



DIIS · DANISH INSTITUTE FOR INTERNATIONAL STUDIES
STRANDGADE 56 · 1401 COPENHAGEN K · DENMARK
TEL +45 32 69 87 87 · diis@diis.dk · www.diis.dk

**RULES OF ORIGIN AND THE EUROPEAN UNION'S
PREFERENTIAL TRADE AGREEMENTS,
WITH SPECIAL REFERENCE TO
THE EU-ACP ECONOMIC PARTNERSHIP AGREEMENTS**

Peter Gibbon

DIIS Working Paper no 2008/15

© Copenhagen 2008

Danish Institute for International Studies, DIIS

Strandgade 56, DK-1401 Copenhagen, Denmark

Ph: +45 32 69 87 87

Fax: +45 32 69 87 00

E-mails: diis@diis.dk

Web: www.diis.dk

Cover Design: Carsten Schiøler

Printed in Denmark by Vesterkopi as

ISBN: 978-87-7605-274-4

Price: DKK 25.00 (VAT included)

DIIS publications can be downloaded

free of charge from www.diis.dk

DIIS Working Papers make available DIIS researchers' and DIIS project partners' work in progress towards proper publishing. They may include important documentation which is not necessarily published elsewhere.

DIIS Working Papers are published under the responsibility of the author alone.

DIIS Working Papers should not be quoted without the express permission of the author.

Peter Gibbon is Senior Researcher and Head of the DIIS Trade and Development Research Unit.

Contents

Abstract	4
1. What are Rules of Origin?	5
2. RoO methodologies	6
3. Measuring restrictiveness and its consequences	10
Quantifying restrictiveness.....	10
Restrictiveness and compatibility with GATT Art. XXIV.....	11
Restrictiveness and compliance costs.....	12
4. EU PTA rules for fish and clothing to 2007	13
Fish/fish products.....	13
Clothing.....	14
5. The current revision of EU PTA RoO	17
The EU Communication of 2005	17
ACP Reactions to the EU Communication of 2005.....	19
The 2007 Cotonou+ RoO	21
The Draft (GSP) Regulation of 2007	24
6. Conclusion	28
References	31

Abstract

Economic opinion is in the process of re-interpreting low levels of uptake of non-reciprocal preferential trade agreements (PTAs) partly in terms of administrative barriers to preference utilization. Primary amongst these barriers are Rules of Origin. This paper reviews the literature on Rules of Origin as administrative barriers to the utilization of preferences accorded to African, Caribbean and Pacific (ACP) countries under the Cotonou Agreement, before going on to examine current revisions of EU PTA Rules of Origin. These are embodied in a new (so-called 'Cotonou+') set of rules for the interim EU-ACP Economic Partnership Agreements (EPAs) and a second proposed set of rules for the EU's Generalised System of Preference (GSP) arrangements, including Everything But Arms. The Cotonou+ rules include some important concessions by the EU, especially for those ACP countries that do not have Least Developed Country (LDC) status, but are supposed to be re-negotiated within a fixed period in line the new EU GSP rules. However, the new GSP rules as revealed in the EU Draft Regulation of 2007 contain no real concessions for non-LDCs, and they introduce potentially trade-restrictive administrative requirements. These rules are currently (July 2008) under reconsideration by the EU, but it is clear that this exercise does not cover these elements. For this reason, harmonisation of the Cotonou+ and new GSP rules may be a source a serious discord in the negotiation of full EPAs, a process which is supposed to occur during 2008.

I. What are Rules of Origin?

Rules of Origin (RoO) define the economic as opposed to the geographical origin of products. That is, they define what an importing country considers the amount of value added in a good in a given exporting country sufficient for it to be counted as an export from that country. In addition, RoO can restrict the number of countries from which an exporting country may source its non-originating raw materials or components (if it permitted to use these), while still having its products defined as originating.

Countries (or Customs Unions) may have two distinct sets of RoO, one applied to Non-Preferential or Most Favoured Nation (MFN) trade, and one applied to Preferential Trade Agreements (PTAs). Actually, only around 30 countries currently have Non-Preferential Rules of Origin (NPROs) and in some cases these consist of only a line or two of text. A need for countries to distinguish origin in MFN trade exists in WTO terms only if it wishes to apply WTO rules on anti-dumping duties, countervailing measures, safeguard measures or origin labeling. Otherwise, origin of MFN trade is important only from the viewpoint of collection of trade statistics.¹

Invariably, PTA RoO are more restrictive than MFN ones. Theoretically, the reason for this is to prevent 'trade (and, in some versions of the argument, investment) deflection'. Trade deflection involves transshipment of a good or service via a preference-holding country in order for it to obtain the margin of preference available under the PTA. Under MFN trade there is normally no incentive to misrepresent origin, since all exporting countries face the same tariff.

Transshipment to take advantage of preferences is common, meaning that there is clear case for a country's PTA RoO being stricter than MFN ones. However, PTA RoO may serve purposes other than preventing trade deflection. Principally, they may act as non-tariff instruments of protection or mercantilist trade promotion, or both. They may serve as a protectionist instrument by substituting a tariff barrier by a domestic production requirement that is difficult to meet (thus in effect acting as a tariff on the raw material or component rather than the final product [Kreuger, 1993]). They may serve as an instrument of mercantilist trade promotion by allowing only raw

¹ A WTO Agreement on NPROs has existed since 1995. Under this, WTO members agreed to a work programme on NPRO harmonization, originally to be completed by 1998. However, the Technical Committee responsible did not agree a consolidated text until February 2008 (G/RO/W/111/Rev.2) and even this signals that work remains to be done in relation to products falling under HS Chapters 84-91 (machinery, transport equipment and electrical and electronic equipment).

materials or components from the importing country itself to count on an equal basis with local ones in conferring origin on finished goods.

For these reasons, debate concerning RoO in PTAs invariably revolves around the issue of levels of restrictiveness. The discussion here will also focus on this issue in relation to trade in goods under the EU's PTA RoO, mainly but not only in the context of the Economic Partnership Agreement (EPA) negotiations between the EU and the African, Caribbean and Pacific (ACP) group of countries. Individual preference-granting countries' PTA RoO tend to have a high level of similarity across agreements. This applies to the US's PTAs, which broadly follow the North American Free Trade Area (NAFTA) model and to the European Union (EU)'s PTAs, which have broadly followed the so-called Pan-Euro model.

As a prelude to this, Section 2 outlines the different types of methods used in RoO for determining origin of goods. Section 3 examines attempts in the literature to give the term 'restrictiveness' a more precise meaning, and reviews the results of comparative analyses of the EU PTA RoO effective until the end of 2007 against this background. Section 4 discusses two product-specific pre-2008 EU PTA Rules that historically were subject to most criticism, those for fish/fish products and for clothing. Section 5 examines the current revision of the EU PTA RoO, both in general and in specific relation to the EU-ACP EPA negotiations. The revision process is covered up until July 2008 only. Section 6 sums up and concludes.

2. RoO methodologies

A knowledge of the methods used to define origin and implement RoO is necessary both in order to follow the discussion on restrictiveness, to understand why the EU PTA RoO on fish and clothing have been especially controversial, and to evaluate the current revision of the EU PTA RoO.

RoO are administered by Customs Departments rather than by trade ministries. As a result, the Kyoto Convention of the World Customs Organisation (1973, revised 1999) is the main international basis for defining them. The Kyoto Convention recognizes two basic criteria for deter-

mining origin (both of which date back in practice long before 1973²). The first is the notion of *wholly obtained/produced* in the exporting country. Rules based on this criterion are typically applied in relation to agricultural goods and minerals. They are also applied typically in relation to fish although, as will be seen, in this case ‘wholly obtained’ tends to be defined in terms of the nationality of vessels that catch fish, rather than where they are caught.

