of Origin*, *supra* note 43.

116. REYNA, *supra* note 3, at 87. A detailed and complex accounting process must be followed to establish the net-cost value. Total costs must be calculated, and then all non-applicable costs must be deducted. Rules become even more intricate in the case of various types of materials that have specific rules regarding their value, such as

RVC=[(NC-VNM)/NC]x100, where: NC = the net cost of the good.

Because the transaction-value method is a broader basis for calculating content, the RVC required is higher than for net-cost method.[117] The general rule is 60% RVC where the transaction-value method is used, and 50% when the net-cost method is used.[118]

Generally, exporters and producers may choose which valuation methodology they prefer, but there are exceptions.[119] For automotive goods, footwear, and word processing equipment, only the net-cost method may be used.[120] This is also true for goods for which there is no acceptable transaction value, as in the following circumstances:

- There is no transaction value for the goods.
- The transaction value is unacceptable under Article 1 of the GATT Customs Valuation Code.[121]
- The transaction value for the good is unacceptable because the producer has made repeated and consistent sales of the good, and of identical or similar goods, to related persons.[122]

The net-cost valuation procedure has been criticized, insofar as it relies on complex and detailed calculations, and even on information. that may not be accessible to the interested parties.[123]

A different view is that a more manageable basis of valuation—"customs value" or "appraised value"—should be followed in all instances, instead of only allowing this basis if there is an acceptable "transaction value."[124] The Customs

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automotive goods, packing materials, and containers. Allocations of costs is also key in the use of the net-cost method. Where a good is made up of many parts, or where a manufacturer produces a number of different lines of products, establishing the net-cost could prove to be a nightmare. *Id.* The NAFTA calls for a *reasonable* allocation, but no specific standards are established to define what is reasonable. NAFTA, *supra* note 1, art. 402(8), 32 I.L.M. at 350; *see* REYNA, *supra* note 3, at 103.

117. *NAFTA Rules of Origin*, *supra* note 43.

118. *Id.*

119. *Id.*

120. NAFTA, *supra* note 1, art. 402(5), 32 I.L.M. at 350.

121. Customs Valuation Agreement, *supra* note 112, 34 U.S.T. 1154. The cases involve issues where there are restrictions to the disposition or use of goods by the buyer (art. 1.1 (a)), or when the sale or price is subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued (art. 1.1 (b)). *Id.*

122. *See* REYNA, *supra* note 3, at 85. Customs authorities will normally accept the price paid between related parties, unless they have doubts as to whether the price was influenced by their relationship. *Id.*; *see* Customs Valuation Agreement, *supra* note 112, art. 1.1 (c), 1(2), 34 U.S.T. at 1151(3)-(4).

123. OAS, *supra* note 15.

124. Sheppard & Leo, *supra* note 14, at 216.

Valuation Code[125] provides for different methods of determining value without resorting to intricate net-cost calculations.[126]

4. Accumulation Rule

This rule is used to determine if a good qualifies as originating, taking into account whether it underwent production in more than one NAFTA territory.[127] Thus a producer may add the production costs that were accumulated in all the NAFTA territories, to the effect of increasing the net cost or transaction value (provided however that tariff-shift and/or RVC criteria are met, where applicable).[128]

5. De Minimis Rule

NAFTA Article 405 provides for a de minimis rule that would consider products containing no more than seven percent of non-NAFTA source material as an "originating" product for purposes of the Agreement (or nine percent in the case of some products, like cigarettes and cigars).[129] To qualify for the seven percent exception, the non-originating component must undergo a tariff subheading change in the territory of a NAFTA party.[130] For example, a Mexican exporter of palm kernel oil may import third-country crude oil, refine it, and combine it up to the de minimis level with Mexican refined oil for export as a NAFTA product.[131]

Where the foreign input is above the de minimis level and there is no required change in classification, the finished product would still be considered originating if the originating content is 60% or more under the "transaction-value" approach or 50% or more under the "net-cost" approach.

However, there are exceptions to the de minimis rule.[132] In some cases it does not apply, and, in others, more favorable provisions are substituted.[133]

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125. Customs Valuation Agreement, *supra* note 112, 34 U.S.T. at 1151(1).

126. *Id.* arts. 4-7, 34 U.S.T. at 1151(6)-(8).

127. NAFTA, *supra* note 1, art. 404, 32 I.L.M. at 352.

128. REYNA, *supra* note 3, at 112-13.

129. *NAFTA and Rules of Origin* (last modified May 25, 1995) <http://ffas.usda.gov/fasresources/ag-trade-policy/nafta/ruleofo.html>; *see* REYNA, *supra* note 3, at 114. This de minimis rule was included in the NAFTA as a reaction to the provision in the CUSFTA, which prohibited non-originating materials from being included for the good to qualify as originating. This caused a considerable concern both to producers and exporters. *Id.*

130. *NAFTA and Rules of Origin*, *supra* note 129.

131. *Id.*

132. *Id.*

133. *Id.* Dairy products may contain up to 25% of non-NAFTA butterfat, and up to

6. Facilitation Process

The NAFTA has a twenty-four hour automated information system provided free of charge by the U.S. Department of Commerce.[134] It includes information on NAFTA implementation, tariff rates, rules of origin, and doing business in Canada and Mexico.[135] Information may be sent electronically to the interested party's fax machine within approximately twelve hours of the inquiry.[136]

This service has proved to be a fundamental requirement due to the complexity of the NAFTA rules of origin. Many have complained that they should be simplified.[137]

B. MERCOSUR

On March 26, 1991, Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asunción, creating an integration scheme that would eventually lead to a common market (*Mercado Común del Sur* or MERCOSUR), effective as of January 1, 1995.[138] The Treaty of Asunción, later complemented by the Ouro Preto Protocol (signed on December 17, 1994) was set-up as a framework agreement[139] for future negotiations leading to a customs union, and at a later stage, to a common market.[140] Starting in 1995, there will be a consolidation of

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10% of non-NAFTA milk solids; peanut products, sugar, and citrus must be 100% NAFTA source. *Id.*

134. *Nafta Facts*, 6 MEX. BUS. MONTHLY, Feb. 1, 1996.

135. *Id.*

136. *Id.*

137. *Trade Official Does Not Rule Out Possible Revisiting of Origin Rules*, Int'l Trade Rep. (BNA), at 40 (Nov. 15, 1995). The Canadian Chamber of Commerce also recommended the simplification of the NAFTA rules of origin, as well as a less complicated certificate of origin. *Canadian NAFTA Survey*, U.S.-Mex. Free Trade Rep. (Sept. 15, 1995).

138. Ana María de Aquinis, *Symposium NAFTA at Age One—Can MERCOSUR Accede to NAFTA? A Legal Perspective*, 10 CONN. J. INT'L L. 597 (1995); *see also* Treaty of Asunción Establishing a Common Market Among Argentina, Brazil, Paraguay and Uruguay (MERCOSUR), Mar. 26, 1991, 30 I.L.M. 1041 [hereinafter MERCOSUR].

139. De Aquinis, *supra* note 138, at 601; *see also* Ouro Preto Protocol to the MERCOSUR Agreement, Dec. 17, 1994, *available in* LEXIS, B.D.I.E.L AD LEXIS 97 (1995). It has been said that the NAFTA was created as a treaty-law, while MERCOSUR was originated as a treaty-framework. The extension and complexity of the NAFTA may seem oppressive compared with the foundational treaties of MERCOSUR which contain merely one hundred articles and six annexes. All of this regulation gives the NAFTA a complexity that significantly exceeds the traditional Latin-American notion of a free-trade-zone. De Aquinis, *supra* note 138, at 631-33.

140. De Aquinis, *supra* note 138, at 608.

the free trade zone to be completed by the year 2000[141] and of the customs union by 2006 (final elimination of the exceptions to the CET).[142]

Rules of origin are applied to (1) products exempted from the CET; and (2) to products that have internal parts or pieces that are exempted from the CET and have a significant participation in the production of the final goods (more than 40% of the FOB value).[143] The general rule for free intrazonal circulation requires a shift in the tariff classification, and in some cases that 60% of the value be added locally (in the original Asunción Treaty it had been 50%).[144] Thus there is a tariff-shift, plus a RVC of 60% that may be added. The 60% may also be required when there is no tariff-shift, as in the cases of mere assembly.[145]

By way of summary, MERCOSUR rules of origin apply to:

- Products that are pending coverage by the CET;
- Products subject to the CET, made up of parts or components that are not part of the CET, except in cases where the total value of said parts and components does not exceed 40% of the final FOB value of the product;
- Products subject to special commercial policies applied by one or more of the parties; and
- Exceptional cases to be established by the Commerce Commission.[146]

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141. *Id.* The aim is to reduce tariffs between member countries to reach a zero percent tariff. There is still a list of exceptions, with an automatic schedule for reductions until 1999 for Brazil and Argentina, and until 2000 for Uruguay and Paraguay. The mechanism is as follows: Argentina and Brazil grant an initial allowance on Jan. 1, 1995, then a further rebate amounting to 25% in Jan. 1996; 50% in Jan. 1997; 75% in Jan. 1998; and 100% in Jan. 1999. For Uruguay and Paraguay, the system is the same, but it begins in Jan. 1996. The process may be carried out in a speedier way, if the countries decide to do so. *MERCOSUR's Common Market Group, Res. No. 48/94* (visited Apr. 2, 1997) <http://www.intr.net/mercosur/res4894.htm> [hereinafter *Res. No. 48/94*].

So far, the number of exceptions comprise 221 products for Argentina, 427 for Paraguay, 1018 for Uruguay, and initially 29 for Brazil. Brazil requested the right to be able to vary its tariff rates on "temporary emergency grounds," and thus to increase the list. De Aquinis, *supra* note 138, at 617.

142. De Aquinis, *supra* note 138, at 608. CET has a maximum of 20%, with several exceptions that will remain in place until 2001 and with certain products exempted until 2006, when all the exceptions shall expire. Since January 15, 1995, the member countries are charging a CET on 85% of the transactions of MERCOSUR. *Common Market Group, Decs. Nos. 13/93, 7/94* (visited Apr. 2, 1997) <http://www.intr.net/mercosur/resol.htm>.

143. De Aquinis, *supra* note 138, at 618.

144. *Id.*

145. *Regulation on Origin of Goods,* art. 3 (visited Apr. 2, 1997) <http://www.intr.net/mercosur/dec694.htm>.

