Pan African Chamber of Commerce and Industry

AfCFTA POINTER

9 Points to Understand 'Rules of Origin'

1 Defining the term 'Rules of Origin'

Simply put "rules of origin" are rules that determine the origin of goods which may enter a country under preferential treatment. When operational the African Continental Free Trade Agreement (AfCFTA) will have provisions determining the origins of good which may benefit from special treatment. The main purpose is to ensure that the benefits of preferential tariff treatment are restricted to only those products which have been harvested, grown produced or manufactured in the exporting Regional Trade Agreements (RTA) member.

Rules of origin are therefore the criteria needed to determine the national origin of a product. If a product is produced wholly in one country, the problem of determining rules of origin will not be an issue; but in a world where more and more products are fabricated through the mixing/blending of inputs from different countries, assigning origin to a product may not be an easy task. However, rules of origin should be designed so as not to restrict trade owing to their complex methods of implementation and the associated procedures should not be too enormous. The rules of origin are therefore, a key element determining the size of the economic benefits that accrue from trade agreements and who gets them. They have important implications for the development of manufacturing sector as a whole.

2 Are Rules of Origin the same in all Free Trade Agreements?

Rules of Origin can be different under different agreements. Currently the numbers of agreements recognized by WTO are more than 200. And this number is expected to increase.

Many African states are participating in more than one regional trade blocks, each following different rules of origin criteria.

Countries participating as members of the AfCFTA offer zero or reduced duty access on imports from their trading partners. Please note this will happen in a time span of five but often 10 to 13 years. The first few years the tariff preferences will not be too high. They therefore often apply rules known as 'preferential rules of origin', hence ensuring that only goods originating in participating countries enjoy tariffs or other preferences.

3 The impact of Preferential Rules of Origin Agreement on market access

In any preferential trading arrangement the developmental role of the rules of origin can have the following positive effects on a preferential trading arrangement:

Preventing trade deflection In any preferential trading arrangement, participants set their own external tariffs but give preferential tariff treatment to each other.

The divergence between external tariffs of the participants and the preferential tariffs given to a Regional Trade Agreement (RTA) partner is a potential source of trade deflection.

In the absence of any rules of origin within the RTA, the participant with the lowest external tariffs is likely to serve as an entry point into the regional market for the goods of the non-participants. In this sense, rules of origin are an important tool for checking the trade deflection of third country (non-participant) goods from one participant to another participant.

Facilitating value addition The modalities of determining the origin of a product are aimed at "substantial transformation" in inputs. Thus, rules of origin facilitate value addition in the country of manufacture. Such requirements, checking the import content of value addition, have the potential for generating backward and forward linkages in a country adhering to the rules. Thus, a participant is prevented from becoming a mere trading country as these requirements act as a deterrent to activities relating to packing, repacking, transportation, simple assembly or reassembly etc.

Expanding intra-regional trade and investment flows Cumulative rules of origin allow manufacturers to import raw materials or inputs from a country which is party to the same regional trade agreement without undermining the origin of a product. In effect, such imported materials from RTA partner countries are treated as being of domestic origin in the exporting country. A regional preferential trading arrangement having the provision of cumulative rules of origin is more liberal and better, as it enhances intra-regional trade prospects.

The restrictive effects of rules of origin on intra-regional trade arising out of countries' high import dependence could be reduced somewhat if countries take greater advantage of the regional cumulation facility. Rules of origin, not only can prevent trade deflection within a regional grouping but can also contribute to the development process for participants through trade and value addition effects.

The preferential rules of origin agreement can also be manipulated to achieve other objectives, such as protecting domestic products by forcing import cost to go high and by requiring changes in production.

4 Why Determine the Origin of a Product?

Determining the origin of a product in both the preferential as well as the multilateral (non-preferential) regimes is necessary to ascertain the country of origin of imported products in order to apply trade policy measures. These measures include tariffs, anti-damping taxes, quantitative restrictions, and safeguard measures.

The WTO Rules of Origin Agreement provides for the following four basic principles (Lazaro and Medalla, 2006);

- **Non-discrimination:** rules of origin must apply equally for all purposes of non-preferential treatment;
- **Predictability:** rules of origin must be objective, understandable and predictable;
- **Transparency:** rules of origin must not be used directly or indirectly as instruments to pursue trade policy objectives;
- **Neutrality:** rules of origin must not, in and of themselves, have a restrictive, distorting or disruptive influence on international trade.