The second Kyoto criterion is that of *substantial transformation*. In other words, although a good or service is not entirely produced in a given country, it can be counted as originating there if it has been substantially transformed in the country in question. Three groups of sub-methods are used to operationalise substantial transformation:

Change of Tariff Classification (CTC), referring to the Harmonised System (HS) of tariff classification. The HS system classifies goods at item (8-10 digits), sub-heading (6 digit), heading (4 digit) and chapter (2 digit) level. Correspondingly, a RoO may demand that a local operation is performed on an exported good that results in a change from one to another category. When applied, CTC rules are often accompanied by *exceptions*. These prohibit the use of non-originating raw materials or components in transitions between specific tariff classifications. CTC at 4 digit level is the sub-method applied almost exclusively in the proposed harmonized WTO NPROs (see footnote 1), qualified by the exclusion of some CTC 4 digit level changes from conferring origin.

Value Added (VA). A RoO may require an exported good to embody a minimum local VA, have specified originating parts comprising a specific share of final value, or embody a maximum import content measured in value terms. As will be seen, there is also some variation in the base prices against which VA should be calculated (e.g., Ex-works, Net Production Cost, FOB, CIF, etc). Where VA rules are applied in US and EU PTAs, the level of local VA required has usually fallen in a range of 25-60%.

Technical Requirement (TR). A RoO may insist that one or more specified manufacturing operation must take place on the good in the exporting country for it to be classified as originating. A reverse form of this rule can also be found in many PTAs, whereby specific manufacturing operations are identified which are insufficient to confer origin (e.g., labeling, packaging or assembly).

² Estevadeordal & Suominen (2004) state that one of the first PTAs ever signed, the Canada-US FTA, from its inception in 1908 used a version of the ‘substantial transformation’ criterion – ‘production of a new and different article’.

According to WTO data on PTAs for 2002 (cited in Estevadeordal & Suominen [2004, 5]) the most widely applied of these rules is CTC (present in 89 of 93 agreements for which there were information). The current EU PTA RoO are also predominantly of a CTC kind, although for 20% of tariff lines covered there is no reference to CTC. In the cases of the EU Cotonou³ and Generalised System of Preferences (GSP) RoO, VA was the sole test in 10-13% of tariff lines (ODI 2006, Cadot et al 2005a).

Rules based on CTC and VA are applied mainly to manufactures other than textiles and clothing, while TRs are very common for the latter products. Quite often, goods are expected to conform to more than one method of proving 'substantial transformation', although the prevalence of the use of multiple methods does not seem to have been measured in the literature. It should also be noted that, in the case of many North-South PTAs, derogations might be granted to certain (groups of) countries – normally LDCs – in respect of origin requirements for time-limited periods, to accommodate what are agreed to be lack of raw materials or local production. The most famous of these derogations is the 'Third country fabric' provision for 'lesser developed beneficiary countries' in the US's Africa Growth and Opportunity Act (AGOA) (see below).

Rules defining origin are invariably accompanied by other rules providing for specific methods that mitigate their impact. There are three main rules of this kind:

De minimis or *Tolerance*. This permits a specified share (normally between 7% and 15%) of the final value or volume of the product, or of the aggregate processing operations involved in its manufacture, to be non-originating. When applied to product value or volume, the components to which the rule applies may be specifically identified (for example, zips, buttons and inter-lining for clothing). Alternatively, there may be a negative list of components that may not be included in the allowance. In the case of the EU's pre-2008 GSP, a *de minimis* provision of 10% applied, but not to products in HS Chapters 50-63 ('Textiles and Textile Articles').

Roll-up or *Absorption*. This permits raw intermediate products which are not in themselves wholly obtained but which are counted as originating on the basis of meeting one or other of the rules mentioned earlier, to be counted as wholly originating for the purpose of determining the origin of a final product that incorporates them.

³ The Cotonou Agreement governed trade relations between the EU and the ACP group of countries until 2007.

Cumulation. Under cumulation rules PTA members may source non-originating raw materials or components from specified countries and count them as originating. There are three types of cumulation - (i) *bilateral*, where only raw materials or components originating in the preference-granting country can be counted in this way; (ii) *diagonal*, where raw materials or components from the preference-granting country and a list of other designated countries to which the same RoO apply can be counted; and (iii) *full*, where raw materials from all countries to which the same RoO apply can be counted. Whereas the EU-Chile PTA provides only for bilateral cumulation, the EU's GSP provides for diagonal cumulation, in that beneficiaries can cumulate from fellow members of designated regional groupings in east Asia, southern Asia and Latin America. The Cotonou Agreement provided for full cumulation between the 78 ACP signatories plus the EU itself, as well as some diagonal cumulation from designated regional groups of developing countries. There were however restrictions on ACP cumulation from South Africa.

According to the same WTO data set for 2002 already referred, full cumulation was permitted in only 8 of 88 PTAs for which information was available, while diagonal cumulation was permitted in only 58 (Estevadeordal & Suominen 2004, 6). The EU has always presented Cotonou's enhanced cumulation provision not merely as a mitigation of its strict basic rules for conferring origin, but also as a means by which its RoO incorporated a 'development' dimension. Implicitly, development has been equated with backward integration. Thus, even if backward integration was not possible in an individual ACP country because of the absence of opportunities for economies of scale (some ACP countries and territories have populations as small as 2,000 people), it was considered possible on an all-ACP basis.

A final aspect of PTA RoO is that they are always accompanied by more or less restrictive administrative conditions. One frequent condition is a prohibition on beneficiary countries providing their exporters with remission of import duties (duty drawback) on non-originating raw materials or components, where these enter into products benefiting from a margin of preference. Another condition is certification of qualified exporters and verification of the origin of qualifying exports by the customs authorities of the exporting country. In the case of NAFTA, exporter self-certification is the rule. Under Cotonou, exporters required a EUR 1 form verified by local customs authorities for each consignment; frequent exporters could however apply for 'approved' status which, when granted, allowed self-certification. AGOA requires a 'customs visa system' to be set up by beneficiary country customs authorities. This entails procedures for verification of each consignment by exporting country customs, monthly submission to the US of lists of verified consignments and open access of all exporting firms to roaming US Customs Department 'jump squads'.

3. Measuring restrictiveness and its consequences

Since 2000 a literature has emerged seeking to give more substance to the broadly accepted understanding that PTA RoO act as barriers to trade. This is in the context of a turn in the economic literature on under-utilisation of North-South PTA preferences. While historically under-utilisation was seen as an inefficiency effect of North-South PTA's non-reciprocal character, today it is usually seen in terms of the high compliance costs of preferential access. These are now seen as reducing real margins of preference to negligible levels. The new literature on RoO restrictiveness therefore has two components: firstly an effort to quantify restrictiveness as such and demonstrate its relation to preference under-utilisation, and secondly to translate measures of restrictiveness into costs falling on exporters. A sub-component of the first of these efforts examines the compatibility of restrictive PTA RoO with GATT Art. XXIV (on PTAs).

QUANTIFYING RESTRICTIVENESS

Quantification of the restrictiveness of PTA RoO was initiated by Estevadeordal (2000), in relation to NAFTA. Estevadeordal developed a rating system whereby specific RoO were attributed a score between 1 (least restrictive) and 7 (most restrictive). In allocating scores to rules, two basic principles were followed (i) for CTC rules, change at the level of chapter was considered more restrictive than at the level of heading, change at the level of heading more restrictive than at the level of sub-heading, and so on; (ii) VA and TR conditions added to a CTC were considered to be more restrictive than a CTC alone.

In a comparison of NAFTA and contemporary EU PTA rules Estevadeordal & Suominen (op. cit.) concluded that, while both sets of rules were restrictive, NAFTA RoO had a higher overall level of restrictiveness than the EU's. This result was based on a comparison of averages of restrictiveness ratings across 20 HS Chapter headings. The EU's ratings were highest for fruit and vegetable products (6.6), textiles and clothing (6.1) and food products (5.0), while NAFTA's were highest for textiles and clothing (6.9), fruit and vegetable products (6.0) and leather goods (5.6). The NAFTA average for all 20 sections was 5.1 and the EU PTA one was 4.5. At the same time, NAFTA RoO showed a higher level of variance in their restrictiveness than the EU's, which were consistently 'moderately restrictive' or 'restrictive'.