146. *Id.* art. 4. The Commission is an inter-governmental body created by

1. Origin Criteria

Annex II to MERCOSUR, "General Rules of Origin," subsequently complemented by the Regulation on Origin of Goods[147] (hereinafter the Regulation) establishes the general rules for classification of origin:

a. As in the NAFTA, goods "manufactured wholly in the territory of any of the parties" are classified as being of MERCOSUR origin, when only originating materials are used in their manufacture.[148]

b. Goods produced in the territory of a member party (pursuant to the concept of "fully produced or obtained.")[149] The following are classified as produced in the territory of a party: [150]

- Mineral, plant, and animal products, including hunting and fishing products, extracted, harvested or gathered, born and raised in the territory or in the territorial waters or exclusive economic zone of a party.
- Products extracted outside territorial waters and exclusive economic zone by vessels flying a party's flag or leased by companies established in its territory.

c. Goods originate when—even though they are made from non originating materials—they "result from a transformation . . . that gives them a new individuality, characterized by the fact that they are classified in the Common MERCOSUR Nomenclature[151] in a different category from the mentioned components, except in the cases when a RVC of sixty percent is required in addition to the tariff shift."[152]

Decision No. 9/94 of the Common Market Council for the purpose of assisting the executive bodies of MERCOSUR in watching after the application of commercial policies as agreed upon by the parties, and for the purpose of controlling and revising said commercial policies, intra-regional commerce, and commerce with third countries. *MERCOSUR Commerce Commission* (visited Apr. 1, 1997) <http://www.intr.net/mercosur/dec994.htm>.

147. *Regulation on Origin of Goods*, *supra* note 145, art. 3. The Regulation was adopted by Decision No. 6/94 of the Common Market Council, later complemented by Decision No. 23/94, and finally adopted as an Additional Protocol to the MERCOSUR Treaty. *See id.*

148. *Regulation on Origin of Goods*, *supra* note 145, art. 3(a).

149. MERCOSUR CUSTOMS CODE, *supra* note 28, art. 19.

150. *Regulation on Origin of Goods*, *supra* note 145, art. 3(b).

151. The author notes that the Common MERCOSUR Nomenclature is an Amendment to the Harmonized System and is based on the Harmonized System of Designation and Codification of Goods by a six-digit description, and thus, replaces national nomenclatures and regimes.

152. *Regulation on Origin of Goods*, *supra* note 145, art. 3(c). *See* MERCOSUR

The Regulation also establishes that when such processes or operations simply involve assembly, packaging, division into lots or volumes, selection and classification, marking, the putting together of assortments of goods, or other equivalent operations or processes, the products shall not be considered to originate.[153]

d. In the event that the requirement established under subsection (c) above cannot be complied with because the "transformation" that occurred does not result in a change in the tariff category in the Common MERCOSUR Nomenclature, it shall suffice that the CIF[154] value of the components from third parties does not exceed forty percent of the FOB value at the port of destiny of the goods considered.[155]

e. Even where there is no transformation, the products resulting from assembly operations in a MERCOSUR country, using components originating in third countries, shall be considered to originate when the CIF value of non-originating materials at the port of destination or CIF maritime port does not exceed forty percent of the FOB value of the final product.[156]

f. According to Article 4 of the Regulation, the MERCOSUR Commerce Commission may establish specific requirements of origin in the future which shall prevail over general classification criteria.[157] For the determination of specific requirements, the following elements may be considered, either individually or jointly:

- The presence of a preponderant raw material or a material that essentially characterizes the product;
- A part or component that essentially characterizes the product;
- A percentage of parts or components in relation to the total weight of the product; and
- The type of transformation or elaboration process used in relation to the total value of the product.[158]

CUSTOMS CODE, *supra* note 28. The MERCOSUR Customs Code essentially repeats these terms under Article 20.1, with the exception of mentioning that the transformation has to be "substantial." *Id.*

153. *Regulation on Origin of Goods*, *supra* note 145, art. 3(c).

154. INCOTERMS, *supra* note 114. CIF means cost, insurance, and freight, which is paid by the shipper of the goods and is included in the invoice cost of the goods to the buyer. *Id.*

155. *Regulation on Origin of Goods*, *supra* note 145, art. 3(d). Under the Annex, the required percentage was 50% of the FOB value. This is no longer applicable. *See* MERCOSUR, *supra* note 138, Annex II, 30 I.L.M. at 1054.

156. *Regulation on Origin of Goods*, *supra* note 145, art. 3(e).

157. *Id.* art. 4.

158. *Id.* art. 5.

In exceptional cases, where specific requirements cannot be met because of circumstantial supply problems (availability, technical specifications, delivery date, and price), materials not originating in the states parties may be used.[159] In this situation, the exporting country shall issue a certificate informing the importing state party and the Commerce Commission of such circumstances, and enclose the necessary information and/or documentation.[160]

The rules established above are the general rules of origin, which apply to the vast majority of MERCOSUR products. There is no detailed list of specific rules for particular items, as in the NAFTA. However, some limited special rules of origin were established for chemicals, steel, computers and related software, and electronic equipment.[161] The automobile sector, for its part, has its own rules of origin requirements which are the result of pre-MERCOSUR bilateral accords between the members.[162]

2. Tariff-Shift

In MERCOSUR, tariff-shift confers origin when all inputs undergo a change. There are no provisions for a de minimis rule, as is the case under the NAFTA. However, the required tariff-shift may be disregarded in cases where the RVC requirement is met, except for the cases where both criteria have to be complied with.[163]

The tariff-shift procedure under Article 3 subsection (c) of the Regulation specifically resorts to the traditional notion of "substantial transformation."[164] The new "individuality" resulting from this transformation is what makes the product undergo a change in its classification.[165]

A special case of substantial transformation (i.e., change in character) is required for chemical products.[166] This must be obtained following a process that involves molecular modification and creates a new chemical entity.[167]

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159. *Id.*

160. *Id.*

161. *Id.* art. 3. Annex II was enacted by Decision No. 23/94 of the Common Market Council. *Annex II of the Regulation* (visited Apr. 1, 1997) <http://www.intr.net/mercosur/dec2394.htm> [hereinafter Dec. 23/94].

162. O'Keefe, *supra* note 73; *see* discussion *infra* Part VI.A.3.

163. *Regulation on Origin of Goods*, *supra* note 145, art. 3(c), (d).

164. *Id.* art. 3(c). The term "substantial" is not expressly included in this article; however, it is established under Article 20 of the MERCOSUR CUSTOMS CODE. *See* MERCOSUR CUSTOMS CODE, *supra* note 28.

165. *Regulation on Origin of Goods*, *supra* note 145, art. 3(c).

166. Dec. 23/94, *supra* note 161, § 1; *see* discussion *infra* Part VII.D.

167. Dec. 23/94, *supra* note 161, § 1.

3. Regional Value Content (RVC)

As we have seen, this procedure is used as an alternative method of establishing origin, or as an additional requirement for some products. The general rule is 60%, although capital goods have an 80% RVC requirement.[168]

Calculation of the RVC does not involve intricate operations or differentiations between net cost or transaction value. All references to RVC are made with relation to a percentage of the FOB price of the goods, which facilitates the process.[169]

C. A General Approach to the EU

A general reference to the European Union (EU)—the successor to the European Economic Community (EEC)—in its effort to achieve economic, legal, and social integration, is necessary for a complete discussion on rules of origin.[170]

Although some efforts towards "deepening" the integration process have not yet yielded satisfactory results (such as the Economic and Monetary Union, and the Political Union), the EU has achieved great success in the free movement of goods. In an effort to implement this free movement of goods, origin determinations had to be made. The following is an overall synopsis of how origin criteria are applied in the EU.

1. History

The Treaty Constituting the EEC (1956)[171] included a Protocol on originating goods.[172] This Protocol emerged from the fact that some members applied preferences to goods imported from third countries.[173] The Treaty did not provide for the modification of these preferences.[174] However, it provided that goods imported by a member according to such a preference system could not be re-exported to another member.[175] This gave rise to the need to impose a

168. *Regulation on Origin of Goods*, *supra* note 145, art. 3(f).

169. *Id.* art. 3(d).

170. The Treaty establishing the European Union was agreed to at Maastricht in December 1991, and signed in February 1992. TREATY ON EUROPEAN UNION, Feb. 7, 1992, 31 I.L.M. 247, *reprinted in* GEORGE A. BERMANN, ET AL., EUROPEAN COMMUNITY LAW—SELECTED DOCUMENTS 104 (1993).

171. *Id.*

172. *Id.*

173. BERMANN, *supra* note 80, at 979.

174. *Id.*

175. *Id.*

uniform system of origin, and to the adoption of Regulation No. 802/68.[176] The application of a common external tariff and the elimination of internal tariffs call for the identification and control of the origin of goods from third countries.[177]

2. Origin Criteria

The EU's notion of origin provides that goods wholly obtained or produced in a country are originating from that country.[178] A good produced in different countries is considered to originate in the one where the last transformation or significant elaboration took place.[179] Also, as in other international trade arrangements, special regimes are specifically established for sensitive products.[180]

A process will not confer origin if it is established that its only goal was to circumvent EU provisions applicable to goods from specific countries.[181] The criterion adopted to evaluate the transformation of a manufactured or semi-manufactured product and the relevance of the last elaboration, will in most circumstances be a tariff change.[182] However, in some cases the European Court of Justice has followed other criteria, namely substantial transformation.[183]

In *Gesellschaft für Uberseehandel, MBH v. Handelskammer Hamburg*,[184] it was established that it was necessary for the product to have its own individuality, its own properties, and a composition of its own, which it did not possess before the process or operation. The Court thus concluded in this case that the cleaning and grinding of a raw material, together with the grading and packaging of the product obtained, do not constitute a substantial process or operation.[185]

Courts have stated that Article 5 and the criterion of last substantial process or operation is compliant with Rule 3 of Annex D.1 to the Kyoto Convention,[186] adopted by the EU by Council Decision 415/77.[187]

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176. Council Regulation 802/68 on the Common Definition of the Concept of the Origin of goods, 1968 O.J. SPEC. ED. 165, *amended by* Regulation 1318/71 1971 O.J. (L 139)1.

