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**Rules of Origin
in International Trade**

A Comparative Study

**Edited by
Edwin Vermulst,
Paul Waer, and
Jacques Bourgeois**

Ann Arbor

THE UNIVERSITY OF MICHIGAN PRESS

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Published in the United States of America by
The University of Michigan Press
Manufactured in the United States of America
© Printed on acid-free paper

1997 1996 1995 1994 4 3 2 1

A CIP catalogue record for this book is available from the British Library.

Rules of origin in international trade : a comparative study / edited by Edwin Vermulst,
Paul Waer, and Jacques Bourgeois.

p. cm. — (Studies in international trade policy)

Includes bibliographical references (p.) and index.

ISBN 0-472-10411-X (acid-free paper)

1. Certificates of origin. 2. Customs administration—Law and legislation. 3.
Customs administration. I. Vermulst, Edwin A., 1958– . II. Waer, Paul,
1958– . III. Bourgeois, Jacques, 1936– . IV. Series.

K4640.074R85 1994

341.7'54—dc20

93-45611
CIP

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The progenitors of this book are to be commended for taking the initiative, and pursuing that initiative, through the arduous burdens and delays of editorship to completion. The topic of rules of origin has fluctuated in importance in Community legal practice over the past twenty years. I wish to consider the reasons for those fluctuations, to commend greater frankness and realism when examining the Community's record, and to submit that the controversy over whether rules of origin are being "abused" is really misplaced and that in truth such controversy is the natural consequence of using inadequate instruments to make painfully difficult decisions in the application of protective trade policy measures.

In the 1970s, the major preoccupation of those who followed Community rules of origin was preferential rules of origin. Preferential trade between the Community of nine Member States and the EFTA countries was established by the various association agreements concluded in 1972 and 1973, under which, at the end of a transitional period, duty-free status was granted to all industrial products originating in the EEC or the several EFTA countries. Considerable effort was devoted to arranging investment patterns to avoid customs duties on shipments from, for example, Portugal to France. Legal and accounting skills were deployed in ensuring that traffic patterns such as Portugal-Norway-EEC were duty free despite the incorporation of significant levels of U.S. or Japanese content at the first two stages. Although the penalties for being wrong could be momentarily severe (unpaid duty, interest, arrears of duty, financial penalties of astonishing ferocity in the case of France and mild or moderate severity in the case of other Member States with a less brutal customs regime), the rules and the benefits accorded by satisfying them were reasonably clear.

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The topic of nonpreferential rules of origin attracted relatively little attention from practicing lawyers and generated little political controversy. These halcyon conditions reflected the fact that EC antidumping policy was only an embryonic possibility and that the Community's external competence was less significant in reality than in theory. Putting it differently, Member States controlled their external trade relations much more than today and needed relatively limited recourse to Community powers to protect themselves.

However, by the 1980s, the main preoccupation of trade lawyers was not the availability of duty preferences, but the basic problems of achieving or preventing access to the Community marketplace. A principal factor underlying this phenomenon was anxiety about the size and intractability of the Japanese trade surplus. As informal national techniques for hindering imports were gradually eliminated, and as the principles of free circulation were more consistently respected, only Community-legal mechanisms for blocking or restraining unwelcome imports could be counted on (save in those Member States where Community law was disregarded).

Customs duties seemed of little use for protective purposes. European Community customs duties, following the reductions effected in successive rounds of multilateral tariff cutting, are now on average around 4% ad valorem. Thus they are usually no significant barrier to imports into the Community. By contrast, the emergence of antidumping measures as a regularly invoked element in the Community's external relations policy, the major changes in what conduct would be deemed to constitute dumping, and the absence of exhaustive judicial verification of the validity in legal terms of these changes did constitute a major obstacle to penetrating the Community market; these developments marked the end of the Community's trade policy innocence.

The steps leading from 1975 when EC antidumping procedures were almost unknown and, if conducted, would have followed methods that corresponded to laypeople's concepts of what constituted dumping and how to deal with it to 1985 when EC antidumping procedures were frequent, profoundly acrimonious, and controversial are described in *EEC Trade Law and the United States*¹ as well as in many other works. One of the difficulties in deciding what goods should be reachable by antidumping matters is that there is a deep ambivalence in whether antidumping measures are intended to correct excessively cheap imports from a particular country or to chastise unfair exporters.

1. I. Forrester, *EEC Trade Law and the United States*, 469 Fordham Corporate Law Institute (1988).

An antidumping procedure is in practice directed against individual enterprises. It involves what amounts to an accusation of unfair or abusive conduct against specific parties, on whom specific penalties in the form of antidumping duties may be imposed. They must be investigated and defended. They are of course entitled to be treated fairly in procedural terms even if the underlying legislation inevitably contains elements of unfairness. Antidumping officials thus have to balance the world of trade policy negotiated in Geneva between states and the behaviour of an individual company and the marketplace in which it operates.

