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EU preferential rules of origin

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1. INTRODUCTION

The European Parliament in its *Resolution of 5 July 2016 on a new forward-looking and innovative future strategy for trade and investment,* requested a report explaining the changes made in EU preferential rules of origin in the last 10 years. On 4 May 2017, the Committee on International Trade of the European Parliament organised a hearing on rules of origin for trade in goods, with participation of the European Commission, business and researchers.

The objective of this Commission Staff Working Document is to address the European Parliament's request by describing the developments related to EU preferential rules of origin since the adoption of the Commission Communication "*The rules of origin in preferential trade arrangements. Orientation for the future*" in 2005, and in particular the reform of EU preferential rules of origin in 2011 and their subsequent further modernisation. The analysis covers the three key aspects of rules of origin, namely general provisions, product specific rules of origin, and origin procedures (claim for preferential tariff treatment and verification).

Rules of origin have been identified by various studies as one of several factors to be examined in relation to lower preference utilisation rates of EU preferential exports in comparison to preference utilisation on imports into the EU. In addition to internal analysis, in July 2018 the Commission conducted a survey on rules of origin to gather information about the application of preferential rules of origin in EU Free Trade Agreements. The main results of the survey are presented here as well.

2. OVERVIEW OF EU PREFERENTIAL RULES OF ORIGIN

Preferential rules of origin are intended to ensure that only products originating in preferential trade partners or beneficiaries of autonomous preferences benefit from reduced or zero duties. They establish a minimum required level of working or processing that must take place in the exporting country in order for the final product to qualify for preferences in the importing country. EU preferential rules of origin can be found:

- for autonomous preferential arrangements – in the Union Customs Code and Implementing provisions (Delegated Act/ Implementing Act[1]) for the Generalised Scheme of Preferences and the autonomous trade measures, in the Council Regulation No. 1528/2007 (Market Access Regulation) for some Africa, Pacific and Caribbean countries;[2] Council Decision No. 2013/755/EU for overseas countries and territories[3] and Regulation (EU) 2015/2423 for Kosovo(*);[4]

[1] Articles 37 and 41-58 of the Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code; Articles 60 and 70-112 of the Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code. The list rules are contained in Regulation 2015/2446, Annex 22-03.

[2] Council Regulation No.1528/2007, OJ L 348 of 31.12.2007.

[3] OJ L 344, 19.12.2013, p.1.

[4] Regulation (EU) 2015/2423 of the European Parliament and of the Council of 16.12.2015 amending Council Regulation (EC) No 1215/2009, applicable until 31.12.2020. *This designation is without prejudice to

- for Free Trade Agreements – in a Protocol, Annex, or Chapter on rules of origin.

The legal provisions of preferential rules of origin traditionally consist of three parts:

- *general provisions* – the general rules that clarify how to determine the origin of a product.
- *product specific rules* – this is a list of specific rules of origin for all products in the Harmonized System[5] Nomenclature, mostly at Chapter (2 digit) and some at Heading (4 digit) level.
- *origin procedures (claim for preferential tariff treatment and verification)* – this section regulates the ways to prove the originating status of a product when the preference is claimed (i.e. by statements made out by the exporters or by official certificates), as well as procedures for the Parties to verify the originating status of a product i.e. visits by customs to the exporters or producers.

While the basic concepts of rules of origin remain generally stable across EU Free Trade Agreements, product specific rules and origin procedures have evolved in the last 10 years. The main changes in EU preferential rules of origin were introduced in 2011, first for the Generalised Scheme of Preferences with the objective to subsequently introduce them to EU Free Trade Agreements.

In the 2015 Communication "*Trade for All: Towards a more responsible trade and investment policy*"[6], the Commission recognised that rules of origin and customs procedures play an important role in better implementation of its Free Trade Agreements and committed to "*strive for simplicity and consistency of rules of origin and provide user-friendly information on trade opportunities*", particularly having in mind small and medium-sized enterprises and ensuring effective implementation of Free Trade Agreements. All these aspects are important to limit the compliance costs for EU exporters and producers, to limit legal uncertainty for EU importers and to facilitate the functioning of the global value chains for the EU operators.

3. DETERMINATION OF PREFERENTIAL ORIGIN AND CUMULATION OF ORIGIN: MODERNISING EU PREFERENTIAL RULES OF ORIGIN

3.1. General provisions on determination of preferential origin

The general concepts of rules of origin are largely stable and are similarly applied by the WTO members despite the lack of a formal process of harmonisation. In the recent EU Free

positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

[5] The Harmonized System, also known as the Harmonized Commodity Description and Coding System, is a standardised international nomenclature of names and numbers used to classify goods, developed and maintained by the World Customs Organization.

[6] COM (2015) 497.

Trade Agreements efforts are made to further streamline the legal provisions to make them user friendly for economic operators[7], especially smaller companies.

Only products *'originating'* in the Parties can benefit from the preferential market access under EU Free Trade Agreements. To qualify as originating, products must be either '*wholly obtained*', produced exclusively from originating materials or '*sufficiently worked or processed'* in a Party. Similar provisions apply in the EU autonomous preferential arrangements.

- *Wholly obtained* traditionally includes vegetable products or plants harvested in a territory of a Party, minerals extracted there, live animals or products of slaughtered animals born and raised there, products from animals raised there, or fish caught within the territorial waters of a Party.

  Fish caught outside the territorial sea of a Party is wholly obtained only if the 'nationality' of the vessel is ensured, i.e. a vessel sails under the flag of one of the Parties, is registered in one of the Parties and fulfils appropriate ownership criteria. Following the reform of EU preferential rules of origin, the EU has removed the requirement concerning the nationality of the crew.