Moreover rules of origin should: clearly define requirements for conferring origin; be based on a positive standard; be published in accordance with GATT Article X:I; and be applied prospectively. In the AfCFTA context where around 80-90% of the rules of origin have been agreed (and the rest not yet). It is important to publish those that have been agreed upon. It is important to note that the Agreement distinguishes (if not focused on one) between preferential and non-preferential rules of origin.

5 How important are the costs of administering the preferential 'rules of origin'

The cost of administering the systems of the Rules of Origin and the expenses incurred by firms to improve conformity with these rules can be important. Costs will be greater if there is a degree of unpredictability in the application of the systems if the rules of origin and in particular with regard to the acceptance of certificate of origin by customs.

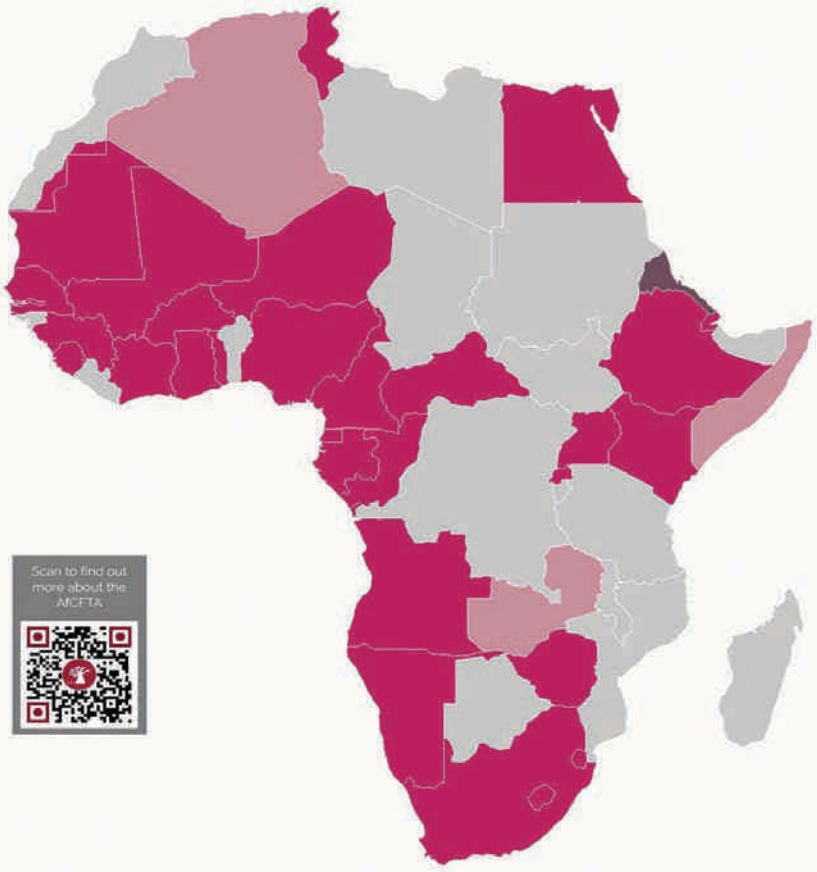
These costs reduce the value of the tariff preferences that are made available through free trade. Rules of origin may also affect investment decisions of firms. The literature says that compliance cost might run up from 3% to 5%, meaning that preferential trade and application of preferential rules of origin will happen mostly if the tariff preference is 5% or more.

6 What is the 'Spaghetti-bowl' of trade agreements?

One feature of the rise in the number of RTA's is the growing number of overlapping agreements ('Spaghetti-bowl') with each following different administrative procedures – customs, technical standards, and rules of origin – and thereby raising the costs for both enterprises and governments.

With conflicting rules these agreements would lead to fragmented markets and increase the transaction costs of trade, thus adversely affecting the volume of trade as well as global and national welfare. Therefore, to achieve significant benefits in terms of lower administrative costs and more effective implementation, it would be necessary to rationalize the current structure of such 'Spaghetti-bowl' agreements.

Which countries have ratified the AfCFTA Agreement?