Only one term, *dumping*, is available to connote two different phenomena: wilful predatory or preemptive pricing intended to injure foreign industry and a situation where there is no particular intent to injure but where after a comparison of the relevant prices and costs and exchange rates, a margin of dumping is found. Complaints almost always allege wilfulness or at least recklessness. Exporters almost always deny intent to injure and assert their commitment to fair trade. Investigators pay little attention to the (of course unverifiable) question of intention. It is unfortunate that the term dumping is so emotionally charged, but it is the only one available to describe a whole range of financial and economic circumstances.

It is not the purpose of this comment to argue that antidumping measures should be abolished. On the contrary, their availability is probably a kind of safety valve, an alternative to more widespread trading hostilities. Confining the process to clearly identified categories of goods from identified sources is a desirable means of limiting the scope of a process that is certainly crude and often not completely rational, either in terms of fairness or accounting. However, since dumping is officially defined as unfair trade, there is a natural temptation to chastise unfairness wherever it may be found, from whatever country it comes. If antidumping duties are applied to the exports of "Tanaka K.K." of Osaka, this implies that the exports of that company have been priced at an unfairly low price. Community industry will ask why the same conclusion should not be drawn as to the identical goods made by "Tanaka New York Inc."? The same group makes the same goods and sells them at the same low price in the Community: surely there must be something that can be done? Once more we see the difficulty in deciding whether antidumping duties are trade policy measures, to correct by a neutral tax a trade distortion, or penalties.

Logic and commonsense might suggest to us that if a group disrupts trade in the Community with cheap exports, the geographic base for such activities should make no difference to the Community's capacity to take remedial action. But the GATT Anti-dumping Code makes it clear that duties may be imposed only on imports of goods from a particular country or countries and may not be imposed by reference to the identity of the dumper. Rules of

origin are the mechanism that allows the Community legally to hit exports to the Community by the same dumping group, but exported from another country. Putting it differently, they are the mechanism that can serve to immunize products coming from Canada against EC antidumping duties (or other protective measures) applicable to physically identical products from Singapore. If the goods made in Canada, from Singaporean and other components, originate in Canada, they should not be subject to duties on Singaporean products.

Unfortunately, the Community's rules of origin were not designed with this application in mind. Indeed, the concept of a single origin is ill-adapted to modern times; due to the globalization and interdependence of the world industry, it is often unrealistic to attribute a single origin to a product in the manufacture of which two or more countries have contributed. Dumping is also often a slippery and unsuitable concept for today's business world with its growing internationalism. Companies based in America have factories in Japan and Europe. Japanese companies have joint ventures with European companies who complain about them in dumping cases. European companies depend on components supplied by the alleged dumpers. American companies have production facilities in Korea, Japan, and Europe. Dumping measures, it is submitted, are based on outdated assumptions of defenders of a clearly defined territory and penetration by aggressors. It is difficult to tell whether an American-based multinational with its European headquarters in Sweden, a factory in France, and an affiliate in Japan is friend or foe according to traditional concepts when considering a possible dumping case. Despite these ambivalences and despite a much more critical attitude to the wisdom of antidumping measures, there is growing support for the suggestion that tighter origin and antidumping rules should be adopted.

Let us now look at the rules that are used to make such important distinctions. Council Regulation 802/68 establishes criteria that Member State customs officers shall follow in determining origin where no specific rules of origin apply to the particular import. Article 5 of Regulation 802/68 provides that a product should be deemed to originate

in the country in which the last substantial process or operation that is economically justified was performed, having been carried out in an undertaking equipped for the purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture.

That Article contains a number of elements: (1) substantial nature of the operation; (2) economic justification; (3) adequacy of the equipped nature of the place of manufacture; and (4) (i) new product or (ii) important stage in the manufacturing process. The text is written as if these tests are cumulative

(with the alternative under 4 (i) and 4 (ii). But good sense would suggest that any one individually ought to be enough to associate the product significantly with the exporting economy. It would seem absurd to argue that a substantial operation was not economically justified, or that even although economically justified, the place of manufacture was inadequately equipped. The explanation of the strange text lies in the fact that the rule when first formulated was a pastiche of several Member States' different rules. These were pressed into one rule that was not altogether internally consistent.

It would seem difficult to argue that a photocopier made in a large and well-equipped factory from a large number of small parts did not originate there. But such was the determination of the Commission's services to declare Ricoh's exports of photocopiers from California to the Community as susceptible to the same antidumping regime as Ricoh's exports of photocopiers from Japan that a regulation with this intended effect was adopted.² (As things turned out, some Member States in effect declined to apply the new rule.) Ricoh's difficulties owed much to the fact that a Ricoh official imprudently announced that the establishment of its U.S. factory was influenced by the imposition of duties on direct exports from Japan. Thus the Commission's services might well have felt the need to do something to bring an evader within the net of sanctions. It seems intellectually very difficult, however, to reconcile this with Article 5, which attributes origin to the place of last substantial processing.

