

Challenges faced by LDCs in complying with preferential rules of origin under unilateral preferences scheme

Paper presented by the Uganda on behalf of the
LDCs Group
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1.1 Background (I)

- Hong Kong Ministerial Decision on DFQF contained wording : RoO need to be *"transparent and simple, and contribute to facilitating market access"*
- Between 2006 and 2013, LDCs proposals on rules of origin by Zambia (2007), Bangladesh (2011) and Nepal(2013)
- WTO Ministerial Decision on Preferential Rules of Origin (RoO) in 2013 entrusted the CRO with:
 - *"Review annually developments in preferential rules of origin applicable to imports from LDCs."*
 - Agenda item in the CRO: *"Intensify efforts in the CRO to exchange information regarding existing preferential rules of origin for LDCs."*

1.1 Background (II)

- The Decision on preferential rules of origin for LDCs is a not binding decision, it provides guidelines.
- However Members agreed to have an agenda item to engage in a transparency and out-reach exercise on preferential rules of origin where a *"contribution to this dedicated agenda item would be the paper to be submitted by the LDCs about their specific challenges."*
- The CRO mandate is to review NEW or modified rules of origin.

1.2 Current challenges and status of the Decision

- The world has changed: Globalization of production and emergence of global value chains
- MFN reductions lowering the preferential margins
- Limited recognition of extreme need to reform RoO for LDCs:
 - Changes in the Canadian RoO in 2003
 - EU reform of RoO entered into force in 2011
 - US GSP has not changed its RoO since 1974, nor Japan
- LDCs have little industrial base and certain RoO are demanding antiquated industrial processes
 - Can the Decision and discussions in CRO leverage additional reforms in RoO ?
 - This paper and subsequent contributions have to be read in this context

1.3 Starting points

- LDC Group does not argue for harmonizing RoO
- RoO should be trade creating permitting full utilization of trade preferences
- Change in RoO in EU and Canada have generated a market response in terms of FDI and trade flows

1.4 Possible improvements

- Form
"Way in which the RoO are written using different methodologies."
- Substance
"Degree of restrictiveness of a RoO with respect to an existing value chain context."

1.5 Lessons learned from "*form*"

- Different *forms* to draft a RoO:
 - Change in tariff classification
 - Percentage criterion
 - Working or processing requirements

- Emergence of lessons learned and best practices on how to draft the *form* of a RoO using the percentage criterion

2. Form: Percentage Criterion

Criterion	Calculation	Application or criterion
Minimum amount of value added	Percentage of direct processing + cost of local originating material out of ex-factory price	US GSP, AGOA, Australia, New Zealand
Maximum amount of imported material	Percentage of foreign inputs out of the ex-works price	EU EBA, Japan (Denominator: FOB price)
Value of materials ("Build-down")	Subtraction of the value of imported material from the ex-works price out of the ex-works price	US-CAFTA

2.1 QUAD comparison

	EU EBA	JAPAN GSP	Canada GSP	US GSP	AGOA
Numerator	Value of non-originating materials	Value of non-originating materials	Value of non-originating materials	Cost of material of beneficiary developing country + direct processing cost	Cost of material of beneficiary developing country + direct processing cost
Denominator	Ex-works price	FOB price	Ex-factory price	Appraised value	Appraised article value
Percentage level	Maximum of 70% of imported inputs	Maximum of 40% or 50% of imported inputs	Maximum of 60%	Minimum of 35%	Minimum of 35%

- Major reforms by EU and Canada in 2011 and 2003, respectively.
 - EU: Increase the maximum allowance of foreign import to 70% and allow single stage transformation
 - Canada: Reduce the minimum limit of value added to 40%
- US GSP has not changed its RoO since 1974, neither Japan since the 70'.