177. *Id.*

178. *Id.*

179. *Id.*

180. Jeri Jensen-Moran, *Trade Battles as Investment Wars: The Coming Rules of Origin Debate*, 10 WASH. Q. 239 (1996). In the case of the EU that includes textiles, radio-TV receivers, computers, and integrated circuits. *Id.*

181. BERMANN, *supra* note 170, at 604.

182. *Id.*

183. *Id.*

184. Case 49/76, Gesellschaft v. Handelskammer, 1977 E.C.R. 41; *see also* BERMANN, *supra* note 80, at 980.

185. BERMANN, *supra* note 80, at 982.

186. *Id.*

187. *Id.*

In *Brother Intl. GmbH v. Hauptzollamt Bieben* , it was established that mere assembly does not constitute a substantial process or operation.[188]

As we have already pointed out, the "substantial" test is not always easy to apply, and may be guided by subjective interests.[189] In some cases, for example, the European Court of Justice has shifted the analysis to determining whether or not there is value added to the product.[190] This has the effect of promoting investment in the EU, by causing companies to establish facilities in the EU to carry out the complex assembly operations *in situ*.[191]

We have mentioned before, when analyzing the differences between different kinds of trade agreements, that rules of origin still maintain their significance in a customs union, although they apply in a less intense manner in the internal movement of goods. For example, the EU through the years has granted preferential treatment to different countries or groups of countries, and said preferences have been subject to compliance with rules of origin. The Lomé Conventions[192] have afforded special treatment to the ACP Group (Africa, Caribbean, and Pacific countries), while several Asian and most Latin American countries benefit from a General System of Preferences (GSP).[193]

Under these regimes, when a product is not wholly obtained in a particular nation, the general rule is that processing is sufficient when it entails a tariff-shift.[194] However, there are some exceptions calling for specific processes or setting maximum percentages of third party components that may be present in the final product.[195]

D. GATT Rules of Origin

Since GATT did not originally codify rules of origin,[196] work began in the late 1970s to establish international guidelines in this area.[197] The work finally

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188. *Id.* at 983.

189. *See* discussion *infra* Part III.A.

190. BERMANN, *supra* note 80, at 983.

191. Jensen-Moran, *supra* note 180.

192. *See* Lomé Conventions, African, Caribbean, and Pacific States—E.U., 14 I.L.M. 595 [Lomé Convention I]; 19 I.L.M. 327 [Lomé Convention II]; 24 I.L.M. 571 [Lomé Convention III]; 29 I.L.M. 783 [Lomé Convention IV]. The Lomé Conventions were a series of conventions, the last of which was signed in 1989, and which will remain in force until the year 2000. *Id.*

193. *The European Union—New GSP Scheme*, Memorandum of Jan. 1, 1995, Spokesman's Service of the European Commission (visited Apr. 2, 1997) <http://www.bso.com/eu/legislat/gsp/scheme.htm>. The purpose of the system is to offer developing countries lower customs tariffs than those applied to developed countries, thus, giving them preferential market access in the community and promoting the general growth of their economies. *Id.*

194. *Id.*

195. *Id.*

196. REYNA, *supra* note 3, at 322. As we have seen, the only applicable

culminated on March 15, 1994, when representatives of over 115 countries gathered in Marrakesh, Morocco, and adopted the final agreement on the Uruguay Round negotiations, including an Agreement on Rules of Origin.[198]

Under GATT, the purpose of rules of origin is to determine whether Most Favored Nation (MFN) tariff rates or general rates will be applied, depending on whether the product originated in a WTO member country or not.[199] Rules of origin may also affect the application of anti-dumping or countervailing duties.[200]

One of the aims of the WTO Agreement on Rules of Origin is to ensure that these provisions will not themselves create unnecessary obstacles to trade, or impair the rights of members under GATT 1994.[201] The diversity of rules and their practices has a restrictive effect on trade, thus making harmonization essential.[202] This harmonization clearly covers regional agreements also.[203]

In establishing preferential trade agreements, WTO member countries may not create restrictions to trade.[204] GATT Article XXIV recognizes the benefits of regional trade agreements (FTAs and customs unions) as a way to foster the expansion of international trade.[205] However, the GATT also acknowledges that

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provisions were those of the Kyoto Convention. *See* Kyoto Convention, *supra* note 16, 22 U.S.T. 320, 347 U.N.T.S. 127.

197. REYNA, *supra* note 3, at 322.

198. *See* Agreement on Rules of Origin, *supra* note 5.

199. *Id.* at 332.

200. *Id.*

201. *Id.* at 324.

202. *Id.*

203. *Id.*

204. GATT art. XXIV.

205. *Id.* This principle was reiterated at the Ministerial Conference of the WTO, held in Singapore, December 9-13, 1996. Under the heading of Regional Agreements, the Ministerial Conference established that:

> We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expanded vastly in number, scope and coverage. Such initiatives can promote further liberalization and may assist least-developed, developing and transition economies in integrating into the international trading system. In this context, we note the importance of existing regional arrangements involving developing and least-developed countries. The expansion and extent of regional trade agreements make it important to analyse whether the system of WTO rights and obligations as it relates to regional trade agreements needs to be further clarified. We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules. In this regard, we welcome the establishment and endorse the work of the new Committee on Regional Trade Agreements. We shall continue to work through progressive liberalization in the WTO as we are committed in the WTO

they may also serve the purpose of raising new barriers between the members of such regional arrangements and other members of the WTO.[206] Article XXIV thus provides that:

> The duties and other regulations of commerce [imposed by the customs union or FTA] should not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such [FTA or customs union]. . . .[207]

The 1994 WTO Agreement on Rules of Origin consists of nine Articles divided into four Parts and two Annexes—Technical Committee on Rules of Origin and Common Declaration with Regard to Preferential Rules of Origin.[208]

This Agreement covers only non-preferential rules of origin, except for the "Declaration" which deals with international standards applicable to preferential rules of origin.[209] One may predict, however, that the provisions adopted regarding non-preferential rules will be the basis for subsequent regulations on preferential rules of origin.

The harmonization process is scheduled to span a three-year period starting as of the effective date of the Agreement establishing the WTO, January 1, 1995.[210]

To achieve harmonization, the Technical Committee will first develop detailed uniform criteria for determining when goods are wholly obtained in one country.[211] Second, it will develop a uniform list of minimal operations or processes that do not by themselves confer origin to a good.[212] Finally, and most importantly, the Committee will establish when the last substantial

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> Agreement and Decisions adopted at Marrakesh, and in so doing facilitate mutually supportive processes of global and regional trade liberalization.

Singapore Ministerial Declaration, (visited Apr. 2, 1997) <http://www.wto.org/Whats_new/wtodec.htm>.

206. GATT art. XXIV(5).

207. *Id.*

208. Agreement on Rules of Origin, *supra* note 5; *see also* REYNA, *supra* note 3, at 331-32.

209. REYNA, *supra* note 3, at 339. Under Annex II, preferential rules of origin are defined as "[t]hose laws, regulations and administrative determinations of general application applied by a Member to determine whether goods qualify for preferential treatment under contractual or autonomous trade regimes leading to the granting of trade preferences going beyond the application of Article I:1 of GATT 1994." Agreement on Rules of Origin, *supra* note 5. The author notes that, consequentially, preferential rules include those established under trade agreements such as the NAFTA or MERCOSUR, among others. Non-preferential rules, as mentioned, are those that refer to the marking of products, and the ones used for the determination of quotas, countervailing duties, or anti-dumping orders applicable to certain goods.

210. REYNA, *supra* note 3, at 334.

211. Agreement on Rules of Origin, *supra* note 5, art. 9.

212. *Id.*

transformation of a good produced in more than one country occurs.[213] This will be through the use of the change in tariff classification method, using the Harmonized System as the underlying nomenclature and, when supplemental tests are necessary, through the use of the value-added and specified-processing methods of determining origin.[214] The Origin Agreement thus states that origin will be conferred where the last substantial transformation occurred, not where the most significant occurred.[215] This rule increases certainty in application and simplifies the determination of origin because the custom authorities can disregard previous operations.

The Agreement calls for the exclusive use of the Harmonized System nomenclature to determine origin by the tariff-shift approach.[216] Only when this procedure proves to be insufficient is the Technical Committee able to elaborate on other requirements, on the basis of the criterion of substantial transformation.[217] For particular products or a product sector, this includes ad valorem percentages and/or manufacturing or processing operations.

At the first meeting of the NAFTA Working Group of the WTO in July, 1995, the NAFTA's strict rules of origin were questioned by the EU, Japan, Korea, Switzerland, and Australia, in light of their potential conflict with GATT principles.[218] Japanese automakers have repeatedly characterized rules of origin—and particularly the NAFTA rules of origin—as an unfair trade policy.[219]

Subsequent meetings of the WTO Committee on Rules of Origin were scheduled during 1996 for the months of May, September, and November, to address continuing efforts for harmonizing rules of origin.[220]

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213. *Id.*

214. *Id.* art. 9, § 2(c)(i)-(iii). In the cases in which the ad valorem method is used, the procedure to calculate such percentage will be indicated in the applicable rules of origin. No determination is currently made regarding the application of the net-cost and/or transaction-value method. *Id.*

215. *Id.* art. 3(b).

216. *Id.* art. 9.

217. *Id.*

218. *WTO Members Challenge NAFTA Rules of Origin*, U.S.-Mex. Free Trade Rep. (Aug. 21, 1995).

219. *International Trade: U.S. Coercion of Japanese Automakers Raises Legal Issues*, Int'l Trade Rep. (BNA), at 27-28 (Mar. 30, 1995). The requirement of local content in auto parts "would also have the same effect as import restrictions and safeguards against parts from Japan and other countries," thus, violating the GATT Article XI that prohibits quantitative import restrictions, and the Safeguards Agreement prohibiting the application of "gray measures" by private companies. *Id.*

220. *WTO Programme of Meetings 1996* (visited Apr. 1, 1997) <http://gatekeeper.unicc.org/wto/progmt.html>.