A critical point in the quantitative literature is that a correlation was established at product level between high levels of RoO restrictiveness and high margins of preference. In other words, where incentives for preference utilization were highest, the highest barriers to their utilisation

were found. This is demonstrated by Cadot et al (2005a), using a modified version of Estevadeordal's method. Cadot et al (op. cit.) compares levels of restrictiveness of RoO for tariff lines where there are MFN tariff peaks and those for tariff lines on which low tariffs were applied.⁴ The NAFTA average scores for high and low tariffs are 6.2 and 4.8 respectively, while the EU PTA averages are 4.2 and 3.4 respectively.

Cadot et al (2005a) go on to demonstrate an association between RoO restrictiveness at product level and preference under-utilisation. Cadot et al (2005b), examining this relation for the Eastern and Southern Africa (ESA) grouping in the EPA negotiations, show that the main losers have been non-LDCs, since these are the countries most capable of exporting the value-added products to the highest preference margins (and most restrictive rules) typically apply. Annual losses for the four ESA non-LDCs, represented by their export of goods under EU MFN RoO rather than Cotonou ones, are computed at €201 million (or equivalent to 16% of the value of the preferences for the tariff lines concerned). Cadot et al (2006) find similar levels of losses for all EU PTA beneficiary countries.⁵

Estevadeordal's method has been subject to criticism for the arbitrariness of its assumptions by Erasmus et al (2004). According to these authors, because gradations in the Harmonised System of Tariff Classification were not mainly designed to reflect differences in levels of processing at product level, inputs and outputs of particular processes are often found at the same sub-heading level.⁶ Likewise, TRs are not restrictive *per se*, only specific TRs are. Finally, a combination of less restrictive conditions may be less restrictive than a single more restrictive one. On the other hand, Rivas (2006) reporting the use of an alternative and somewhat more nuanced method for measuring restrictiveness, comes to conclusions broadly consistent with those of Cadot et al.

RESTRICTIVENESS AND COMPATIBILITY WITH GATT ART. XXIV

Rivas's contribution (op. cit.) is aimed mainly not at measurement of preference under-utilisation, but at providing an empirical demonstration of the effects of restrictiveness that could support an argument that certain PTA RoO are incompatible with the provisions of GATT Art. XXIV: 5(b),

⁴ 'Tariff peaks' were operationalised as tariff levels three times or more higher than average tariff levels, while low tariffs were operationalised as tariffs one third or less of the average.

⁵ Cadot (2008) also mentions that only 65% of Mexican textile and clothing shipments to the US since the inception of the NAFTA agreement have (successfully) claimed NAFTA eligibility.

⁶ Similarly, there is no classificatory distinction in the HS system between product parts and accessories.

on ‘Other Rules of Commerce’ (ORCs) within PTAs. This states that ORCs shall not become more restrictive in the transition from one PTA regime to another, unless this prevents the new regime’s creation or integrity. Examples are provided of two NAFTA rules, relative to the rules of the earlier Canada-US FTA, where rules have been changed in a more restrictive direction in the absence of such grounds.⁷ Rivas does not suggest what remedy could be applied via WTO (or any other forum) in these cases though.

RESTRICTIVENESS AND COMPLIANCE COSTS

Having demonstrated a relationship between RoO restrictiveness and preference under-utilisation, Cadot et al (2005a) provide estimates of overall trade-weighted costs of compliance with the NAFTA and EU PTA regimes. Prior to this work, most discussion of the subject had relied on extrapolations from Waer’s (1992) calculation that compliance costs were equivalent to 3% of the value of European Free Trade Area (EFTA) exports to the EU under the old EU-EFTA PTA. Based on a model using reference utilisation rates as a proxy, Cadot et al (2005a) arrive at a trade-weighted cost of compliance with contemporary EU PTA RoO of 8.0% of the value of exports under these PTAs (the cost of compliance with NAFTA is 6.8%). Why EU PTA RoO should have had significantly higher compliance costs than NAFTA, despite NAFTA RoO being more restrictive, is attributed to the higher administrative costs of EU PTA RoO. These are estimated as 6.8% of the value of exports under EU PTAs, as opposed to only 1.9% of those under NAFTA’s. In other words, although the restrictiveness of RoO imposes costs considerably higher than would be the case with ‘neutral’ RoO, in the case of the EU, actual costs of conformity are outweighed by costs of proving conformity.

Almost identical estimates of RoO compliance costs into the US and EU markets for Sub-Saharan African beneficiary countries are arrived at using a slightly different model by Brenton & Ikezuki (2006). They estimate African exporters’ compliance costs for AGOA and the US GSP at 6.7% *ad valorem*, while those for Cotonou are estimated at 8.4%.

⁷ South Africa’s insistence on tightening SADC RoO for several product groups (described in Erasmus et al 2004) would also be WTO incompatible according to this reasoning.

4. EU PTA rules for fish and clothing to 2007

Although the system of EU PTA RoO was subject to repeated criticism from developing country governments, NGOs and academics, those for fish/fish products and clothing attracted the most comment.⁸ In the case of fish/fish products this was firstly because elements of them were claimed to depart from the guidelines provided in the WCO Kyoto Convention, in addition to which they appeared to openly benefit EU fishing interests. In the case of clothing it was mainly because of adverse comparisons with AGOA in terms of trade creation effects. Not surprisingly given the earlier discussion, fish/fish products and clothing are subject to either relatively high average tariffs (EU MFN tariffs for clothing average 12%) and/or to tariff peaks (EU MFN tariffs for whole and processed tuna are 22% and 24% respectively).

FISH/FISH PRODUCTS

Prior to 2008, the EU's method for determining the origin of fish/fish products was whether they were wholly obtained/produced. All fish caught within a beneficiary country's 12 nautical mile territorial waters and landed in that country were considered to be 'wholly obtained', regardless of the nationality of the vessel it is caught by. The problem is that there is very little commercial stock of fish remaining in the territorial waters of most countries. But large volumes of fish are caught in countries' Economic Exclusion Zones (EEZs), which extend 200 nautical miles offshore. Under Cotonou rules, for a fish caught in these waters to be considered wholly obtained, it had to be caught by a vessel registered and flagged in the beneficiary country or the EU or an EU overseas territory (EUOT). The vessel also had to be at least 50% owned by nationals of or a company based in the same countries. At least half of the crew (including master and officers) must have been nationals of the beneficiary country or the EU or EUOTs.⁹ Nationals of these countries could charter vessels belonging to citizens of third countries and still qualify, but only when a joint EU-ACP committee approved this as building local capacity, and where the EU Distant Water Fleet had been offered access by the country concerned and had declined it.

For processed fish under Cotonou, the catch had to have been wholly obtained or it could have been cumulated from any other ACP country (providing its origin in this country could be

⁸ Other rules attracting particular criticism were those for sugar products, where no cumulation was permitted.

⁹ For the EU GSP 75% of the crew including officers had to be nationals of the beneficiary country or the EU or EUOTs.

proved). Diagonal cumulation was also possible from some but not all neighboring developing countries.¹⁰ In the cases both of fish and fish products there was a 15% *de minimis*, applied on a per consignment basis (i.e., any given consignment could contain up to 15% non-originating material but there could not be, e.g., separate production runs of originating and non-originating processed fish). It is generally recognized that this provision was hardly used, due to the practical and administrative challenges that it presented, and the concomitant risk of loss of preference in the event of misuse (Megapesca Lda 2007). For tuna, special rules applied allowing a quota of 2,000 tons of loins and 8,000 tons of canned tuna to be exported by beneficiary countries without regard to the RoO. This was divided between nine ACP countries and was administered by the ACP itself.