The most natural reading of the words of Article 5 of Regulation 802/68 is; Where did the last process occur? Was that process substantial? However, this reading has been modified significantly to read; Of the various processes that occurred, which was the most substantial? The rule for semiconductors in effect puts the test slightly differently: Of the various not insubstantial processes that occurred, were the later operations significantly less important than the earlier operations? The "significantly less important" test of Regulation 288/89 on the origin of integrated circuits asserts that the complex, sophisticated and costly process of assembly is

so significantly less important than diffusion that they cannot individually or collectively constitute a substantial operation and thus cannot meet the requirement of being the last substantial operation in the manufacture of integrated circuits³

2. Commission Regulation (EEC) No. 2071/89 of 12 July 1989, O.J. (1989) L 196 at 24.

3. O.J. (1989) L 33 at 23.

I do not argue that it is unreasonable to decide the origin of a photocopier by reference to where its lens rather than its drum is manufactured, or to decide that where a semiconductor die is diffused is more important than where the integrated circuit is completed and tested. A trade policy case could certainly be made for such a conclusion. But it seems difficult to reconcile such a conclusion with the words of the basic EEC origin regulation.

It is understandable that origin officials were reluctant to express themselves about the originating status of goods made in newly established factories in the Community or in third countries. They were being asked to decide whether such goods might be hit with protective measures, and the tools at their disposal to make that decision were manifestly inadequate. Regulation 802/68 was drafted in another era. Using liberal origin rules in deciding whether to apply or not to apply a protective trade policy measure could not be other than controversial and politically sensitive. It could not be nonpolitical. It might be unfair for the officials to be accused of being influenced by political considerations, but their decisions are inevitably politically sensitive. The significance of the decision is too politically heavy. Either a trade policy objective of the Community will be thwarted, or the 1960s notion of origin will be ignored twenty years later.

That said, it would be wrong to imply that difficult or sensitive origin questions were regularly resolved in favor of the imposition of duties and against the interests of the exporting group. For example, in the case of Mita Hong Kong, an elaborate investigation was conducted of the premises at which assembly and subassembly operations were carried out, and it was concluded that the machines made in Hong Kong did indeed originate there and were not liable to be hit with EC antidumping duties.

It is therefore submitted that the Community's nonpreferential rules of origin cannot be examined in a vacuum. The decisions about what goods to hit with antidumping duties are reached after a lengthy and careful procedure, in which broad economic issues are debated as well as technical issues. It could not be expected that the mushrooming of new factories in other countries to manufacture identical goods to the "dumped" goods would have occurred without any Community reaction.

It cannot be argued that nonpreferential rules of origin are interpreted and applied now as they were ten years ago. This outcome is not surprising though it might be regretted. Thus rules of origin, like antidumping measures, lost their innocence as the Community's trade policy came of age in the late 1980s.

Rules of origin have also been debated in a quite different context in past years, in the field of free circulation. It is well-known that Italy has maintained in force GATT-valid and EEC-legal quotas on Japanese cars, motorcycles, and other products. Article 115 of the EEC Treaty permits a

Member State to obtain from the Commission authorization to support such quotas on direct imports from third countries by exclusions from Community treatment at internal frontiers. Otherwise, Japanese origin cars could enter Germany quota free, then enter Italy by virtue of free circulation. Questions frequently arose whether vehicles assembled in Europe with Japanese components under Japanese or partly Japanese auspices should be regarded as Japanese (and therefore liable to be included in the Italian quota) or non-Japanese. The test was not whether they originated in the Community, but rather whether they originated in Japan.

In the case of the Honda Accord car and the Scoopy motorcycle, Commission origin experts carefully investigated the technical processes, the value added, and other relevant factors. They concluded that the vehicles should not be regarded as originating in Japan, and the Italian government did not obstruct their importation. In this case, the system worked well. A challenge was made, an investigation was conducted, a legal conclusion was reached, and a trading pattern developed in consequence.

By contrast, in the case of the Nissan Bluebird car, the French Republic sought to argue that cars made in the North of England by a subsidiary of the Japan-based Nissan group were Japanese and were therefore ineligible for importation into France. The French posture was, in terms of Community law, total nonsense. The quota announced by President Giscard d'Estaing at the Paris Motor Show in 1979, whereby Japanese cars imported into France could not exceed 3 percent of new car registrations in France, was no secret. Yet its existence was never revealed (admitted might be more accurate) in any official text. The French authorities refrained from stating publicly what they were in practice doing. By this means the French authorities were able to maintain a flagrant infringement of Community law for more than a decade.