VI. SPECIFIC RULES FOR CERTAIN SECTORS—SENSITIVE PRODUCTS

A. Automobiles

1. European Union

Technically, the EU does not have a special rule of origin for automobiles.[221] However, according to U.S. industry sources, the EU application of rules has not always been straightforward.[222] At times it has applied the equivalent of a value-added requirement as high as 75% in the case of Japanese automobiles, although there is no written rule to this effect.[223]

Proposals have been made in the past for the EU to adopt a written rule of origin based on a value-added determination.[224] Proposals range from 50% to 80%.[225]

2. The NAFTA

Under the NAFTA, the automobile sector was one of the most visible examples of restrictive rules of origin.[226] It was implemented to limit the use of the Agreement by Japan and other overseas auto manufacturers to export into the U.S. market.[227] Together with the electronic and textile industries, automobiles presented unique problems.[228]

The U.S.' opening position in the NAFTA negotiations was 65% of North American value content, a more stringent rule than the 60% RVC applicable as a general rule.[229] In the final days of the negotiations, Canada and Mexico agreed to 62.5%.[230] The measure has proved successful. Not only has Japan been prevented, with some exceptions, from exporting to the U.S. from Mexico, but investment in North American production of vehicles and parts has significantly increased.[231] All Japanese companies producing in North America have made known their plan to comply with the more stringent 62.5% rule so they may trade freely within North America.[232] The special automotive rules of origin,

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221. Jensen-Moran, *supra* note 180.
222. *Id.*
223. *Id.*
224. *Id.*
225. *Id.*
226. *Id.*
227. *Id.*
228. Gantz, *supra* note 84, at 374-75.
229. Jensen-Moran, *supra* note 180.
230. *Id.*
231. *Id.*
232. *Id.*

however, do not replace the NAFTA general rules of origin. Rather, they complement the general rules by addressing specific concerns. One of these concerns was the need to establish a RVC as well as a procedure to calculate it.[233] The sole basis for determining the RVC of automobiles,[234] key automotive components such as engines and transmissions, and raw materials used to produce these components is the net-cost method.[235]

3. MERCOSUR

To date there is no final regional regulation addressing automotive products under MERCOSUR. However, negotiations are under way. Decision No. 29/94 of the Common Market Group created an Ad-hoc Technical Committee (Technical Committee No. 9 of the Commerce Commission) to develop a proposal to become effective on January 1, 2000.[236] It would regulate, among other things, free regional trade, CET, and required RVC rates.[237] By December 1997, the Committee must submit to the Commerce Commission the full text of the Common Regime to be implemented by the year 2000.[238]

So far only bilateral agreements are in force among MERCOSUR members.[239] The only MERCOSUR members with a well established automobile industry are Argentina and Brazil, although Uruguay and Paraguay have some assembly facilities.[240] The current agreement in force between Argentina and Brazil, in force until the year 2000, requires sixty percent of the components to be produced within MERCOSUR countries.[241]

This sector has been a sensitive issue in MERCOSUR. In April 1995, Brazil, faced with a surge of imports, announced plans to enact import quotas on

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233. REYNA, *supra* note 3, at 206.

234. *Id.* at 207. An automotive good may be subject to a change in tariff classification test, a RVC requirement, or both, for purposes of determining whether it qualifies as "originating." However, the NAFTA specifies that the RVC for certain automotive goods must be calculated solely on the net-cost method. NAFTA, *supra* note 1, art. 402(5)(d)(i)-(iv), 32 I.L.M. at 350. Specific provisions for automotive goods are established under Article 403 and Annexes 403 (1)-(3). *Id.* art. 403 & Annex 403(1)-(3), 32 I.L.M. at 351, 356-58; *see also* REYNA, *supra* note 3, at 205.

235. NAFTA, *supra* note 1, Annexes 403.1, 403.2, 32 I.L.M. at 356-57 (listing automotive parts and components that are subject to the net-cost method).

236. *Dec. 29/94 of the Common Market Group* (visited Apr. 1, 1997) <http://www.intr.net/mercosur/dec2994.htm>.

237. *Id.*

238. *Id.*; *see also Report of the MERCOSUR Sectorial Commission*, EL PAIS, Feb. 3, 1995 (visited Apr. 2, 1997) <http://www.rau.edu.uy/mercosur/faq.merco.htm>.

239. O'Keefe, *supra* note 73.

240. *Report of the MERCOSUR Sectorial Commission*, *supra* note 238.

241. *Id.*

automobiles.[242] Naturally this caused concern in Argentina.[243] Brazil eventually dropped its plan to place quotas on auto imports, and instead sought higher tariffs, though it did not impose the increased duties on MERCOSUR members.[244] Tariffs were increased by as much as 32% to 70%.[245]

B. Televisions, Computers, and Electronic Products

1. The NAFTA

Color televisions represent the largest consumer electronics sector in Mexico.[246] For a television set (over fourteen inch screen size) to be considered North American under the NAFTA, the color tube, its major component, must be of North American origin.[247] The rationale behind this rule is to attract television tube production—the source of the highest paid jobs in the industry—to North America.[248]

As for electronic products, they are generally governed by three types of rules of origin under the NAFTA:

- A change in tariff classification;
- A change in tariff classification combined with a RVC requirement;
- Rules requiring or prohibiting the incorporation of specific parts or components.[249]

The NAFTA rule for computers requires a change in tariff classification, provided that the motherboard is of North American origin.[250] During negotiations, the electronics industry was primarily concerned with key sub-assemblies, such as motherboards, flat panel displays, and integrated circuits.[251] Now, according to this rule, if the motherboard is not originating, then the computer is subject to an RVC requirement of 60% under the transaction-value

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242. *OAS Trade Bulletin, Dec. 1995* (visited Apr. 2, 1997) <http://www.sice.oas.org/FTAA/cartage/news1/tzones.htm>.
243. *Id.*
244. *Id.*
245. *Customs Unions* (visited Apr. 2, 1997) <http://www.oas,org/en/prog/trade/free42e.htm>.
246. Jensen-Moran, *supra* note 180.
247. Gantz, *supra* note 107.
248. Jensen-Moran, *supra* note 180.
249. REYNA, *supra* note 3, at 243-44.
250. *Id.*
251. *Id.* at 244-45.

method, and 50% under the net-cost method.[252] A common external tariff of 3.9% on computers will come into effect in 2004.[253]

2. MERCOSUR

Telecommunications equipment is subject to a tariff-shift and a special manufacturing process requirement.[254] This includes the assembly of at least eighty percent of the printed circuit boards, and the assembly and soldering of all circuit board components.[255] The same principle applies to television sets, video cassette recorders, and video cameras.

There are very detailed provisions for computer products that require that all components be assembled and soldered in the circuit board, as well as the assembly of mechanical and electrical parts.[256] Portable computers must comply with this regulation for all components.[257] Medium-sized to high-capacity computers (classified under headings 8471.91.20, 8471.91.30, and 8471.91.40) have a different rule, which requires the assembly and soldering of all components of the circuit boards implementing three (or in the case of high capacity computers, two) of a set of five functions: a) central processing; b) memory; c) control of peripheral devices; d) system support and diagnosis; and e) channels or interfaces communicating to the output/input of data/peripheral devices.[258]

C. Textiles

1. The NAFTA

The production of most textile and apparel goods is a four-step process:

- Fibers, hair, wool, and other raw materials are gathered or harvested;
- Fibers are spun to make yarn;
- The yarn is woven into fabric; and
- The fabric is cut and sewn (or assembled) into a garment.[259]

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252. *Id.*; NAFTA, *supra* note 1, Annex 401, 32 I.L.M. at 397.
253. Jensen-Moran, *supra* note 180.
254. *Regulation on Origin of Goods*, *supra* note 145, art. 3(c). Annex II applied as of January 31, 1995. Prior to these provisions, which were enacted by Dec. 23/94, the general rules of origin applied. Dec. 23/94, *supra* note 161.
255. *Regulation on Origin of Goods*, *supra* note 145, art. 3(c).
256. *Id.* § 4.
257. *Id.*
258. *Id.*
259. REYNA, *supra* note 3, at 250-51.

For most textile and apparel products to receive preferential treatment under the NAFTA, they must undergo the last three of the steps described above, in one or more NAFTA country.[260] Specifically, the NAFTA requires that to qualify as originating, a textile or apparel good must be produced entirely from the yarn-spinning stage forward in a NAFTA country (yarn-forward rule).[261] This highly restrictive rule is intended to prevent factories from setting up operations dependent on yarns or cloth imported from outside North America.[262]

A variation of the yarn-forward rule is the fiber-forward rule.[263] This rule applies to specific textile and apparel goods that are made of cotton or man-made fibers.[264] In this case, the fiber used to produce yarn and other materials must be obtained in a NAFTA territory.[265] Consequently, all four production steps must be carried out in a NAFTA country.[266] This rule was designed to protect the cotton and man-made fiber industries of the NAFTA parties.[267] Where other fibers are concerned, such as silk, exceptions to this rule were established.

2. MERCOSUR

As with automobiles, a special Technical Committee (No. 10) was appointed to deal with textiles and apparel.[268] No specific provisions are included so far in the Regulation of Origin, due to the fact that textiles are still outside the scope of MERCOSUR.[269] All four countries have agreed to include this product as an exception to the zero percent tariff agreed within the region, with tariffs to be finally eliminated either by 1999 (Argentina and Brazil) or by the year 2000 (Paraguay and Uruguay).[270]

The Committee's policy must take into consideration the rules emerging from the Uruguay Round of GATT.[271] As long as no final agreement is attained, each country will apply its own regulations.[272]

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260. *Id.*
261. *Id.*
262. Gantz, *supra* note 107.
263. REYNA, *supra* note 3, at 252.
264. *Id.*
265. *Id.*
266. *Id.* at 253.
267. *Id.*
268. *Common Market Group Res. No. 124/94* (visited Apr. 2, 1997) <http://www.intr.net/mercosur/res12494.htm> [hereinafter *Res. No. 124/94*].
269. *Id.*
270. *Res. No. 48/94*, *supra* note 141.
271. *Res. No. 124/94*, *supra* note 268.
272. *Id.*

D. Chemicals

In MERCOSUR, the reason for the existence of special rules of origin for chemicals is to attempt to close a loophole that was created by the prior comparatively liberal rules of origin.[273] Since MERCOSUR's tariff reduction schedule took effect in 1991, Uruguay experienced a huge increase in chemical imports.[274] The reason was that Uruguay charged lower tariffs than Brazil on imported chemicals.[275] Because of their fungible nature, chemicals were imported into Uruguay, underwent minor processing, and then were shipped to Brazil at preferential tariff rates as a Uruguayan product.[276] Currently, the applicable provision calls for a tariff-shift that must include a particularly restrictive notion of substantial transformation.[277] This means that the final product must be obtained following a process that involves molecular modification, creating a totally new chemical entity.[278]

Under the NAFTA, a tariff-shift is also necessary.[279] However, it is often accompanied by a RVC requirement of 50% or 60%, depending on the calculation method (net-cost or transaction-value).[280] The trend, however, seems to be towards the elimination of the RVC requirement in this area.[281]