2.2 Issues of the Percentage Criterion

- **Limitations of the Percentage Criterion**
 - Affected by exchange rates
 - Level of percentage arbitrarily set
 - Cost of labor relatively cheap; turn asset into penalty
 - Requires accountancy expertise
- **Adequate percentage level**
 - Depend on the product and the production processes
 - Need to consult with the private sector

2.3 Suggested practices (*FORM*)

- Percentage criterion for determining a substantial transformation:

- Method Based on Value of Non-Originating Materials :

$$LVC = \frac{EW - VNM}{EW} \times 100$$

- Method Based on Value of Originating Materials :

$$LVC = \frac{VOM}{EW} \times 100$$

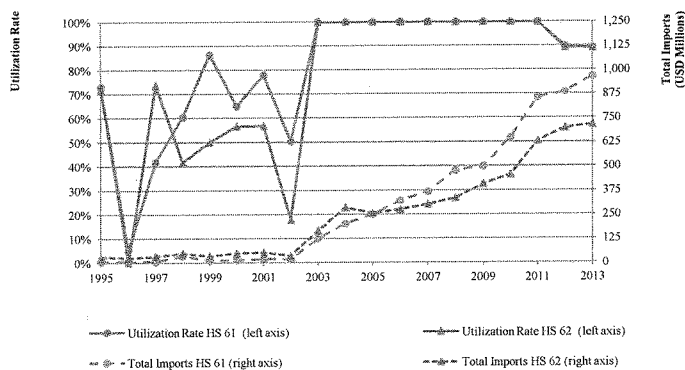
- Percentage level
 - 15-25% or even lower for certain product categories
- Transport costs
 - Percentage criterion-based rules should take costs of freight and insurance into account when determining value of materials
 - Especially for landlocked and islands LDCs

3. Substance

- Preferential RoO are industry-related
 - Example: European industrial context vs. context of Central Africa
- Commercial viability of RoO depends on the industrial context
- Market response of RoO in a given context can be seen in the Utilization Rate

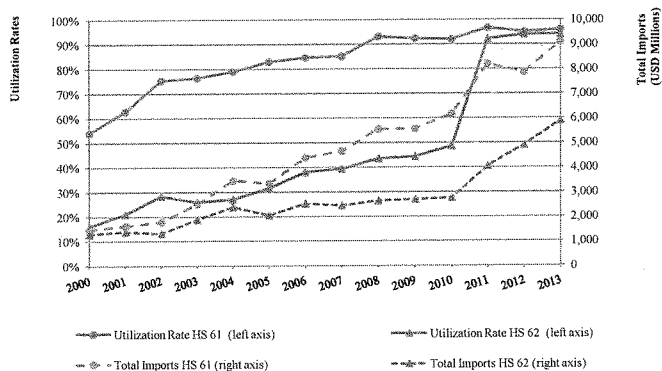
3.1 Trade effects of Canadian reform

Canadian imports from LDCs and GSP utilization rates
 Art of apparel & clothing access, HS 61 knitted/crocheted and HS62 not knitted/crocheted



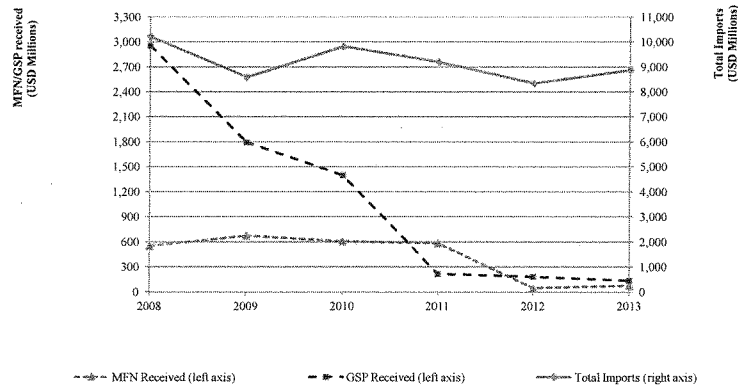
3.2 Trade effects of EU reform

EU imports from LDCs and GSP utilization rates
 Art of apparel & clothing access, HS 61 knitted/crocheted and HS62 not knitted/crocheted