Listed by date on which the AfCFTA instrument of ratification was deposited with the AUC Chairperson

Country	Date
Ghana	10/05/2018
Kenya	10/05/2018
Rwanda	26/05/2018
Niger	19/06/2018
Chad	02/07/2018
Eswatini	02/07/2018
Guinea	16/10/2018
Côte d'Ivoire	23/11/2018
Mali	01/02/2019
Namibia	01/02/2019
South Africa	10/02/2019
Congo, Rep.	10/02/2019
Djibouti	11/02/2019
Mauritania	11/02/2019
Uganda	09/02/2019
Senegal	02/04/2019
Togo	02/04/2019
Egypt	08/04/2019
Ethiopia	10/04/2019
Gambia	16/04/2019
Sahrawi Arab Democratic Rep.	30/04/2019
Sierra Leone	30/04/2019
Zimbabwe	24/05/2019
Burkina Faso	29/05/2019
São Tomé & Príncipe	27/06/2019
Equatorial Guinea	02/07/2019
Gabon	07/07/2019
Mauritius	07/10/2019
Central African Rep.	22/09/2020
Angola	04/11/2020
Lesotho	27/11/2020
Tunisia	27/11/2020
Cameroon	01/12/2020
Nigeria	05/12/2020

Rules of Origin

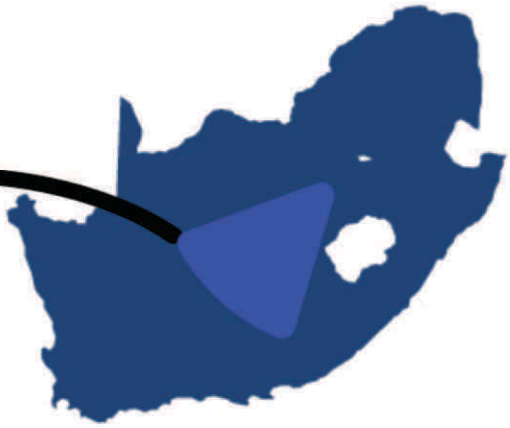
This widget represents any product or good that can be exported or further processed, adding additional value.

Rules of origin in trade agreements set out specific criteria that products need to meet in order to be considered as originating from a state or territory in order to benefit from tariff concessions.

Criteria

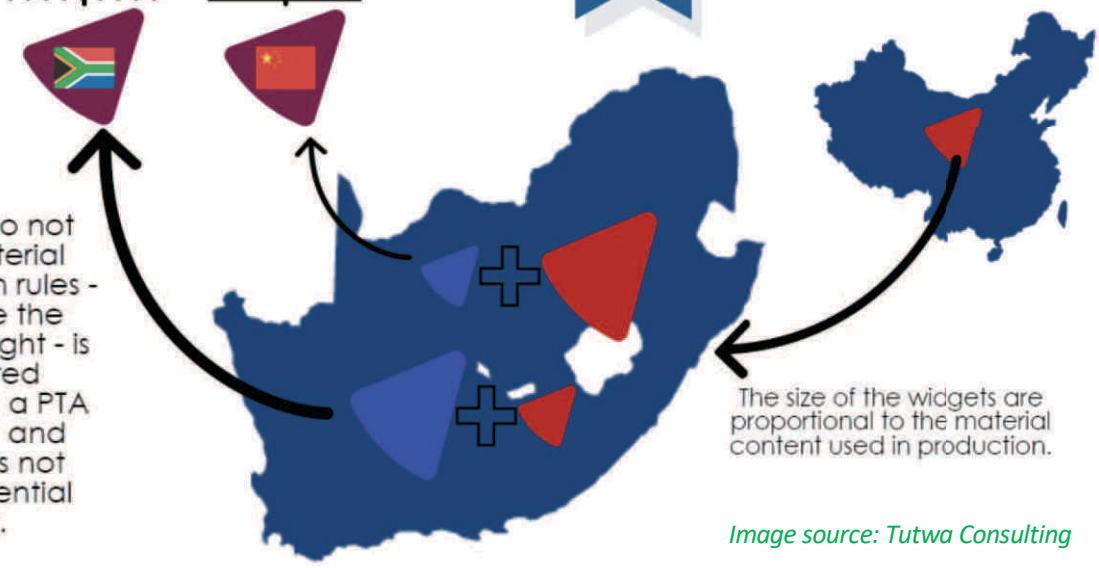
Sufficiently transformed

#1 Wholly obtained



Nowhere in the process have inputs from other countries been used or added to the widget. 100% a product of South Africa.

#2 Material content addition



Widgets that do not satisfy the material content addition rules - in this instance the widget on the right - is not considered originating from a PTA member state and therefore does not receive preferential treatment.