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273. O'Keefe, *supra* note 73.
274. *Id.*
275. *Id.*
276. *Id.*
277. *Regulation on Origin of Goods*, *supra* note 145, Annex II, § 1. A change of character is needed for the transformation to confer origin. *Id.*
278. *Id.*
279. NAFTA, *supra* note 1, Annex 401, § VI, 32 I.L.M. at 400.
280. *Id.*
281. Telephone Interview with Wes Peters, International Business Branch, Industry Canada (June 4, 1996). As of Jan. 1, 1996, several changes were introduced to Section VI of Annex 401, reflecting new product classifications under the Harmonized System, and eliminating the need for the RVC requirement for several headings and subheadings. Since even before the NAFTA became effective, the chemical sectors of the three countries have shown concern for the elimination of RVC requirements, and slow advances have been made in that field. By way of example, before Jan. 1, 1996 it was necessary for organic chemicals (Chapter 29) to meet RVC requirements of 50% to 60% when there was a change to subheading 2901.10 through 2942.00 from any other subheading within Chapters 28 through 38. Current regulations are much more detailed in the enumeration of the treatment granted under Chapter 29, and for many categories the need for RVC has been eliminated (for example, 2901.10-2901.29; 2902.11-2902.44; 2902.60-2902.90; 2905.11-2907.30, etc.). *Id.*

VII. CUSTOMS COOPERATION BETWEEN MEMBER COUNTRIES, AND BETWEEN MEMBERS OF DIFFERENT REGIONAL TRADE ORGANIZATIONS

Cooperation between customs authorities is essential, since that is the level where rules of origin are ultimately applied. This is a complex process that includes the declaration of the goods and documentation to be submitted, classification of goods, valuation, verification, and penalties. Different rules and principles are applied throughout the world and trading agreements in each one of these fields. However, efforts are also under way to harmonize these procedures.

A. The NAFTA

The NAFTA parties have adopted a uniform certificate of origin, and regarding customs procedures, they have agreed to exchange pertinent information on advance rulings, origin determinations, and classification of goods, and to adopt uniform customs procedures.[282] Uniform Regulations as adopted by the NAFTA countries apply to certificates and declarations of origin, records, origin verification, advance rulings, and reviews.[283] Further, documents and information can be exchanged electronically.[284]

B. MERCOSUR

To implement the customs union, a Working Group was appointed to assist the Common Market Group, under the directives of the Common Market Council (Working Group 2—Customs Issues).[285] The Group was made up of representatives (experts) from each country, who first established the goals of each member, and then held several meetings to achieve their common goals.[286] As of January 1, 1995, the functions of Working Group No. 2 are carried out by Technical Committee No. 2, under the direction of the Commerce Commission of MERCOSUR.[287] This does not cover, however, issues related to tariffs,

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282. NAFTA, *supra* note 1, art. 512, 32 I.L.M. at 362.

283. REYNA, *supra* note 3, at 745 (Annex E-4).

284. The information is sent in a format called a Customs Declaration Message, which is defined by EDIFACT. MARGARET A. EMMELHAINZ, ELECTRONIC DATA INTERCHANGE A TOTAL MANAGEMENT GUIDE 21 (1990).

285. *Report of the MERCOSUR Sectorial Commission*, *supra* note 238.

286. Declaration of the National Customs Administration of the Republic of Argentina [hereinafter Declaration of Argentina] from the MERCOSUR—Principales Acciones y Experiencias de Integración de los Países Miembros en el Campo de la Operativa Aduanera, National Customs Directors of Latin America, Spain, Portugal, & Cuba, 16th mtg. (Oct. 30-Nov. 3, 1995) (on file with author).

287. *Id.*; *see also Directive No. 1 of the MERCOSUR Commerce Commission*

nomenclature, and classification of goods, which are analyzed by Technical Committee No. 1.[288] Technical Committee No. 2 has four sub-committees:

1. Border Operations and Controls: to unify and facilitate the movement of goods across the borders.[289]
2. Customs Regulations: in charge of the implementation of the MERCOSUR Customs Code (MCC) and other applicable regulations, as well as the revising and eventual modification of the MCC.[290]
3. Valuation: this Committee participates in the uniform application of valuation regulations and criteria, in compliance with the GATT Valuation Agreement.[291]
4. Customs Information: aimed at the development and implementation of a computerized system for the exchange of data and information "on line" between the customs services.[292]

1. The Present State of Customs Proceedings and Regulations: MERCOSUR—EU

The MCC was written following prior national legislation, the Customs Code of the EU, the Kyoto Convention, the GATT Customs Valuation Agreement, and LAIA's rules of origin and regulations.[293] In compliance with the Ouro Preto Protocol, the MCC becomes effective after the second ratification has been submitted.[294] Currently, the only country that has not ratified the MCC is Argentina. Thus the MCC is currently in force for the other three countries, and in the relationships with Argentina national regulations are applied, although some articles of the MCC have already been approved by Argentina.[295]

(visited Apr. 2, 1997) <http://www.intr.net/mercosur/dir195.htm>.

288. *Directive No. 1 of the MERCOSUR Commerce Commission, supra* note 287.

289. *Directive No. 2 of the MERCOSUR Commerce Commission* (visited Apr. 2, 1997) <http://www.intr.net/mercosur/dir295.htm> [hereinafter *Directive No. 2 of the MERCOSUR*]; *see also* Declaration of Argentina, *supra* note 286.

290. *Directive No. 2 of the MERCOSUR, supra* note 289.

291. *Id.*

292. *Id.* At present, the customs services of Argentina and Brazil are interconnected, which has greatly facilitated the process of following up and dealing with goods, as well as determining the existence of irregularities, and even crimes. *Id.*

293. *Id.*

294. *Id.*

295. *Id.* Within their objectives up to the year 2000, the parties have anticipated the implementation and full force of the MERCOSUR Customs Code: attainment of a final result in the elaboration of provisions in said code; implementation of controls in the borders; interconnection of computer systems between the customs authorities of the parties; coordination of measures to prevent customs crimes; and uniform application of provisions and criteria of customs valuation. *Id.*

The most urgent concern of customs authorities currently seems to be the facilitation and harmonization of customs forms.[296] This task is still being undertaken by experts of all four countries.[297]

Another important task has been that of training employees in customs, immigration, and phytosanitary issues.[298] A significant step has been taken in this regard through the establishment of a framework agreement between the EU and MERCOSUR.[299] Article 7 of this agreement calls for the exchange of information, development of new techniques in the coordination of measures, exchange of employees, simplification of customs proceedings, and technical assistance.[300] To train MERCOSUR employees and assist in the formulation of operative regulations for the export and import of goods, a technical assistance program is under way sponsored by the EU.[301] In October 1995, MERCOSUR employees were invited to observe customs proceedings in different ports, airports, and customs terminals in Europe.[302] In November, 1995, EU customs employees traveled to MERCOSUR countries to evaluate the operation of integrated controls.[303]

C. Towards the FTAA and How Rules of Origin Should Evolve

Despite the efforts undertaken to the contrary, rules of origin continue being criticized as an obstacle to international trade. Some have pointed out that there is an implied threat behind the NAFTA's rules of origin: "buy North American, or else. . . ."[304] There has been a virtual embargo in Mexico on Asian-made products.[305] Some think this should be called regional xenophobia.[306]

Just as nations negotiate free trade agreements in key regions throughout the world, they may erect a series of regional trade barriers that become a source of "new protections."[307] These result in preventing products from moving freely

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296. *Id.*
297. *Id.*
298. *Id.*
299. Acuerdo Marco Interregional de Cooperación Unión Europea—MERCOSUR (on file with author). On September 29, 1995, MERCOSUR signed a framework cooperation agreement with the European Union in Montevideo. Cooperation in commercial areas will include, among other field-provisions regarding rules of origin, special customs regimes and harmonization of commercial regulations with GATT/WTO provisions. *Id.*
300. *Id.*
301. Declaration of Argentina, *supra* note 286.
302. *Id.*
303. *Id.*
304. *No End to the NAFTA Debate*, WASH. TIMES, Jan. 10, 1996, at B4.
305. *Id.*
306. *Id.*
307. Jensen-Moran, *supra* note 180.

between regions and subverting the broad vision of trade liberalization.[308] Rules of origin thus become instruments of forced investment, driving foreign companies to either invest in production facilities within the region, or not to trade with it at all.[309]

In the history of regional trade arrangements, rules of origin have been used as instruments of commercial policy to force investment and protect critical high-tech industries or local producers.[310] The European Community was the pioneer of using rules of origin as a trade policy to encourage EC content, EC sourcing investment, and manufacturing facilities in the region.[311] The NAFTA, on its side, has implemented its rules of origin to prevent the use of Mexico as an export platform into the U.S. market by Japan and other countries.[312] In automobiles, electronics, textiles, telecommunications, machine tools, fabricated metals, household appliances, furniture, and other sectors, the NAFTA rules of origin require that a substantial portion of these products originate in the NAFTA countries.[313] In some cases, other countries have complained that these rules raised levels of protection above pre-NAFTA levels, thus colliding with GATT principles of non-discrimination,[314] elimination of trade barriers,[315] and the requirements necessary for the formation of regional trade arrangements.[316]

Industries and producers complain too. Valuation and classification processes may turn out to be very complex, and compliance with the rules in many cases forces companies to set up expensive internal procedures that add significantly to the cost of sales.[317] Many would rather pay the tariff. With automobiles, for example, producers may prefer to pay the U.S. tariff (2.5%) rather than have to trace the North American value-added content; the same could apply to televisions (5%).[318]

Another considerable factor has been the imposition by customs authorities of significant penalties when certificates of origin have been erroneously

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308. *Id.*
309. *Id.*
310. *Id.*
311. *Id.* The article mentions the example of the EC semiconductors where, after several years of treating semiconductors assembled in the EC as being of EC origin, the rule was changed. Currently the process of diffusion has to be performed in the EC so that integrated circuits may be considered of local origin. *Id.*
312. *Id.*
313. *Id.*
314. GATT art. III.
315. *Id.* art. XI.
316. *Id* art. XXIV; *see supra* notes 214-16.
317. OAS, *supra* note 15.
318. *See Comments About Origin* (visited Apr. 24, 1997) <http://www.nifcosynergy.com/Product/Origin/basic_quotes.html>. As to customs authorities, opinions differ. Some complain about the current system—others say that even though the rules of origin are more detailed and complex, they provide the trade community with more certainty. *Id.*

completed.[319] The risk of severe penalties for noncompliance with documentary and record-keeping requirements is a factor to be kept in mind when deciding whether or not to claim the benefits of NAFTA origin.