According to Block & Grynberg (2005) the rules for processed fish departed from the provision of Annex D1 of the Kyoto Convention. Here it is stated that where two or more countries have taken part in the production of a good, then its origin should be determined by the method of substantial transformation (rather than that of whether it is ‘wholly obtained’). The authors go on to argue that the choice of the ‘wholly obtained’ rule for fish – and its interpretation in terms of vessels rather than territory - was designed to provide a subvention to the EU Distant Water Fleet. On its basis, the fleet obtained near-exclusive or exclusive access to ACP waters while at the same time obtaining a very high preference margin for its ‘exports’ – or a substantial premium where it sold its catch to canneries in the few ACP countries with a significant canning industry.¹¹

CLOTHING

The Cotonou rule for clothing comprised a TR for ‘double transformation’. That is, for clothing to be considered as originating both production of fabrics or cloth and production of items of clothing itself had to take place within the same beneficiary country. Bilateral and full ACP cumulation was possible, as was diagonal cumulation from three regional groupings of developing countries (ASEAN, SAARC and the Andean groups). Value added in the beneficiary country carrying out the final export had however to exceed value added in the countries from which origin of thread, fabric, cloth or components were cumulated. In contrast to the EU GSP, the Cotonou rule was mitigated by a 15% *de minimis* allowance. However, the latter’s utilization by

¹⁰ Cumulation from South Africa was not possible.

¹¹ Papua New Guinea, Mauritius, Seychelles, Ghana, Senegal and Namibia.

exporters was also restricted, not least because it was not permitted to count linings and interlinings against the *de minimis* – to the direct benefit of the EU textile industry.

Traditionally the Commission defended the Cotonou clothing rule in terms of its supposed stimulation of vertical integration in ACP countries.¹² In reality vertical integration in the ACP was achieved only by Mauritius, where earnings from sugar exports, liberal bank lending practices and local community ties to Hong Kong favoured large-scale local and foreign investment. Elsewhere, until the late 1990s when Mauritians began investing in neighboring Madagascar to take advantage of cheap labour, there was very little wider supply response. The Commission's position was widely criticised, in its own terms, for failing to acknowledge changes in the organisation of the global clothing trade in the years following 1975, when the first EU-ACP trade agreement was signed. These changes entail a model where production of textiles and clothing on a geographically separate basis is normal and where there is declining competitive advantage in vertical integration.

Late in 2000 the US government introduced AGOA. Under this arrangement, distinct RoO were applied to Mauritius, South Africa, Botswana and Namibia¹³ on the one hand and to other Sub-Saharan African countries (so-called 'lesser developed beneficiary countries')¹⁴ on the other. Originating products from the first group were faced with a 'yarn forward' TR.. For knits this implies two stages of production (yarn to fabric, fabric to clothing) while for wovens it implies three (yarn to thread, thread to fabric, fabric to clothing). This group could cumulate from the US or any other AGOA beneficiary and had access to a 10% *de minimis*. For the second group there was a time-limited derogation (currently extended until 2012) allowing origin to be conferred on the basis of 35% local value added. This is currently limited by a quota ceiling of 3.5% of all US imports by volume. As noted earlier, conformity requirements are strict. In the context of the relatively generous quota ceiling, this was the most neutral clothing RoO applied by any large trading country in a PTA until 2008.

¹² Similar arguments were advanced by South Africa for a the highly restrictive SADC clothing RoO, see Erasmus et al (2004).

¹³ Botswana and Namibia were subsequently admitted to this second category.

¹⁴ Note that this group included non-LDCs such as Kenya.

Table 1: Clothing exports from Sub-Saharan Africa to the US, 1999-2007, million US\$
(Source: USTR Otexa)

	1999	2000	2001	2002	2003	2004	2005	2006	2007
AGOA	2.8	2.7	359.5	803.3	1202.1	1613.5	1418.4	1255.6	1266.2
Non-AGOA	619.2	786.5	638.5	333.0	349.9	142.6	46.0	36.2	27.2
Total	622.0	789.2	998.0	1136.3	1552.0	1756.4	1464.4	1291.8	1293.4
M&SA	359.1	420.5	450.8	469.7	538.7	408.0	270.6	165.8	138.5
%SSA	57.7%	53.3%	45.2%	41.3%	34.7%	23.2%	18.5%	12.8%	10.7%
SSA - M&SA	262.9	368.7	547.2	666.6	1013.3	1348.4	1193.8	1126.0	1154.9

Key: M: Mauritius; SA: South Africa; SSA: Sub-Saharan Africa

Table 2: Clothing exports from Sub-Saharan Africa to the EU 15, 1999-2007, million US\$
(Source: EU Market Access database)

	1999	2000	2001	2002	2003	2004	2005	2006*	2007§
Total	959.2	1035.7	1015.3	839.9	932.8	1007.7	916.2	1035.9	1047.3
M&SA	741.3	708.0	670.9	643.2	703.8	710.7	600.0	640.2	674.0
%SSA	77.3%	68.4%	66.1%	76.6%	75.4%	70.5%	65.5%	61.8%	64.4%
SSA - M&SA	217.9	327.7	344.4	196.7	229.0	297.0	316.0	395.7	373.3

Key: *EU 25 ; § EU 27

for other abbreviations see key to Table 1.

Unlike Cotonou, AGOA was successful in generating a substantial supply response. Sub-Saharan Africa's exports to the EU have remained practically stationary since 2000. The share of the two traditional African exporters, Mauritius and South Africa, has remained in a range between 62% and 77% of all Sub-Saharan African clothing exports to the EU, while exports from all other countries have remained in a range between \$300-400 million per year. Exports to the US on the other hand increased by over \$500 million between 2000 and 2007. The whole of this increase has come from non-traditional producers, while exports to the US by traditional exporters have declined. Following removal of quotas on China at the end of 2004, total Sub-Saharan African exports to the US declined – although the traditional producers have accounted for around 60% of this decline. Thus, there are grounds to believe that a US-directed clothing sector will persist in non-traditional producing countries in Sub-Saharan Africa in the long-term (post-Multifibre Arrangement) environment. This case appears to demonstrate a strong link between neutral RoO, trade creation and export diversification.

5. The current revision of EU PTA RoO

THE EU COMMUNICATION OF 2005

Efforts by the EU to reform its PTA RoO date back to the early 1990s. The first decade of these efforts focused upon harmonization of existing rules. In 2003 the EU unveiled proposals for reform of their content, referred to at first in terms of simplification. Certainly there was – and remains - a strong case for simplification. Prior to 2008 there were 545 EU PTA rules for 509 different product groups, plus 107 alternative rules to some of the 545 (EC 2005a). Following a round of public consultation, the Commission issued a Communication on the subject (EC 2005b). Besides proposing a method for simplifying EU RoO for PTAs with developing countries, this also emphasised ‘efficiency of procedures’ and ‘enforceability’. This Communication formed the basis of the initial EU position on RoO in the EPA negotiations.

The Communication stated that it was the EU’s intention to replace all its existing methods for determining origin with a single one. This would be a local VA requirement, set at different levels according to product group. The Communication justified the VA criterion in terms of its simplicity and its flexibility and transparency in measuring value, while dismissing CTC as depending on a classificatory system whose design was purely *ad hoc* (see above, page 11).

The document mentioned that this requirement might still be supplemented by additional tests in the cases of agricultural products, fish/fish products and textiles and clothing. It was proposed to calculate local VA in terms of ‘net production cost’, as opposed to ex-works value (the basis for those tariff lines where value added was used as a criterion under Cotonou). Three impact assessments were commissioned. Two would model the trade effects of requiring different levels of local VA for fish/fish products (Megapesca Lda 2007) and for textiles and clothing (Scheffer 2007) as product groups. The other would model the ‘development effects’ of different average VA thresholds (Cadot et al 2006). Final proposals would not be drafted until these were complete. The only sector dealt with separately in the Communication was fisheries, where it was stated that existing requirements on composition of crews would be definitely removed for all EU PTAs, and that an (unspecified) simplification of vessel ownership requirements would also occur.

The Communication repeated past EU assertions that provision for cumulation secured a link between RoO and development objectives. In addition, cumulation was portrayed as contributing to regional integration between developing countries. Reference was made to extending full and

diagonal cumulation provisions, including through the possible designation of new regional groups.

As far as 'efficiency' and 'enforcement' was concerned, the Communication stated that the EU would require registration of all exporters utilising PTAs. Customs Departments in exporting countries would be required to conduct assessments of the financial records of all such exporters, provide a list of them to the EU and monitor them on a regular basis. Customs Departments would be also required to report regularly to the EU on how such arrangements were working and actively cooperate in any investigations undertaken.