3.3 Utilization rate - US GSP

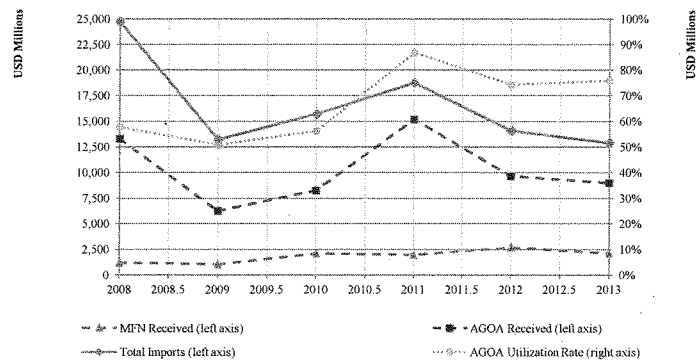
US Total Imports from LDCs excluding AGOA beneficiaries



--△-- MFN Received (left axis) --■-- GSP Received (left axis) ○..... Total Imports (right axis)

3.4 Utilization rate - AGOA

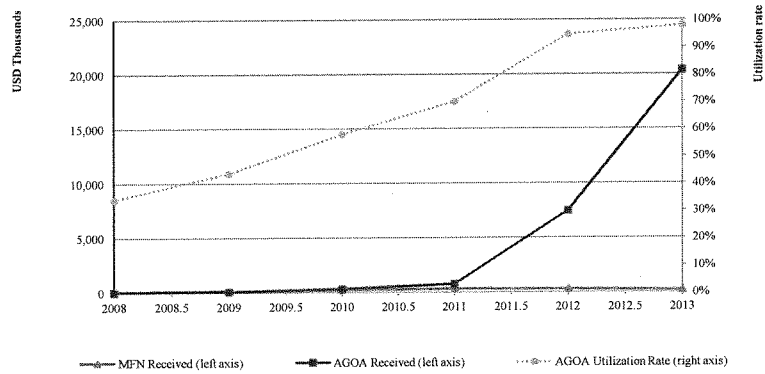
US Total Imports from LDCs AGOA Beneficiaries



--△-- MFN Received (left axis) --■-- AGOA Received (left axis) ○..... Total Imports (left axis) ◇..... AGOA Utilization Rate (right axis)

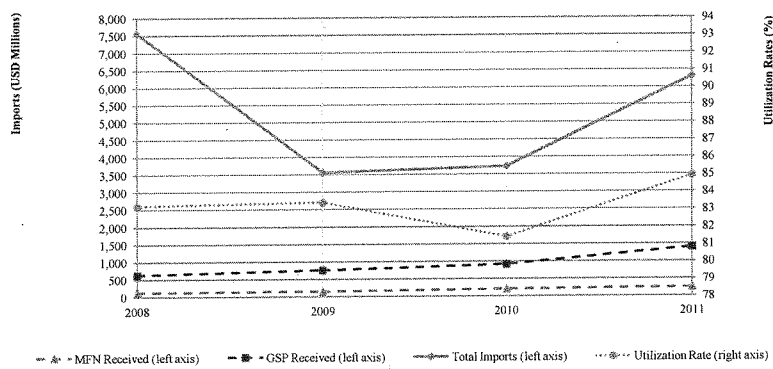
3.5 Utilization rate - AGOA

US Total Imports from LDCs AGOA Beneficiaries
HS 64: Leather Footwear



3.5 Utilization rate - Japanese GSP

Japanese Total Imports from LDCs and Utilization Rates



3.6 Suggested practices (*SUBSTANCE*)

- Reforms of RoO reflecting global value chains and commercial reality:
 - Robust evidence from EU and Canadian to engage in reform: Rise of utilization rates and overall imports
 - Unequivocal evidence that a market response in LDCs is generated
 - Forms of market response: Relocation of factories to LDCs, increased manufacturing capacity, more skilled jobs creation and backward linkages
- US and Japan as well as other preference giving countries are invited to consider appropriate reform of the *substance* and form of their rules of origin

4. Future contributions by LDCs in form of papers to the next CROs

- Further Develop CTC concept according to the wording of the Decision
 - HS is not designed for RoO purposes
 - Identify product/sectors where simple CTC with/without exceptions could be used
- More research in setting appropriate levels of substantial transformation
 - Facilitate insertion into global value chains
- Research on best practices of certification requirements related to RoO
 - Avoid non-manipulation requirement for landlocked or island countries
 - Reduce costs related to certification requirements: Share experience on lessons

Thank you for your attention!