Statistics show that trade between the NAFTA countries has increased significantly since the NAFTA came into effect.[320] Yet little of this international trade comes from small and medium-size businesses.[321] Some of this disappointing result, at least, is due to the need to comply with laborious regulations.[322] The net-cost method and the transaction-value method can be quite complicated, and the inappropriate choice of the net-cost method could result in an otherwise NAFTA-originating good being considered foreign.[323]

In MERCOSUR, implementation of rules of origin has gone at a different pace. Traditional products—agriculture, fishing, and cattle raising—pose practically no problems, since they all fall within the category of fully obtained or produced goods, and thus qualify as originating in the region. On the other hand, high-tech products—computers, telecommunication equipment, etc.—require detailed specifications on their compliance with rules of origin, and the determination of the processes to be followed in order for those goods to originate.[324] Other sensitive products—particularly textiles and automobiles—still have no final provisions as to the origin criteria they have to meet.

This is a situation similar to the one Mexico had to face when entering the NAFTA. The NAFTA was Mexico's introduction to rules of origin.[325] Before these agreements, Latin American countries maintained closed economies for the most part, with different degrees of protectionism and state participation through monopolies.[326] Therefore, there was little need for rules of origin.[327]

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319. U.S. Customs has exercised the authority to issue major penalties for merely negligent violations, even in cases where there is no loss of revenue in the U.S. These penalties can range up to $10,000 per false certificate of origin, and penalties for non-revenue loss violations may amount to as much as the value of the merchandise. *Nafta's New Double Whammy, Customs and International Trade Newsletter (1995)* (visited Apr. 24, 1997) <http://www.dttus.com/dttus/publish/tradenew/1995/citn95-3.htm>.

320. *Free Trade Isn't For Owner of Small Business* (visited Apr. 2, 1997) <http://www.beachnet.org/chiletrade/nafta.htm>.

321. *Id.*

322. *Id.*

323. *Id.*

324. *Regulation on Origin of Goods, supra* note 145, art. 3.

325. REYNA, *supra* note 3, at 40.

326. *Id.* at 40-41.

327. *Id.* at 40.

1. Is Harmonization of Rules of Origin Possible in the International Arena?: The Notion of Hemispheric Trade

The idea of hemispheric trade has been in the minds of statesmen and businessmen alike for decades. Implementing this long sought objective is a challenge of our time, and for the near future. The Enterprise for the Americas Initiative set the formal negotiations going in the desire to develop further international trade and investment relationships throughout the continent.[328]

On June 19, 1991, following this initiative, the governments of Argentina, Brazil, Paraguay, Uruguay, and the U.S. established a Consultative Council on Trade and Investment.[329] This Council was to stimulate trade, investment, and economic growth on a competitive basis, consistent with the obligations and procedures under the GATT.[330]

The main objective is the eventual harmonization of practices to enable the integration of the entire continent.[331] The U.S. and others argue that this effort

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328. George Bush, *Remarks Announcing the Enterprise for the Americas Initiative, in* 1 PUB. PAPERS 873, June 27, 1990; *see also* Rebecca D. Dankeler, *The Rose Garden Agreement: Is MERCOSUR the Next Step to a Hemispheric Free Trade Zone?* 24 LAW & POL'Y INT'L BUS. 157 (1992).

329. Dankeler, *supra* note 328, at 160; *see also* Agreement Among the Gov'ts of Argentine Rep., Federative Rep. of Braz., Rep. Para., Oriental Rep. Uruguay, and the Gov't of the U. S. A., Concerning a Council On Free Trade and Investment, June 19, 1991, 30 I.L.M. 1034 [hereinafter Agreement Among the Governments].

330. Agreement Among the Governments, *supra* note 329, 30 I.L.M. at 1034. This Agreement was signed shortly after the first four countries entered into the MERCOSUR Agreement, on March 26, 1991. *See* MERCOSUR, *supra* note 138, 30 I.L.M. at 1041.

331. *See* Liane L. Heggy, *Free Trade Meets U.S. Farm Policy: Life After the Uruguay Round*, 25 LAW & POL'Y INT'L BUS. 1367 (1994).

> Under the aegis of EAI, the United States began negotiations with MERCOSUR in late 1990, in order to build a multilateral framework agreement. These negotiations led to the Rose Garden Agreement, signed in June 1991 by the United States and the MERCOSUR nations of Argentina, Brazil, Paraguay, and Uruguay.
>
> While the agreement does not approach or attempt free trade and does not require the parties to make any changes in trade policy, it does establish and promote the EAI vision of eventual hemisphere-wide free trade.

Id. at 1384.

> It is too early to predict the extent to which this enthusiasm for signing agreements will translate into actual trade liberalization. The various agreements are specific with regard to tariff reductions, ranging from the detail of the NAFTA to the designation of "working groups" in MERCOSUR. In virtually all cases, deadlines have come and gone. The

could be undertaken under a system similar to the NAFTA.[332] In this sense, the question would be how to approach hemispheric integration, whether that be by the acceding of subregional groups or by attempting a country-by-country accession.[333] The first attempts seem to indicate an intention to follow this second option, considering the efforts being made in order for Chile to enter the NAFTA.[334] However, this may lead to regional problems. Uruguay has already stated that if Argentina joins the NAFTA, it will have to renounce its membership in MERCOSUR.[335] Former Uruguayan President, Luis Alberto Lacalle, further supported this position by saying that MERCOSUR member states could not negotiate separate terms for accession to the NAFTA.[336] Brazil has not been too enthusiastic about U.S.-led hemispheric integration either.[337]

Meanwhile, MERCOSUR also is striving to gain new entrants. So far, side-agreements have been signed with Bolivia and Chile.[338] Furthermore, under Article 20 of the Treaty of Asunción, MERCOSUR is open to the addition of other members of LAIA.[339] The goal is the gradual growth of membership with the incorporation of new partners, and the coordination of efforts in subregional integration.

> best indicator of the future is that, in all cases, negotiations are ongoing and, bit by bit, progress is being made.

Id. at 1389.

332. Paul A. O'Hop, *Hemispheric Integration and the Elimination of Legal Obstacles Under NAFTA-Based System*, 36 HARV. INT'L L.J. 127, 127 (1995).

333. *Id.* at 132.

334. *Id.* at 153.

335. *Id.* at 158.

336. *Id.* at 158 n.198.

337. *Id.* at 158. On the other hand, an attempt by the U.S. to negotiate the accession of an entire sub-region *ab initio* would have both legal advantages and disadvantages. The potential for internal obstacles (e.g., conflicts with domestic constitutions and other internal laws) increases as the number of countries involved grows. These obstacles can be reduced if the states in the sub-region have already laid the constitutional groundwork for integration in connection with the formation of the sub-regional organization. Accession to a new broader integrated organization, however, would still require either that: (1) constitutional authority for direct accession to the new organization exist, or (2) that the new organization be deemed the legal successor to the sub-regional organization and that the domestic constitutional structure of each member state permit the transfer of authority to such a successor organization. *Id.*

338. *Agreement for Economic Complementation, June 25, 1996, MERCOSUR-Chile, MERCOSUR Database* (visited Apr. 1, 1997) <http://www.intr.net/mercosur/chilacue.htm> (Chile); <http://www.intr.net/mercosur/boliacue.htm> (Bolivia). These agreements are framework agreements that establish the basis for future free trade agreements.

339. MERCOSUR, *supra* note 138, 30 I.L.M. at 1049.

2. Harmonization of Rules of Origin

The application of the NAFTA rules of origin in a Free Trade Area of the Americas (FTAA) may prove to be an unlikely, if not outright impossible, objective.[340] Applying the valuation method, as we have seen, as well as a myriad of product specific rules of origin, would be an administrative nightmare both for the companies and customs authorities involved (particularly since they do not have the sophistication and technology available to their U.S. and Canadian counterparts).[341] Also, each country added to the Agreement would have to source most of the components of its cars, textiles, machine tools, and electronics from the NAFTA (or applicable agreement) countries, even though cheaper or better components might be available in other geographically closer countries.[342] This would lead to trade diversion and thus collide with WTO principles.[343] Consequently, policymakers should not be too confident that they can realistically replicate the NAFTA model for rules of origin throughout the hemisphere.

For instance, Chile has already called for the relaxation of the MERCOSUR standard that requires RVC at a rate of sixty percent for products to qualify for preferential treatment.[344] Add to this the evaluation of RVC through the net-cost method, the infinite variety of regulations for a wide scope of products, the requirement of special processes in some cases, and you end up with a maze-like system that is hard to disentangle.[345]

Ultimately, the most attractive investments, technology, and jobs will flow to countries that offer the best manufacturing and productivity environment.[346] Otherwise, rules of origin will be used exclusively as a weapon to manipulate trade and investment in suboptimal ways, producing a domino effect as each region tries to out-do the others by establishing high sourcing requirements.[347]

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340. Jensen-Moran, *supra* note 180.

341. *Id.*

342. *Id.*

343. *Id.*

344. *EU/MERCOSUR: Southern Cone Traders Gear Up For Free Market*, EUR. REP., Dec. 9, 1995, *available in* 1995 WL .

345. *Agreement for Economic Complementation, June 25, 1996, MERCOSUR-Chile, MERCOSUR Database, supra* note 338. This Agreement includes, under Article 1 (Purposes), the goal to establish a free trade area between the parties within a period of ten years, through the expansion of trade and the elimination of tariff and non-tariff barriers. *Id.*

The 60% RVC was accepted as a general criterion, in addition to or as an alternative to, the tariff-shift approach; however, a series of exceptions were established, whereby until Jan. 1, 1999, only a 50% or 55% RVC is applicable on certain items in Annex 13, Appendix 1. *Id.*

346. Jensen-Moran, *supra* note 180.

347. *Id.*

Such a course of action would also prove to be counterproductive in the negotiation of WTO or other harmonized rules of origin.[348]

The Denver Ministerial Summit, held on June 30, 1994, was the first series of negotiations towards a FTAA, aiming to be fully consistent with the provisions of the WTO.[349] The Summit of the Americas established as a principle that a key to prosperity is trade without barriers, without subsidies, without unfair practices, and with an increasing stream of productive investments.[350] To achieve these goals, the negotiators decided that the FTAA will build on existing subregional and bilateral arrangements.[351]

The Summit created working groups in different fields, including Customs Procedures and Rules of Origin.[352] At the Cartagena Ministerial Meeting, held in Colombia starting March 21, 1996, these groups submitted progress reports, and made recommendations for future work.[353] In the area of rules of origin, the recommendations include the development and improvement of a complete inventory of customs procedures in the hemisphere, as well as the publication of a Customs Procedures Manual to be used by the private sector.[354] The promotion of electronic filing of customs documentation was also recommended.[355] The working group held three meetings before the Cartagena

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348. *Id.*

349. *Final Declaration 1996, June 30, 1995, Summit of the Americas Trade Ministerial* (Denver) (visited Apr. 1, 1997) <http://www/ustr.go/agreements/americas/denver.html> [hereinafter *Denver Ministerial*].