Against this backdrop, responsibility for declaration of origin would be delegated from Customs Departments to (registered) exporters themselves. The 'extension or revision of an existing (preferential) relation' with a beneficiary country would be conditional upon a EU assessment that the Customs Department of this country had the capacity to implement such a system. The Communication justified these changes primarily in terms of EU revenue concerns. In a couple of test cases the European Court of Justice has ruled that under existing RoO, where a claim for origin proves fraudulent or incorrect, the EU could not claim lost tariff revenue from importers provided that they had been verified by the competent authority of the exporting country and that the importer acted in good faith. The proposed change would introduce traceability and allow full recovery of lost revenue. From whom and by what mechanism is not stated either in the Communication or in the subsequent Draft Regulation, although it appears that EU importers will become financially liable in the first instance,

The Communication stated that a Draft Regulation would be published in mid-2006. Actually, this did not appear before October 2007. This followed circulation of the impact assessments and a second round of consultation in June 2007, on the level at which the qualifying value-added threshold should be set as well as on 'how value should be calculated, whether there should be a list of insufficient operations...and whether the definition of wholly obtained products should remain unchanged' (*SJ Berwin's Community Week*, 22 June 2007).¹⁵ Simultaneous with the new Draft Regulation, the EU made separate offers on RoO to the CARIFORUM EPA grouping (in the context of a full EPA agreement with these countries) and to other EPA groups (in the context of interim EPA agreements). However, both these offers were based on more or less extens-

¹⁵ The consultation announced was in the form of a letter to various European Industry Associations inviting their views.

ive modifications of existing Cotonou rules rather than on the new system for determining PTA origin outlined in the succession of EU communications and draft regulations since 2003.

ACP REACTIONS TO THE EU COMMUNICATION OF 2005

To understand this discrepancy it is necessary to consider both the reaction of the ACP countries to the EU's 2005 proposals, and the manner in which the overall EPA negotiations between the EU and the ACP had evolved from 2005 to 2007. ACP reactions came in the form of papers for and - in a handful of cases - concrete proposals. While expert discussion of the EU 2005 Communication had been critical mainly of the transition to a VA methodology as such (see Naumann 2005 and Brenton 2006)¹⁶, the ACP reaction – while also cool towards the VA methodology¹⁷ – largely continued to revolve around the special problem areas of fish/fish processing and clothing, as well as around the cumulation issue.

For fish/fish products, a proposal by the ACP Group of Experts¹⁸ (Landell Mills 2005) favoured an extension of qualification for 'wholly obtained' status for whole fish to ACP countries' EEZs. For processed fish they favoured a rule based on a change in 6-digit HS classification (i.e., one intended to allow use of fish for local processing without respect to their origin). Exactly the same proposals were embodied in a Pacific Group Non-Paper (2006), and in an ESA grouping proposal (concerning the content of a proposed Regional Fisheries Agreement). Similar proposals

¹⁶ According to Naumann (2005) any VA rule would create disincentives to efficiency gains by exporters, since marginal reductions that were attained in local costs would be reflected in local VA shares that were lower overall. Secondly, the magnitude of local VA shares would depend to a considerable extent on currency fluctuations beyond the control of local exporters. Thirdly, verification of specific levels of local VA in terms of Net Production Costs would carry with it considerable firm-level administrative costs, compared for example to verification of foreign content costs (which he proposed as an alternative). Additional arguments against the Net Production Cost mode of calculating VA were to be raised in the impact assessments (see below). Brenton (2006) argued that, whatever its origins, a 6-digit CTC criterion could accurately discriminate between more and less complex production processes. Furthermore, its use would minimise verification costs. It is worth noting however that some expert discussion is broadly favourable to the VA methodology. This is on the grounds of the superior transparency of a quantified requirement. Quantification thus provides an opportunity, similar to tariffication, for negotiations aimed at progressive reduction.

¹⁷ 'Before Summer 2007 a first draft Protocol on RoO for the EPAs was prepared by the Commission, based on the VA criterion...However, the EPA parties did not agree with the VA criterion, (although) feedback from the EPA parties was very limited on the ways to improve the rules' (EC 2007a)

¹⁸ Set up to work on RoO in the regional EPA negotiations following stalemate on the issue at the end of the all-ACP phase.

were also discussed in the Southern Africa Development Community (SADC) grouping, although here the main emphasis seems to have been on allowing cumulation from South Africa for processed fish.

On textiles and clothing a proposal from the ESA grouping, carried forward later by the East African Community (EAC) grouping¹⁹ was for the AGOA ‘third country fabric’ provision to be substituted for Cotonou rules for all members, irrespective of their development status. Proposals developed for the SADC grouping (PWC 2007) similarly suggested a ‘liberal’ VA threshold on textiles and clothing for the whole group, which ‘if necessary could be raised over time’ (!; cf. footnote 16).

Meanwhile, the Pacific grouping, in the same Non-Paper of 2006, proposed a general abandonment of the cumulation principle in favour of either much more liberal CTC or VA rules. The EU’s emphasis on mitigating restrictive substantial transformation criteria via cumulation was criticised for assuming the regional presence of significant levels of internationally competitive supply capacity. In the Pacific (and other) EPA region(s), markets did not exist on a scale where local production of specialised inputs could ever be competitive. As mitigation via cumulation would bias exporters to buy regionally, their exports to the EU would become uncompetitive unless margins of preference were exceptionally high. Even then, exports to countries outside the EU would remain uncompetitive. Furthermore, mitigation of strict rules via cumulation penalised ACP exporters from participation in truly global supply chains, credited in the Non-paper with creating a variety of efficiency spillovers (Pacific Group 2006).²⁰

Until the second half of 2007, the EU’s general approach to RoO within the EPA negotiations was to defer any concessions, or even any serious discussion, until as late in the game as possible. It was widely believed that the EU was reluctant to move until its internal process of deliberation on the future of RoO was complete, and until agreements on liberalisation of trade in goods had been reached in all EPA regions. The latter was the EU’s first priority, since it needed these agreements to be in place before 31 December 2007 in order for it to conform to the terms of its GATT Art. XXXIV waiver for the Cotonou Agreement. In this scenario, concessions on RoO (like firm commitments on development assistance) could be held out as a carrot for ACP coun-

¹⁹ The member countries of the East African Community detached themselves from the ESA grouping (and in the case of Tanzania from the SADC one) in 2007 to negotiate a separate EPA.

²⁰ Presumably these concerns could also be addressed by providing for progressively wider cumulation possibilities, rather than the elimination of cumulation as such.

tries to sign up to agreements on services, investment, public procurement and competition in a final stage of negotiations that would start in January 2008. In the meantime, the EU planned to secure interim agreements on trade in goods with the ACP non-LDCs, simply by refusing to consider alternative ways in which their market access to the EU could be continued (for example, by seeking an extension of the waiver or by giving them access to the GSP+ scheme).²¹

In the event, negotiations proceeded according to the EU's timetable only in the Caribbean region. Three months before the December 31 2007 deadline, and despite the fact that non-LDC ACP countries faced large increases in tariffs on their exports to the EU after this date, the EU had made no progress in obtaining agreements on trade in goods in any of the five non-Caribbean regions. The EU responded to this problem in two ways: firstly, it let it be known that it was prepared to accept any WTO-compatible offer on trade in goods from these regions. In effect, this meant that ACP countries could submit offers that deferred substantive trade liberalisation until 2022 or 2023 and that excluded whole sectors from obligations to liberalise.²² Secondly, the EU conceded some of the concrete ACP demands on RoO. The resulting concessions were embodied in the 'Cotonou+' RoO offer made in October 2007 to the countries in the EAC, ESA, SADC and Pacific groupings in respect of interim EPAs²³ and (with minor modifications) to the CARIFORUM grouping in respect of a full EPA.