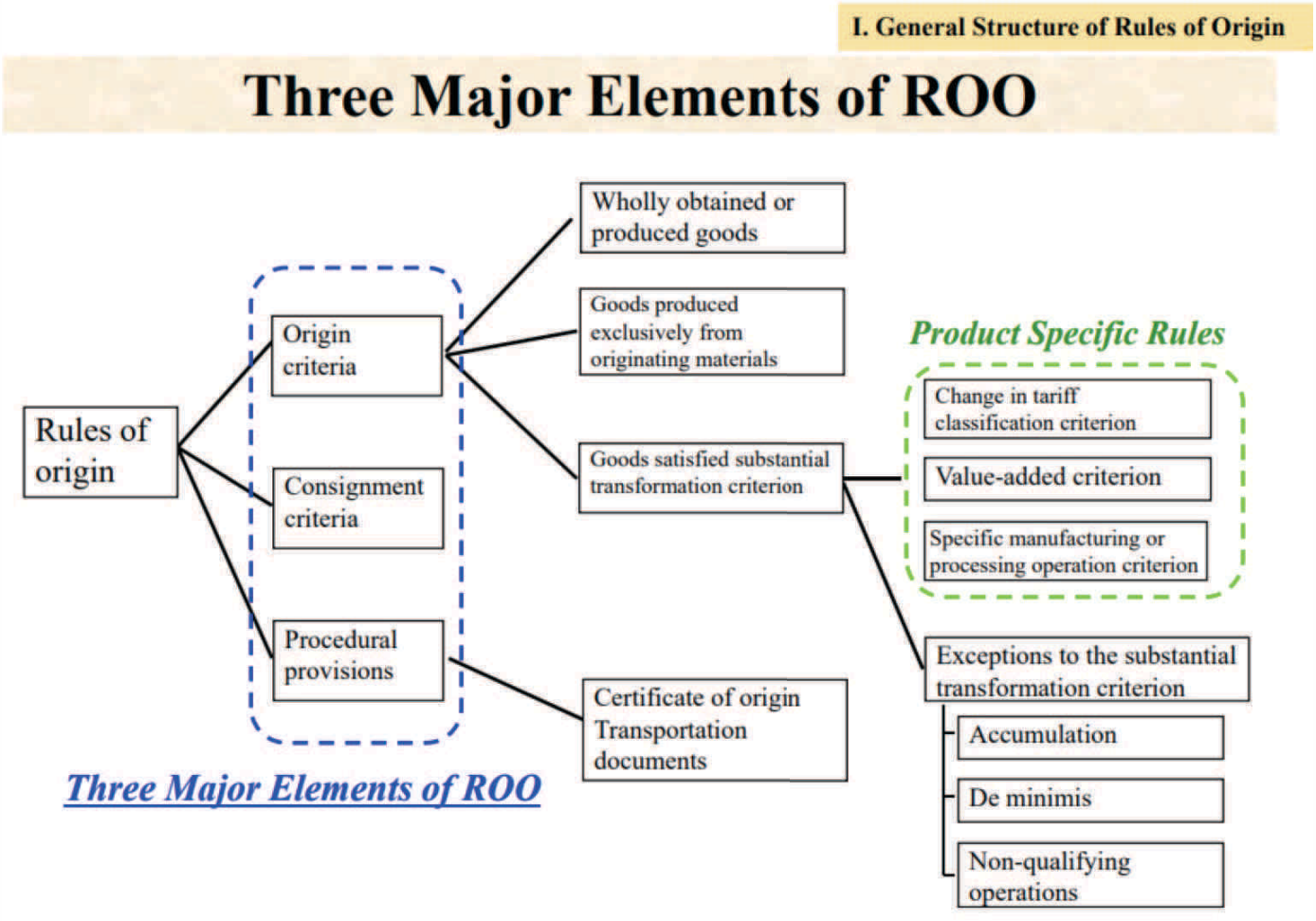
The size of the widgets are proportional to the material content used in production.

Image source: Tutwa Consulting

Preferential rules of origin include the rules for the application of the Preferential Customs Duty rates under Economic Partnership Agreements (EPA) or FTA and the rules for the application of the preferential Customs Duty rates under the Generalized System of Preferences (GSP).

Non-preferential rules of origin are applied to determine the country of origin for the purposes other than granting of preferential Customs Duty treatment (such as the application of WTO tariff rates, trade statistics, etc.).

- Preferential rules of origin
  - (1) application of EPA (Economic Partnership Agreement) tariff rates
  - (2) application of GSP(Generalized System of Preferences) tariff rates
- Non-preferential rules of origin (application of WTO tariff rates, trade statistics, etc.)