350. *Summit of the Americas—Declaration of Principles, Summit of the Americas Center, Fla. Int'l U.* (visited Apr. 2, 1997) <http://americas.fiu.edu/summit/Agreements/zdope.txt>.

351. *Denver Ministerial, supra* note 349.

352. *Id.* As established in the Declaration, the goals of this group were to:

- Compile in the most efficient manner possible a comprehensive inventory of Western Hemisphere customs procedures and determine the feasibility of publishing a Western Hemisphere Guide to Customs Procedures;
- Develop features that are fundamental to an efficient and transparent system of rules of origin, including nomenclature and certificates of origin;
- Identify areas for technical cooperation in customs operation, such as connections among computerized systems and prevention of fraud;
- Recommend a specific approach for hemisphere-wide simplification of customs procedures; and
- Make specific recommendations for conducting negotiations on rules of origin. *Id.*

353. *Joint Declaration, Summit of the Americas, Second Ministerial Meeting* (Mar. 21, 1996) (visited Apr. 2, 1997) <http://www.ustr.gov/agreements/americas/cartagena.html>.

354. *Id.*

355. *Id.*

Ministry, in September 1995, January 1996, and February 1996.[356] As a result, an Informative Register of Customs Procedures (IRCP) was established, and an additional questionnaire was sent out, to lay the initial groundwork for the preparation of the Manual of Customs Procedures for the Hemisphere.[357] A second mandate for the group was the identification of those characteristics that are essential to the establishment of an efficient and transparent system of rules of origin, including nomenclature and certificates of origin (standardized format).[358] Accordingly, rules of origin should:

- Be objective, understandable, predictable, and consistent;
- Provide that a good be regarded as originating in the Free Trade Area if:
  - it was produced in its entirety in the Area, or
  - it was not produced in its entirety in the Area, but meets the necessary conditions to enable it to be regarded as originating in the Area;
- Be administered in a consistent, uniform, impartial, and reasonable manner; and
- Be based on positive criteria, the use of negative criteria being permitted only when a positive criterion needs clarification.[359]

The third mandate included the identification of areas for technical cooperation in customs administration, such as computerized systems linking, and fraud prevention.[360]

Other mandates included the simplification of customs procedures in the hemisphere, as well as offering specific recommendations for conducting negotiations on rules of origin.[361] Regarding the latter, the working group offered the following recommendations:

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356. *Report of the Working Groups to the Ministers* (visited Apr. 2, 1997) <http://americas.fiu.edu/documents/960321b.htm>.

357. *Id.*

358. *Id.*

359. *Id.*

360. *Id.*

361. *Id.* Regarding customs and infrastructure issues, many sectors agreed on the need for simplified procedures. The agribusiness sector pointed out that trade in many countries is distorted or delayed by inadequate infrastructure and inefficient customs procedures. Likewise, the apparel/textile sector urged the governments to develop a rule of origin which can be accepted as a standard for the trade in textiles and apparel, and to adopt regulations and procedures which would facilitate multiple-country sourcing and production. Regarding transportation, it was recommended that port working hours should be extended, electronically transmitted documents should be accepted, and generally speaking, customs delays should be overcome. *See Agribusiness "Early Harvest" Recommendations—Moving Towards Free Trade for the Americas, Cartagena, Colombia* (visited Apr. 2, 1997)

- Defining a working methodology that will enable the analysis of more detailed processes, to facilitate the continued study of new proposals for specific recommendations;
- Designing a standardized certificate of origin that takes into account the experiences of the different countries; and
- Establishing the necessary guidelines for the preparation of a basic common nomenclature conforming to the Harmonized System and its amendments, to serve as an instrument of negotiation.[362]

The group also identified the problem arising from the countries' differing levels of economic development, and whether or not this should result in a differential treatment in the formulation of rules of origin.[363] No conclusions were reached regarding this issue, and it will have to be dealt with in future meetings, either at the working group level, or among the Ministers.[364]

One of the workshops at the meeting, dealing with Obstacles and Solutions to Trade (Workshop IA), discussed, among other things, customs procedures and rules of origin as areas that the private sector regarded as restrictions obstructing trade between the countries in the hemisphere.[365] The workshop also made recommendations stressing the need for harmonization of rules of origin, preferably in accordance with WTO regulations.[366] They discussed whether the FTAA should seek to go beyond the trade liberalization regimes of the WTO, an approach referred to as "WTO-plus."[367]

In the meeting of the World Economic Forum during the MERCOSUR Economic Summit in 1995, the GATT/WTO system was pointed out as a fundamental basis on which to build the FTAA.[368] Incorporating WTO principles has the advantage of avoiding the creation of a parallel agreement and repeating issues that have already been addressed.[369] Furthermore, this decision would guarantee to countries outside the hemisphere that continental free trade is

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<http://americas.fiu.edu/documents/960320a.htm>; *see, e.g. Apparel/Textile Sector Recommendations—Moving Towards Free Trade for the Americas, Cartagena, Colombia* (visited Apr. 2, 1997) <http://americas.fiu.edu/documents/960320c.htm>; *Transportation Sector "Early Harvest" Recommendations Moving Towards Free Trade for the Americas, Cartagena, Colombia* (visited Apr. 2, 1997) <http://americas.fiu.edu/documents/960320i.htm>.

362. *Report of the Working Groups to the Ministers*, *supra* note 356.

363. *Id.*

364. *Id.*

365. *The Americas Business Forum: Summary and Conclusions* (visited Apr. 2, 1997) <http://www.sice.oas.org/FTAA/carta_e.stm#summary> [hereinafter *The Americas Business Forum*].

366. *Id.*

367. *Id.*

368. *Meeting of the World Economic Forum, June 18-20, 1995 (São Paulo, Brazil)* (visited Apr. 2, 1997) <http://www.oas.org/EN/PINFO/SG/025-merc.htm>.

369. *Id.*

just one more step in the furtherance of global trade expansion.[370] If global standards are accepted, the negotiators may focus on specific and sensitive areas that have not been covered by the WTO but are essential in the hemispheric context.[371] This is where regional agreements, such as the NAFTA, MERCOSUR, or the Andean Group may prove important, insofar as they have developed or consolidated principles and experiences that may prove valuable in the integration process.[372]

Due to the complexities surrounding rules of origin, the workshop expressly recommended that the choice for integration be a customs union.[373] This would remove the need for rules of origin and prevent them being used as a protectionist instrument.[374]

Although this would appear to be the ideal solution, it seems quite unattainable as a goal for the near future. While a customs union reduces the need for rules of origin, it does not eliminate it altogether. Specific processing and/or value content requirements will invariably apply, even if only to a restricted list of sensitive products. This is particularly true during the phase-in process leading to the establishment of the customs union. It cannot be expected that tariffs will be eliminated altogether, or that the parties will agree to a CET, without incorporating a list of exceptions, even if they are to be gradually eliminated. This was a slow process for the EU, and the same applies to MERCOSUR. The CET has not been widely used in Latin American integration, since it implies abandoning the power of each country to individually establish its economic policy.[375] The Caribbean Common Market (CARICOM) has found it hard to agree on a CET.[376] MERCOSUR managed to establish a CET, but the list of exceptions still includes important areas such as automotive products, with other significant products being excepted from the tariff elimination process until as late as the year 2000.[377]

The NAFTA, as we have seen, has so far only agreed on a CET for computer products; other products (such as chemicals) have also been mentioned for the purpose of establishing a CET, yet it does not seem realistic to predict that a general CET could be applied any time soon. A CET is hard to negotiate. Particularly among countries with different levels of development, it would be extremely difficult to come to an agreement.

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370. *Id.*
371. *Id.*
372. *Id.*
373. *The Americas Business Forum, supra* note 365.
374. *Id.*
375. *See* Jeffrey E. Garten, *American Trade Law in a Changing World Economy*, 29 INT'L LAW. 15 (1995).
376. James R. Holbein & Gary Carpenter, *Trade Agreements and Dispute Settlement Mechanisms in the Western Hemisphere*, 25 CASE W. RES. J. INT'L L. 531, 550 (1993).
377. *Res. 48/94, supra* note 141. The list includes textiles, footwear, paper, chemicals, and food products. *Id.*

3. The Future of Rules of Origin

The application of rules of origin may yield the following results:

- Rules of origin may be effective in attracting foreign investment and protecting local companies.[378]
- Industrial policies and pressures may lead to "investment wars" that will eventually distort trade and investment, contrary to general principles of international trade. A corollary of this result is that agreements will reflect the position of the most powerful industries, rather than the most strategic or competitive ones.[379]
- The dilemma for negotiators—whether to negotiate rules that stimulate exports by allowing firms to obtain low-cost components, or to negotiate rules that encourage investment and sourcing in a particular region—will heighten in future negotiations on a hemispheric level.[380]

The U.S. automotive industry has already hinted that it will want a rule setting a level even higher than 62.5% when negotiations begin with MERCOSUR.[381] This is because the Brazilian market is much larger and competitive in supplying automotive parts.[382] This of course will give rise to an endless series of debates, and uneasiness in the negotiations. And this is only the beginning.

According to Columbia University free trade scholar Jagdish Bhagwati, there is a great risk that world trade will be fragmented by destructive competition between rival trade blocs.[383] The Uruguay Round Agreement on Rules of Origin aims at solving these disputes. After all, it was the first multilateral agreement to move towards the harmonization of rules of origin in international trade.[384]

Flawed implementation of rules of origin can constitute a serious obstacle for the creation of a FTAA.[385] Due to the impossibility of establishing a single criterion to determine the regional origin of each and every existing good, it is at least desirable to select the minimum number of criteria that will guarantee the maximum effectiveness and clarity possible.[386]

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378. Jensen-Moran, *supra* note 180.
379. *Id.*
380. *Id.*
381. *Id.*
382. *Id.*
383. James Sheehan, *Birthday Blues for NAFTA*, WASH. TIMES, Dec. 8, 1995.
384. REYNA, *supra* note 3.
385. *Id.*; *Towards a Common Policy on Rules of Origin* (visited Apr. 2, 1997) <http://www.oas.org/EN/PROG/TRADE/free63e.htm>.
386. *Towards a Common Policy on Rules of Origin, supra* note 385.