The EC Commission was well aware of the quota, received frequent complaints about it, and conveyed displeasure to the French authorities on numerous occasions, but the measures were never formally challenged before the Court of Justice of the European Communities. This was, it is submitted, a grave breach of the Commission's duty to uphold and enforce the treaty. The reason for the failure to act was, of course, a fear of the political consequences. If France were to be judicially held to account for its conduct, a crisis could erupt.

In any event, during the late 1980s, the French quota came into conflict with the establishment in the United Kingdom of car factories producing vehicles bearing Japanese marques. During 1987 and 1988, there were protracted exchanges of correspondence about the status of the Nissan Bluebird between U.K. officials and ministers, Commissioners and Commission officials, and French officials and ministers. The French justification for blocking such imports was that they did not originate in the

United Kingdom and that in any event the absence of a clear Community rule of origin was lamentable. This justification was baseless for two reasons: First, the French quota was illegal under Article 113 and its provisions on the Common Commercial Policy of the Community. Second, the cars were in free circulation and eligible for free movement, regardless of whatever Japanese content they might have had.

The regrettable silence of the Commission when faced with these misrepresentations caused confusion and uncertainty in the minds of private citizens. Commission representatives said nothing and by their silence compounded the heresy that the eligibility of the cars in free circulation depended on how much value had been added in their production in the Community. The fundamental principle of free movement of goods was misrepresented by the press and politicians as giving entitlement to free circulation within the Community only to goods with EC origin.⁴

In the end, all sides were able to claim a victory. The U.K. authorities were reassured that the cars would be admitted, and the French authorities continued with their idiosyncratic treatment of direct imports of vehicles from Japan. The episode reflects no credit on the political leadership of the Commission: When the Community rule is perfectly clear and is clearly flouted but is not challenged, it is evident that the enforcement of the law is colored by political considerations. If we choose to condemn the illogicalities of how technically outmoded rules of origin are applied in the context of highly sensitive trade tensions, we should also condemn the failure for political reasons to enforce the law.

One final observation is not controversial. Clearer rules of origin can be applied more predictably and neutrally. In 1985, the USITC in *The Impact of Rules of Origin on U.S. Imports and Exports* recorded that companies had reported losing large volumes of sales because of the application of rules of origin and very large expenses in dealing with the administrative costs they create. The estimates of the costs "ranged from negligible costs to several million dollars, with most of them in the \$30,000 to \$100,000 range."⁵ The Community's rules certainly contributed to these burdens. It would be desirable to adopt clearer and less flexible rules, appropriate to the trade policy age in which, for better or for worse, we now live.

4. See, e.g., Montagnon, *Financial Times*, 30 September 1988; and Dawkins and Done, *Financial Times* 1 October 1988.

5. USITC, *The Impact of Rules of Origin on U.S. Imports and Exports* 78 (1985).

SECTION 2

Rules of Origin from a Policy Perspective

Gary N. Horlick and Michael A. Meyer

Rules of origin are usually the stepchildren of other discriminatory devices.¹ If MFN tariffs were the only regulation of trade, there would be no logical need for rules of origin except to satisfy the need of economic analysts (and some politicians) for country-by-country trade statistics² and to maintain the last bastion of economic nationalism, country of origin marking (one can remember when "Made in Japan" was a disincentive for customers).

Since the origin of origin rules is in commercial policy programs, logically each such program could well have its own rules of origin to be interpreted in accordance with the purpose of the program (i.e., a protectionist rule for Steel VRAs and a liberal rule for the GSP).³ The practice, as ably described in Palmetter's review of U.S. cases, has been confusion and a tendency (subject to substantial variation) toward restrictive standards for all programs,⁴

O'Melveny & Myers, Washington, D.C.

1. As Steele and Moulis point out (chapter 4, § 1.1.), without preferences or discrimination, origin becomes commercially irrelevant. As in so many other areas of trade policy, a discriminatory rule (in this case, different rules for closely related products) often signals a trade-distorting motive (see, e.g., the discussion by Waer in chapter 3 § 3).

2. For such statistical series to be consistent, presumably one would need consistent rules of origin used in all reporting countries.

3. Waer reports that the contracting parties to the CCC considered that rules of origin are commercial policy rather than Customs law, which would imply some tailoring of rules of origin to specific commercial trade policy purposes. See chapter 3, citing an interview with Mr. Gervais Farines, of the CCC.

4. As Waer notes (chapter 3, § 4.3.1.), the EC Court of Justice in the *S.R. Industries* case permitted stricter rules of origin for preferential programs than for normal customs tariff purposes. This reaction might be consistent with the observation by Robert Baldwin in his elegant essay on "The Inefficacy of Trade Policy" that, once a distortion to trade is erected, traders will try to find some way around it. Baldwin, *The Inefficacy of Trade Policy*, 150 *Essays in Int'l Fin.* 5 (1982). In a domestic context, this practice is frequently considered to