7 Determining the country of origin of a product

When a product is produced in a single stage or is "wholly obtained or produced" in the partner country then it is easier to establish the origin of the product. In such cases, the proof that the product was produced in the preferential trade partner is normally sufficient

If and when a product for export is wholly obtained or produced in a single country, no one can deny that this country is the country of origin. Therefore, in all the FTAs a list of "wholly obtained or produced" items is prescribed. Although there are slight variations in defining what constitutes wholly obtained or produced, the broad principles remain the same in all agreements.

Generally, Products that are wholly produced or obtained

a. Raw or mineral products extracted from a country's soil, its water or its seabeds;
b. Agricultural products harvested there;
c. Animals born and raised there;
d. Products obtained from animals referred to in paragraph (c) above;
e. Products obtained by hunting or fishing conducted there;
f. Products of sea fishing and other marine products taken from the high seas by its vessels;
g. Products processed and/or made on board its factory ships exclusively from products referred to in paragraph (f) above;
h. Parts or raw materials recovered there from used articles which can no longer perform their original purpose nor are capable of being repaired;
i. Used articles collected there which can no longer perform their original purpose there nor are capable of being restored or repaired and which are fit only for disposal or for the recovery of parts or raw materials;
j. Waste and scrap resulting from manufacturing operations conducted there;
k. Goods produced there exclusively from the products referred to in paragraphs(a) to (j) above.

8 Rules of origin for products that are "not wholly obtained or produced"

Determining the country of origin of a product becomes difficult due to the globalization of economic activities, outsourcing and the use of a mix of inputs supplied by foreign countries and domestic supplies. Therefore, for such cases a general term of "not wholly produced or obtained" is used. In these cases, the rules of origin define how to ascertain whether the particular product has undergone sufficient working or process or has been subject to a substantial transformation (in general these terms can be used interchangeably) in the territory of another member of the FTA and that it has not simply been trans-shipped from a non-qualifying country or has been subject to only minimal processing. Unfortunately, there are no simple and standard rules of origin that can be identified to prevent trade deflection. A number of different rules are available, each of which has different implications for a producer of a given product.

As a general rule, under the percentage criterion, imported inputs (i.e., materials, parts and components) are considered to have undergone substantial transformation if a given percentage of value is added to the imported inputs used for the manufacture of the finished product. This requirement can be defined in two ways:

(i) By providing the minimum percentage of the value of the product (on f.o.b. value or ex-factory price/ cost) that must be added in the exporting country (direct method of calculation), or
(ii) By providing the maximum percentage of non-originating inputs to be used in manufacturing the exported product (indirect method of calculation). This is the approach followed by the AfCFTA. The maximum value of non originating material (VNOM) is set around 60% for many products.

In practice, it is method (ii) which is more commonly used in trade agreements.

9 What is the concept of CUMULATION?

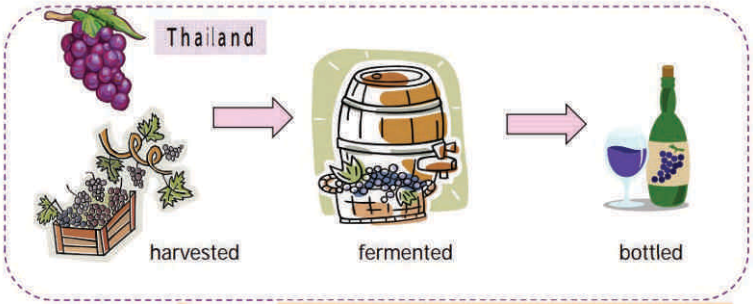
To increase intra-regional trade and facilitate the sourcing patterns within the region in the context of a RTA, the concept of cumulation plays a crucial part in rules of origin schemes. It allows the use of low-cost sources of inputs without compromising the originating status of a final product, by including intermediate products and operations as part of the originating product, even when they are produced outside the country. The possible extent of cumulation depends on the applied rules, outlined below.

Bilateral cumulation. Bilateral cumulation operates between two countries and allows producers in either partner country to use materials and components originating in the other country as if they originated in its own country.