THE 2007 COTONOU+ ROO

The RoO for the interim EPAs and the CARIFORUM full EPA can be found in an EC Council Market Access Regulation (EC 2007b) approved at the end of 2007. These RoO mainly carry forward the Cotonou RoO, entailing that they remain mainly based on the CTC criterion of substantial transformation and also that they require no change in administrative system. How-

²¹ The GSP+ scheme offers EU market access to non-LDC developing countries on terms similar to Everything But Arms, but only a limited group of countries that are in conformity with a long list of international conventions on non-trade issues currently qualify. Throughout the EPA negotiations the EU insisted that GSP+ was not an alternative to EPAs that it was obliged to offer the ACP countries.

²² The ACP countries took advantage of this situation to widely varying degrees. A number of countries or regions made unnecessarily generous offers to the EU, presumably as a result of lack of analytic and negotiating capacity. See ECPDM and ODI (2008) for details.

²³ It is not clear whether the negotiations resulting in interim EPAs with a few individual countries in the West and Central Africa groupings included RoO. In any event, these agreements contain provisions referring to target dates for these negotiations to be completed, rather than protocols incorporating rules.

ever, they do include some important departures from Cotonou RoO in relation to fish/fish products, textiles and clothing, cumulation and derogations.

On fish products the main change introduced applies only to in relation to Pacific region signatories. This scraps the wholly originating requirement for processed fish. Fish processed in Pacific region signatories now may be caught anywhere in the world. This provision has two conditions. Firstly its implementation and continuation will be subject to Pacific countries implementing marine environmental management principles based on the precautionary principle. Secondly, these countries will have to provide advance notification of the species and volumes to be processed and of the products that will be manufactured from them.²⁴ The EU has stated that there is no intention to extend the rule to other regions, although it has let it be known that there will be an automatic derogation for tuna for the ESA region (Zielenski, 2008).²⁵

For fresh fish the main change is that the Cotonou RoO crew composition requirement is dropped, as had been signaled in the Communication of 2005. In the CARIFORUM fresh fish RoO the provision that catch from EEZs by ships leased or chartered by ACP nationals can be counted as wholly originating only when the EU Distant Water Fleet had been offered access to the EEZ via a fisheries agreement but had declined this is replaced by one requiring that the EU Distant Water Fleet be given first refusal of any individual chartering or leasing arrangement that may confer origin (EU-CARIFORUM EPA 2007). This represents an apparent tightening of the rule in question.

On textiles and clothing, a rule roughly equivalent to AGOA's third country fabric provision for lesser-developed countries replaces the complicated and restrictive Cotonou rules. Clothing manufacture alone (irrespective of whether fabric or cloth is originating or non-originating) now confers origin.

On cumulation, the main EU concession is a revision of the full cumulation provision. For products where substantial transformation is required, origin is no longer determined in terms of the country where the greatest extent of substantial transformation has occurred. Rather, it is determined in terms of the last country in which working or processing occurred. This is conditional on the last working or processing that occurred involves an operation in excess of those on a

²⁴ Given that the Pacific Group had requested only that fish from its EEZ should be granted originating status for processing purposes, it is not clear why the formulation 'from anywhere in the world' appeared in the text.

²⁵ It is not clear whether this will (also) apply to the EAC countries.

negative list. Non-originating content incorporated in originating inputs from the beneficiary countries from which cumulation occurs is subject to roll-up, provided that an operation in excess of the negative list has occurred in the country from which cumulation is claimed. Exceptions are made in regard to cumulation from South Africa. In this case, the value added in the final country of export must exceed that added in South Africa. Moreover, no cumulation at all from South Africa is allowed in respect of a very large number of inputs.²⁶ Members of the Southern African Customs Union (SACU)²⁷ are not subject to the first of these exceptions, but are subject to the second. Hence, Namibia's long-standing complaint concerning prohibition of use of South African hake in its processing factories thus remains unresolved.

The fact that a large number of ACP countries have yet to sign EPAs still means that, in practice, possibilities for full cumulation under Cotonou+ are much reduced relative to Cotonou. This is partly compensated for by identification of additional non-ACP developing countries from which diagonal cumulation is permitted on request (in Africa, diagonal cumulation is now possible from Algeria, Egypt, Morocco and Tunisia). However, as in the case of use of originating material from South Africa, in such cases value added in the final country of export must exceed that in countries from which originating inputs have been cumulated.

A final difference between Cotonou+ and Cotonou concerns the prominence given in the text of the Draft Regulation to the possibility for ACP countries to seek temporary derogations from specific RoO, providing that they can show that local conditions make satisfying them difficult. While this provision also existed under Cotonou, it was not given prominence and was rarely used.²⁸ In addition, a series of alternative rules for certain processed food products are introduced and also described in the text as derogations. These alternative rules, which were not found in Cotonou, appear to have been imported from the old EU GSP. They mostly remove the restrictions on use of non-originating sugar found in the main rules. However, these limits are only removed for products containing 20% or less sugar by weight.

²⁶ Motor vehicle parts and components, intermediate aluminum products and most agricultural and processed agricultural products are excluded. The exclusion of motor vehicle parts and components does not affect the CARIFORUM countries. Fish, fish products and pasta are excluded until South Africa eliminates its own tariffs on them.

²⁷ Botswana, Namibia, Lesotho and Swaziland.

²⁸ Only three derogations were still in place when the Cotonou Agreement expired at the end of 2007.

All the EPA agreements including CARIFORUM contain provisions that these RoO must be renegotiated. In the case of SADC and for West and Central African signatories this is after three years of coming into force. In the case of the Pacific group and CARIFORUM it is after five years. In the case of the EAC and ESA groupings it is whenever a full EPA replaces the interim one. The Cotonou+ rules are thus unambiguously temporary.

THE DRAFT (GSP) REGULATION OF 2007

The Draft Regulation (EC 2007c) proposed a completely new set of EU PTA RoO, initially for the GSP and the Everything But Arms (EBA) arrangement. Its principal innovation was to introduce VA as the sole criterion for determining substantial transformation. Correspondingly, provisions relating to *de minimis* and minimum processing requirements were abandoned. ‘Wholly originating’ was retained as the criterion for determining the origin of unprocessed agricultural goods and animal products, minerals and fish (in a special version, see below).

The Regulation’s preamble stated that ‘in order to encourage the industrial development of LDCs the sufficient processing (substantial transformation) threshold applicable to products originating (from them) should always be as low as possible while still ensuring that the operations that take place there are genuine and economically justified’, and that ‘a sufficient processing threshold of 30% for most products should result in increased exports for LDCs’.

Table 3: Extracts from value added schedule in Draft (GSP) Regulation, 2007 (Annex I)

Product	Criterion/ schedule	<i>De minimis</i>	LDC Schedule
Animal products	Wholly obtained	15%	none
Dairy, fruit, vegetable, sugar, cocoa, alcohol and tobacco products	VA 30%	15%	none
Food additives, glues, dyes	VA 50%	none	none
Chemicals, fertilisers, plastics	VA 50%	none	VA 30%
Threads, yarns, textiles	VA 50-55% s.t.f.d.	none	VA 30%
Clothing	VA 50-60% s.t.f.d.	none	VA 30%
Ceramic products, cutlery, ball bearings, electronics, vehicles, cycles	VA 50%	none	VA 30%

Key: s.t.f.d. = subject to final determination

Table 3 sets out some of the basic thresholds appearing in the Regulation's Annex I on 'Specific Processing Thresholds and Specific Rules'. As the table indicates, no separate LDC schedule was specified for manufactured products of agricultural origin. On the other hand, following the findings of its impact assessments that a VA rule based on Net Production Cost (NPC) would have undesirable consequences,²⁹ the Draft Regulation proposes that VA is measured in terms of ex-works price.

The proposed VA rule whose implications are easiest to assess is that for clothing, since the impact assessment in this area (Scheffer 2007) modeled the effects of a series of possible thresholds. As Table 3 shows, the Draft Regulation stipulates a 30% threshold for LDCs and thresholds between 50% and 60% for different clothing product lines for non-LDCs. According to Scheffer (2007), the Cotonou 'double transformation' rule was equivalent to an 85-90% VA rule, when VA is expressed in ex-works price terms. The global average VA for clothing exports (expressed in the same terms) is around 62.5%. But no country with GDP per capita below \$2,400 achieved this level of clothing VA, and no country with GDP per capita below \$1,000 achieved a level of 50% VA. For LDCs as a group the average clothing export VA was 35%, while a number of LDCs (for example, Cambodia and Laos) achieved nothing like this (op. cit.). In other words, the new rule would probably prevent exports to the EU by any non-LDC with

²⁹ In addition to the problems referred to by Naumann (see footnote 13) the impact assessments stated that a NPC system would make exporters' margins transparent to importers, thus shifting commercial negotiating power in the latter's direction (Cadot et al 2006, Scheffer 2007). Secondly, citing the argument of La Nasa (1996) such an NPC system would perversely discriminate against countries with low labour costs (Scheffer 2007).