As we have seen when analyzing GATT rules of origin, harmonization is to be carried out by a Technical Committee of the WTO under the auspices of the Customs Cooperation Council.[387] The Committee is charged with developing internationally agreed definitions of product origin determination for all non-preferential trade, based principally on the tariff-shift classification method.[388] The Harmonized System—adopted by most of the world's trading nations despite some regional differences—is a valuable tool when attempting uniformity and consistency.[389] Thus, by employing such criterion as the basic tool for determining origin, one could use complementary criteria such as the regional content or technical requirements only for those exceptional cases that clearly merit it.[390]

A requirement for advancing in this direction is the definition of a coherent system regarding the changes of tariff classification. Such a system would establish the necessary levels of change (e.g. a change at the level of chapter, heading, or subheading). However, the question remains as to whether to harmonize rules of origin in preferential trading arrangements, such as those discussed in this Article. Otherwise, the impact of the Uruguay Round Agreement would be considerably limited. Hopefully, a point will come when WTO rules of origin will apply to preferential trade agreements as well. This has already been proposed as a goal for the FTAA,[391] although so far no definitive conclusions have been reached. Additionally, how to converge the FTAA and WTO agendas is one of the issues to be dealt with at the next Ministerial Meeting, to be held in Belo Horizonte, Brazil, in May, 1997.[392]

VIII. CONCLUSIONS

No matter what issues are raised, harmonization is not an easy task. Harmonization of rules of origin is no exception. What we have witnessed so far, under GATT and FTAA efforts, amounts to little more than a declaration of goals and expectations.

The success in expanding preferential markets depends heavily on the way rules are established in terms of rigor, transparency, selectivity, and administrative simplicity.[393]

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387. Agreement on Rules of Origin, *supra* note 5, art. 9.

388. *Rules of Origin Crucial for Trading System*, THE DAILY YOMIURI, Nov. 17, 1995.

389. *Towards a Common Policy on Rules of Origin*, *supra* note 385.

390. *Id.*

391. *Id.*

392. *Proposal for the Conference Agenda* (visited Apr. 1, 1997) <http://www.alca.com.br/alca/engl/3_empre.htm>.

393. OAS, *supra* note 15.

The application of rules of origin suffers from various problems. If we are dealing with value-content rules, a high degree of unpredictability is present.[394] This is due not only to the uncertainties in calculations to be carried out or which costs to include (and how to deal with borderline cases), but also to the incidence of exogenous factors, like exchange or interest rates.[395] These can become particularly significant when one is dealing with fluctuating economies, as is the case in many Latin American countries.[396]

With respect to Latin America, and its integration into the FTAA, we must also bear in mind that there is still some "unfinished business." At the Denver Ministerial in 1995, the President of the Inter-American Development Bank, Enrique Iglesias, pointed out that an area where accomplishments have not measured up satisfactorily is the expansion and diversification of exports and markets.[397] A major advance in the modernization of the exporting structure is necessary to increase the proportion of manufactured and other products of greater added value.[398] This growth takes considerable time.[399]

Another important task that remains is the interrelation between the public and private institutional spheres.[400] A transition from monopolies to privatization entails change and the adaptation of institutions that are instrumental to international trade.[401]

Furthermore, the significance of operational and administrative costs incurred in the certification and verification of at least some rules of origin, at both the producer level and national customs level, must be stressed.[402] Regarding these costs, the RVC rules of origin and those requiring the compliance with a particular manufacturing process are particularly noteworthy, since the companies and the authorities need to gather sufficiently substantiated data on costs, distribution, sales, and production. Thus the costs of certification can become quite a significant amount.[403]

At present, there are mainly two generic regimes for qualifying origin, as identified by the Inter-American Development Bank (IDB) (preparing a study on tariffs and rules of origin in the hemisphere).[404] The "first generation" scheme

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394. *Id.*

395. *Id.*

396. *Toward a Hemispheric Capital Market, Remarks by Enrique Iglesias* (visited Apr. 2, 1997) <http://www.ita.doc.gov/ita_home/forum/market4.html>.

397. *Id.*

398. *Id.*

399. *Id.*

400. *Id.*

401. *Id.*

402. OAS, *supra* note 15.

403. *Id.* One case study in West Germany in the early 1980s, regarding its participation in the European Community and the European Free-Trade Association, estimated the cost of the determination of origin to be between 2% and 3% of the value of the goods examined. *Id.*

404. *Id.*

according to this study is the one that characterizes the LAIA system.[405] The "second generation" emerged within the NAFTA.[406] Under the first approach, rules of origin are characterized by their simplicity (following, the author believes, the example set by the EU, formerly the EEC). The LAIA regime applies a generic requirement for the determination of origin: a tariff-shift approach, or alternatively an extra-regional content of no more than fifty percent of the FOB value.[407] This rule applies to almost all items on the tariff schedule, except for a few products which are governed by special rules.[408]

In the "second generation" regime, rules of origin have multiplied: there is a tariff-shift ingredient; RVC many times reaches values higher than fifty percent; and technical requirements for manufacturing processes are often included.[409] Furthermore, the association of these requirements creates multiple possibilities: tariff-shift;. a change in the tariff classification with a value-added content; or value-added requirement/tariff-shift plus a technical test.[410] Descriptions of the mechanisms for specific products cover roughly 200 pages under the NAFTA.

MERCOSUR follows the path set by LAIA. There are relatively simple rules of origin, based either on a tariff-shift approach or a RVC of sixty percent of the FOB value (this being the difference). Added to this is a moderately short list of special provisions for chemicals, siderurgical (iron-steel) industry, electronic products, computers, and computer parts and components. In total, the Regulation of Origin and its Annexes cover twenty-six pages but the list is bound to get longer. MERCOSUR is far from being a customs union in the same sense as the EU, where rules of origin have a relatively lesser significance. The exception, as we have seen, occurs when applying tariffs in some cases of mere assembly, for the purpose of determining quotas or applying anti-dumping duties (non-preferential rules of origin), or in the relationships with third countries.

MERCOSUR has yet to define the treatment of fundamental sectors, such as textiles and automobiles. The process is not one that is devoid of problems, and already criticisms have been heard. The loudest was that of the World Bank, accusing the pact of being protectionist.[411] They argued that the customs union was harming the member countries' economies by discouraging efforts to become more competitive on the world stage, while discriminating against exports from other countries.[412] Actually, this criticism may be applied similarly to other regional trading groups.

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405. *Id.*
406. *Id.*
407. *Id.*
408. *Id.*
409. *Id.*
410. *Id.*
411. *World Bank Official's Study, Critical of MERCOSUR, Fuels Debate*, 30 INSIDE NAFTA (Oct. 30, 1996) <http.//americas.FIU.Edu./Inside/961030.HTM>.
412. *Id.*

The result of this process will be visible in approximately ten years.[413] Hopefully by then the road to a FTAA will be somewhat more defined, and some agreement will be visible regarding the harmonization of rules of origin.

The middle ground should be reached by avoiding the vagueness of the LAIA model. This has been a decisive factor in the system's lack of effectiveness, without, however, reaching the degree of detail and complexity of the second generation of rules of origin that would prove to be equally ineffective for developing countries.[414]

The guideline to follow seems to be the one established by the WTO Agreement on Rules of Origin: the perfection of a system based mainly on a tariff-shift approach, with resort to additional criteria limited to the absolute minimum of products that merit such a distinction.[415] Of course this would be the solution in the ideal world. In the real world of trade industry interests, lobbyists, and political power struggles will tilt the scale one way or the other. A list of sensitive products is bound to result from any proposed agreement on rules of origin, and special mechanisms will be necessary. The larger the number of countries involved, the longer the list will be, reflecting local economies and concerns. The concerns of developing and least-developed countries particularly should also be taken into consideration, as has been repeatedly done under WTO provisions.[416]

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413. OAS, *supra* note 15.

414. *Id.*

415. *See* Agreement on the Rules of Origin, *supra* note 5.

416. *See, e.g.*, GATT art. XVIII (Governmental Assistance to Economic Development). Developing countries were also specifically mentioned at the December 1996 Singapore meeting in Sections 13 and 14:

> 13. The integration of developing countries in the multilateral trading system is important for their economic development and for global trade expansion. In this connection, we recall that the WTO Agreement embodies provisions conferring differential and more favourable treatment for developing countries, including special attention to the particular situation of least-developed countries. We acknowledge the fact that developing country Members have undertaken significant new commitments, both substantive and procedural, and we recognize the range and complexity of the efforts that they are making to comply with them. In order to assist them in these efforts, including those with respect to notification and legislative requirements, we will improve the availability of technical assistance under the agreed guidelines. We have also agreed to recommendations relative to the decision we took at Marrakesh concerning the possible negative effects of the agricultural reform programme on least-developed and net food-importing developing countries.
>
> 14. We remain concerned by the problems of the least-developed countries and have agreed to:

Lessons need to be learned from the experiences of existing trading systems. As with all fields of human undertaking, only time will tell what the outcome of this process will be. That time can be defined as the "road that needs to be traveled." After all, "*time is only the delay of what is about to come.*"[417]

• a Plan of Action, including provision for taking positive measures, for example duty-free access, on an autonomous basis, aimed at improving their overall capacity to respond to the opportunities offered by the trading system;
• seek to give operational content to the Plan of Action, for example, by enhancing conditions for investment and providing predictable and favourable market access conditions for LLDCs' products, to foster the expansion and diversification of their exports to the markets of all developed countries; and in the case of relevant developing countries in the context of the Global System of Trade Preferences; and
• organize a meeting with UNCTAD and the International Trade Centre as soon as possible in 1997, with the participation of aid agencies, multilateral financial institutions and least-developed countries to foster an integrated approach to assisting these countries in enhancing their trading opportunities.

Singapore Ministerial Declaration, supra note 205.

417. José Hernández, *Martín Fierro*, BUENOS AIRES, Editorial Losada S.A. (1941).