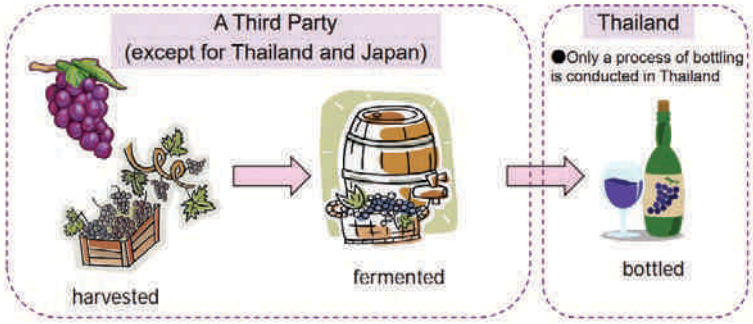
Diagonal cumulation. Diagonal cumulation operates between more than two countries and allows producers to use materials and components originating in either country that is part of the agreement. In one form this is an extension of bilateral cumulation by extending it to the regional level.

Full cumulation. Full cumulation takes into account all of the operations conducted within the countries that are members to an agreement, even if they are carried out on non-originating material. Thus, there are no restrictions on using only originating materials and components for the final good. This concept allows more fragmentation of the production process among members of a trade agreement and increases economic linkages and trade in RTAs. It is not yet clear how this will work in practice.

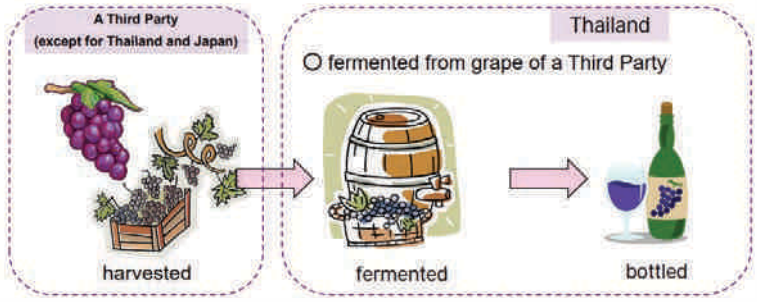
CASE STUDY: Wine's Rules of Origin



CASE 1:
A bottle of wine through all processes in Thailand makes us think that this wine is an originating good of Thailand.



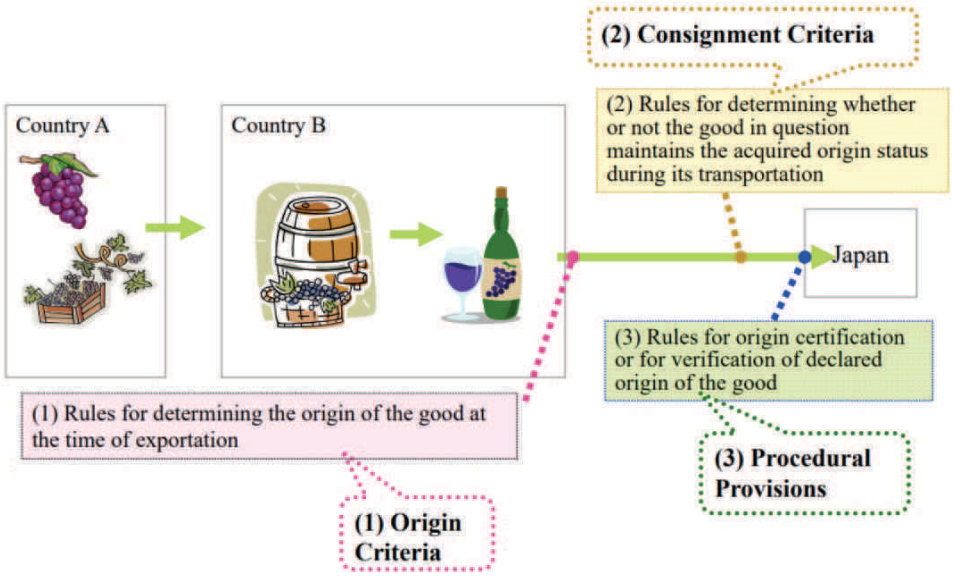
CASE 2:
A bottle of wine through processes here may make us think that this wine is not an originating good of Thailand.



CASE 3:
How about this case? People have lots of different opinions in this case.

IMPORTER A:
I think the wine is an originating good of Thailand because fermentation decides the taste of wine.

IMPORTER B:
I know that. But the quality of grape also decides the taste of wine,so I doubt the wine is originating good of Thailand.



A rule Is necessary to decide which process should be a bottled wine of a Party under EPA . This rule is called "Origin Criteria" and a good Third Party which satisfies the origin criteria is called as "a originating good of a Party". If you want to use preferential tariff rate on EPA for goods, the goods should satisfy the origin criteria to apply such tariff rate.

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