GDP per capita below \$1,000 and likewise prevent exports by the poorest LDCs, despite their concessionary VA threshold.³⁰

The Draft Regulation's fresh fish rule was almost identical to that of the old GSP, despite the strong signals mentioned that at least the crew composition requirement for fresh fish would be dropped.³¹ However, some limited cumulation provision was introduced to the rule, in the sense that it was proposed that flagging, registration, ownership, crewing and chartering might be by citizens of different beneficiary countries and not necessarily all from that country claiming origin.

After some deliberation, the EU did not propose a VA rule for processed fish. The central finding of the fish impact assessment (Megapesca Lda 2007) was that a single rate – or even a dual one – was impractical, as it would have radically different implications for products that were basically similar. Small differences in the way that tuna was processed meant that VA (again in ex-works price terms) might vary by as much as 18%. Secondly, in most cases there was little VA content in processed fish as a result of very high raw material costs. If the *de minimis* provision were removed, then a VA threshold permitting 'reliable conformity' would have to be set as low as 10-25%. Meanwhile, according to the impact assessment, modification of GSP rules to give originating status to any processed fish harvested from a beneficiary country's EEZ faced insur-

³⁰ There are good grounds for considering that the results of the clothing impact assessment can be generalized to manufactured goods generally. Complementing trade data on manufactured exports with UNIDO data on manufacturing VA, an ODI (2006) study arrived at three main findings concerning typical levels of VA in manufactured exports worldwide. Firstly, the average VA in the manufactured exports of all countries varies greatly between (ISIC) product groups, ranging between processed meats (24%) and ceramics (48%). Secondly, for each product group there are significant differences between the average VA incorporated in the exports of low-income and low-middle income countries. Taking meat products as an example, average manufacturing VA in low-income countries is 21% while in low-middle income countries it is 29%. This spread much larger for other industrial product groups. However, there are no significant differences between the average manufacturing VAs of LDCs and those of other low-income countries. Thirdly, in the small minority of tariff lines where the old Cotonou RoO used (ex-works) VA as a method for determining origin, its thresholds were in a range of 30%-130% higher than the actual average manufacturing VAs achieved by low-income countries. The study concluded by proposing that the EU set VA thresholds for each product at the lowest of the three revealed scores (all countries, low-middle income countries and low-income countries) for the product groups covered by the survey. In the great majority of cases this would mean a threshold between 20% and 35%.

³¹ The absence of any change in this area is surprising, since the fish impact assessment reported that no constituency supported the rule in question (Megapesca 2007).

mountable political obstacles within the EU whether it made economic sense or not. Thus the processed fish rule in the Draft Regulation remained identical to that in the old GSP.

The Draft Regulation's proposed changes on cumulation broadly followed those unveiled in the 'Cotonou+' rules just discussed. Diagonal cumulation and roll-up would apply such that origin would be conferred on the last beneficiary country where a processing or transformation operation had been performed in excess of a negative list, provided that any incorporated inputs originating from a country designated for cumulation purposes fulfilled the same condition. There were also similar provisions to those in Cotonou+, under which beneficiary countries might apply for temporary derogations from the rules.

The Draft Regulation carried forward one of the most controversial proposals on the EU's 2005 Communication by requiring an administrative framework in the exporting country where responsibility for origin declarations would fall on exporters, and which required competent authorities to register and monitor all exporters rather than directly verify origin. Beneficiaries of existing preferential arrangements would have their preferences withdrawn if they do not introduce the required reforms or implement them effectively. Transition periods were proposed for beneficiary countries to introduce the system. The retention of this provision was surprising given the hostile response to this proposal from almost all the EU business associations consulted, who argued that it would by default introduce a system of importer liability for exporter fraud or mistakes (see, e.g., Eurocommerce 2007).

If importer liability was indeed a consequence, then this would be likely to have substantial differentiation effects both in the EU and beneficiary countries. Importers would be likely to be more cautious in their use of suppliers from preference-receiving countries and to have to invest more in managing compliance. The former might involve distinguishing exporting countries and individual exporters by risk category, with more risky countries and operators (likely to be least developed countries and smaller and less experienced operators) being delisted or forced to incur additional costs as importers laid off risk to them.³² The latter would involve increased entry barriers to EU SMEs on the import side, which might also rebound on smaller operators in beneficiary countries since, in global value chains, smaller importers typically deal with smaller exporters.

³² For example, by obliging them to trade on a basis other than FOB.

It is worth mentioning that the trend toward importer liability in EU PTA RoO is mirrored in the US, where the US Customs administration has begun to assert that importers are responsible for compliance by exporters under both NAFTA and GSP/AGOA. US Customs recently launched a case against Ford Motor Company to recover \$42 million in unpaid duty on components for which NAFTA preferences had been claimed. US Customs asserted that Ford had an obligation to maintain copies of its Mexican suppliers' records of origin. The case was eventually dropped, though not for legal reasons (Murphy, 2008).

Whatever the Draft (GSP) Regulation's pros and cons, it became clear in May-June 2008 that the EU Commission was rewriting it under pressure from EU manufacturing interests. 'Some of our (DG TAXUD's, P.G.) partners realized that something was happening only when they saw the proposal' (Zielenski, 2008). The final version of the Regulation, promised for the end of 2008, will abandon a VA approach, at least in respect of chemicals, metals, textiles and clothing, in favour of 'more diverse criteria'. Inter alia, this will be accompanied by a reinstatement of *de minimis* provisions. It is unclear what the changes are likely to mean for LDC market access under Everything But Arms.

6. Conclusion

PTA RoO are typically of Byzantine complexity. They are also typically restrictive. A growing consensus amongst trade economists is evident to the effect that there is a clear link between restrictiveness and under-utilisation, since tariff lines with the highest preference margins are normally subject to the most restrictive RoO. The main losers seem to be non-LDCs since, except in the case of fish, these are the main exporters of high preference margin products. Overall, costs of RoO compliance are also very high. Two separate studies of Cotonou's trade weighted compliance costs placed these in a range between 8.0-8.4% *ad valorem*.

The main EU defence of its RoO was traditionally that their provisions for cumulation promote development and regional integration. A similar argument was made on behalf of the highly restrictive clothing rule, where this was combined with full cumulation. This is against the background of a general acceptance that comparisons of African clothing exports under Cotonou and AGOA appear to show that, while a combination of a highly restrictive rule and full cumulation hinders trade creation, a neutral (liberal) RoO promotes both trade creation and export diversification.

In general the EU's RoO approach remained wedded to an outdated model of the global economy, where national and/or regional vertical integration was the rule. Today production typically occurs in global value chains, where different stages of production are dispersed between countries exhibiting different development characteristics. The global value chain model, originally applying only to light manufactures, now applies to manufacturing in general as well as to some services.

The EU Draft Regulation (EC 2007c) for its GSP and EBA arrangements was based on the same assumptions as earlier generations of EU RoO, even though the central methodology that it proposed is a new one. Independent empirical studies on VA levels for manufactured exports in the real economy have suggested that most product-level thresholds set above 30-35% would be restrictive, and penalise low-income non-LDCs in particular. A more liberal or neutral VA-based rule would have entailed the EU having to make deep cuts in its proposed VA-based origin requirements for non-LDCs, as well as some cuts in its proposed thresholds for LDCs. On the other hand, a transition to VA would at least have provided greater transparency and, in a manner akin to the tariffication of quantitative import restrictions, opened up the possibility of negotiating some VA thresholds in a downward direction.

In fact, according to its latest signals, the EU is in the process of abandoning the proposed VA methodology for its GSP, and going backwards to the same level of diversity, complexity and lack of transparency that characterized its PTA RoO historically. The piecemeal changes made to the Cotonou rules as a result of the EPA negotiations embody these same characteristics. However, in this case there are a number of development-friendly improvements also evident. But these 'Cotonou+' rules have only temporary status. In this context, it is hard to see how it will be possible to convince especially non-LDC EPA signatories to engage in a renegotiation process where harmonization with planned GSP/EBA arrangements is on the agenda.

Authors such as Brenton (2006) have suggested that ACP countries aim for EPA rules that would give them a choice between CTC at 6 digit level and a 10% VA threshold. Such demands are perhaps not realistic. More realistic would be to give Cotonou+ rules permanent status, but with modifications allowing generalisation of the Pacific processed fish rule to all regions, together with a case-by-case review of the CTC rules for manufactures in order to allow at least some of them to be reformed to provide a level of neutrality similar to that finally accepted for clothing.

Finally it is important for development-friendly EU member states to pressure the Commission to reverse its insistence on importer liability in the new GSP rules, which will lead in practice to

higher entry barriers for developing country exporters. This is all the more worrying, since it will be these rules that many ACP LDCs use in the future, since they have opted out of the EPA process.

References

- Block, L. & Grynberg, R. (2005). EU Rules of origin for ACP Tuna Products (HS Chapter 16.04). Commonwealth Secretariat, London
- Brenton, P. (2006). Rules of Origin and Development : Issues for the EPA Negotiations. Paper presented to ACP Secretariat, May.
- Brenton, P. and Ikezuki, T. (2006) 'Trade Preferences for Africa and the Impact of Rules of Origin', in Cadot, O., Estevaordal, A., Suwa-Eisenmann, A and Verdier, T. (eds.), *The Origin of Goods: Rules of Origin in Regional Trade Agreements* (Oxford, University Press)
- Cadot, O., Carrere, C., de Melo, J. and Tumurchudur, B. (2005a). 'Product Specific Rules of Origin in EU and US Preferential Trade Agreements'. *World Trade Review* 25 (2), 199-224
- Cadot, O., de Melo, J. and Tumurchudur, B. (2005b). Rules of Origin facing ESA trade: Analysis and Proposals for EPA Negotiations. World Bank, mimeo
- Cadot, O., de Melo, J and Pondard, E. (2006). Evaluating the consequence of shift to value-added method of determining origin in European Union preferential trade agreements. Revised final report. ADE. At http://ec.europa.eu/taxation_customs/customs?customs_duties/rules_origin/preferential/article_777_en.htm.
- Cadot, O. (2008) The current background to rules of origin and their importance for trade. Paper presented to World Customs Organisation conference 'Getting to grips with origin', Brussels, June.
- Erasmus, H., Flatters, F. & Kirk, R. (2004). Rules of Origin as Tools of Development? Some lessons from SADC. SADC Secretariat, Gabarone
- Estevaordal, A. (2000). 'Negotiating Preferential Market Access: the Case of NAFTA'. *Journal of World Trade* 34 (1)
- Estevaordal, A. & Suominen, K. (2004). Rules of Origin in Free Trade Agreements in Europe and the Americas: Issues and Implications for the EU-Mercosur Inter-Regional Association Agreement. Inter-American Development Bank, INTAL_ITD Working Paper 15, Buenos Aires
- European Centre for Development Policy Management and Overseas Development Institute (2008). The new EPAs: Comparative analysis of their content and the challenges for 2008. Policy Management Report. At <http://www.ecdpm.org/pmr14>
- Eurocommerce (2007). Preferential rules of origin: Comments on the proposed reforms. 27 June, Brussels. At <http://www.eurocommerce/be/content.aspx?PageId=39933>.

- European Commission (2005a). Justification of the choice of a value added method for the determination of the origin of processed products. DG Customs and Taxation TAXUD/1121/05 Rev.1.
- European Commission (2005b). Communication from the Commission to the Council, the European Parliament and the European Union Economic and Social Committee. Rules of Origin in Preferential Trade Agreements: Orientations for the Future. COM (2005) 100 final.
- European Commission (2007a) Civil Society Dialogue: Preferential rules of origin. DG Trade, Brussels, 9 October.
http://trade.ec.europa.eu/doclib/docs/2007/october/tradoc_136503.pdf,
- European Commission (2007b). Regulations applying to the arrangements for products originating in certain states which are part of the ...ACP group...provided for in agreements establishing or leading to...EPAs. Council Regulation (EC) 1528/2007, 20 December
- European Commission (2007c). Draft Commission Regulation amending Reg. (EEC) 2454/93 laying down provisions for implementation of Council Regulation 2913/92 establishing the Community Customs Code. DG Customs and Taxation, TAXUD/2046/2007
- European Union Market Access Database at <http://www.mlacddb.eu.int/>
- European Union-CARIFORUM (2007). Economic Partnership Agreement between the CARIFORUM states of the one part and the European Community and its member states on the other. Protocol I concerning the definition of the concept 'originating products' and methods of administrative cooperation. At
http://trade.ec.europa.eu/doclib/docs/2008/february/tradoc_137970.pdf
- Kreuger, A. (1993). Free Trade Agreements as Protectionist Devices: Rules of Origin, National Bureau of Economic Research Working Paper 4352. Cambridge, Mass.
- KVA Consult and Pacific Islands Forum Secretariat (2003). Towards a Framework for EPA Negotiations with the EU: Study on Rules of Origin. Apia, Samoa
- LaNasa, J. (1996). An evaluation of the uses and importance of rules of origin, and the effectiveness of the Uruguay Round's Agreement on Rules of Origin in harmonizing and regulating them. Working Paper 1/96, Jean Monnet Center, New York University School of Law. at <http://www.jeanmonnetprogram.org/papers/96/9601ind.html>
- Landell Mills, P. (ed.) (2005). Capacity Building in Support of Preparation of Economic Partnership Agreement: Project 110 All ACP – Rules of Origin. August.
- Megapesca Lda (2007). Rules of Origin in preferential trade agreements. New rules for the fishery sector. Final Report. Concarneau. At
http://ec.europa.eu/taxation_customs/customs?customs_duties/rules_origin/preferential/article_777_en.htm.
- Murphy, M. (2008) A lawyer's perspective on rules of origin. Paper presented to World Customs Organisation conference 'Getting to grips with origin', Brussels, June.

- Naumann, E. (2005). Rules of Origin under EPAs. Key Issues and New Directions. TRALAC Working Paper 9, Trade Law Centre, Stellenbosch University.
- Overseas Development Institute (2006). Creating development friendly rules of origin in the EU. Briefing Paper 12
- Pacific Group (2006). EPA Negotiations ACP-EU. Non-Paper on revision of rules of origin in the Pacific ACP-EU negotiations: Change in tariff heading at 6-digit level.
- PWC (2007). Sustainability impact assessment of the EU-ACP EPA – Phase III. Rules of origin in the SADC.
- Rivas, J. (2006) ‘Do rules of origin in free trade agreements comply with Article XXIV GATT?’ in Bartels, L. and Ortino, F. (eds.) *Regional Trade Agreements and the WTO Legal System*, pp 149-72 (Oxford, University Press)
- Schleffer, M. (2007). Study on the application of value criteria for textile products in preferential rules of origin. Final Report. Saxion University, Enschede. At http://ec.europa.eu/taxation_customs/customs?customs_duties/rules_origin/preferential/article_777_en.htm.
- S.J. Bernin's Community Week*, No. 328, 22 June 2007
- US Trade Representative, Office of Textiles and Apparel (www.otexa.gov)
- Waer, P. (1992). ‘European community rules of origin’, in Vermulst, E., Waer, P. & Bourgeois, J. (eds.) *Rules of Origin in International Trade: a Comparative Study* (Ann Arbor, University of Michigan Press)
- Zielenski, M. (2008) What are the latest trends in EU preferential rules of origin? Paper presented to World Customs Organisation conference ‘Getting to grips with origin’, Brussels, June.