- Where products are produced only from originating materials, even if these materials contain some element of non-originating materials but fulfil the product specific rules, then the product will always be considered as originating.

- If a product incorporates imported materials from a non-Party it needs to be *sufficiently worked or processed* in accordance with *product specific rules*. There are three types of rules that are used in EU Free Trade Agreements to determine the origin of a product:

  - the production process results in a *change of tariff classification* between the non-originating materials and the final product e.g. production of paper (Harmonized System Chapter 48) from non-originating pulp (Harmonized System Chapter 47);

  - *percentage criterion* – a maximum allowed share of non-originating materials used in the manufacture of a product that are imported from a non-party to a Party to the Free Trade Agreement, calculated as a percentage of the *ex-works price*[8] of the product (typically maximum 50%) or of the *weight* in the final product (for certain agricultural and processed agricultural products); or

  - a specific *production step or process* takes place in the territory of a Party (e.g. chemical reaction for chemicals, or spinning of fibres for yarns). Such rules are mostly used in the textile and clothing, and chemical sectors.

[7] Economic operator means any business, person or public authority that is involved in selling products or services. It is defined in Directive 2004/18/EC. This term should under no circumstance be confused with the term 'authorised economic operator' used in the Union Customs Code.

[8] Ex-works price (EXW) is a widely used international shipping term. It means the price paid for the product ex-works (i.e. when it leaves the factory) to the manufacturer in whose undertaking the last working or processing is carried out, provided that the price includes the value of all the materials used and all other costs related to its production, minus any internal taxes which are, or may be, repaid when the product obtained is exported.

General provisions provide further clarifications on how to determine origin of a product e.g.:

- Any working or processing on non-originating materials needs to go beyond *insufficient working or processing* such as packing, affixing of labels, logos, or operations aimed at preservation of a product in good condition, or simple assembly.
- General provisions also define the *absorption principle* according to which once a product has obtained originating status it can be considered entirely originating when used as material in any further processing.
- *Tolerances* permit a specific share of the value of the final product to be non-originating without the final product losing its originating status (mostly 10% in ex-works price of the final product, 15% for the Generalised Scheme of Preferences and some Economic Partnership Agreements with African, Caribbean and Pacific). Special tolerances apply in the textiles and clothing sector. For agriculture and processed agricultural products, tolerances might be expressed as a percentage in weight.
- EU Free Trade Agreements allow *accounting segregation of fungible materials* without keeping separate physical stocks of such originating and non-originating materials (e.g. sugar) provided no more originating products receive originating status than would be the case if the originating and non-originating materials had been physically separated.
- Earlier EU Free Trade Agreements require *direct transport of goods* from the country of origin in order to keep their originating status (e.g. the Free Trade Agreement with Korea, and Central America). In the most recent Free Trade Agreements (e.g. with Canada and, Japan, or in the negotiated text with Vietnam and in the agreement in principle with Mexico) exporters can split the consignment under customs control while retaining the originating status of a product, provided that the product is not altered (*non-alteration rule*). This modification further facilitates international trade, for example by allowing the use of distribution centres in third countries. The Commission is making efforts to replace the direct transport rule by the non-alteration rule in the earlier Free Trade Agreements.
- Depending on the specific context and respective interests, some EU trade agreements and autonomous preferential arrangements allow for different types of cumulation, subject to specific conditions. This means that materials originating in a partner country can be considered as originating materials for the purpose of fulfilling rules of origin requirements. The main forms of cumulation are:
    - *'Bilateral cumulation'* is applied on *originating materials* between FTA partners: materials originating from one Party may be used as materials originating in the other Party.
    - *'Full cumulation'* applies to non-originating materials that are further worked or processed in the participating countries. For example, if a product is not sufficiently processed to obtain origin in one Party, it can be cumulated with any further processing in the other Party for the product to obtain origin.

In some cases, cumulation can take place in a wider geographical scope than two Parties:

- Cumulation on originating materials or products between more than two Parties linked by Free Trade Agreements with generally identical rules of origin and provision for cumulation is referred to as '*diagonal cumulation*' or *'extended*

cumulation'. Depending on the framework, it requires at least an agreement on administrative cooperation between the customs authorities of all partners involved. It is applied e.g. in the pan-Euro-Mediterranean framework (between the EU, a number of Mediterranean countries, EFTA countries, the Faroe Islands, Eastern Partnership countries, Turkey and the Western Balkans) which is currently being modernised and simplified both in terms of product specific rules and origin procedures. In the pan-Euro-Mediterranean framework, diagonal cumulation may only be applied provided that all the countries involved in cumulation apply FTAs between themselves and that these FTAs lay down identical rules of origin. These common rules are laid down in the Regional Convention on pan-Euro-Mediterranean rules of origin[9]. A possibility for extended cumulation is foreseen e.g. in the Generalised Scheme of Preferences (except for agricultural and processed agricultural products).

- *'Regional cumulation'* is a specific type of diagonal cumulation applicable in the Generalised Scheme of Preferences context, and applies within specifically defined groups of beneficiaries. It also requires an agreement on administrative cooperation between customs of the partners involved. In order to guard against distortion of trade between countries having different levels of tariff preferences, certain sensitive products are excluded from regional cumulation. As more countries graduate from preferences and lose their Generalised Scheme of Preferences beneficiary status, the scope of regional cumulation is becoming more and more limited.

3.2. Reform of the Product Specific Rules

Responding to changing realities of global trade and value chains, in 2011 the EU ***reformed its preferential rules of origin*** in the context of the Generalised Scheme of Preferences:

- *Product specific rules have been simplified* – the number of exceptions has been *reduced* significantly, and for most products the rules of origin are set at Harmonized System *Chapter (2-digit) level* instead of the heading (4-digit) or subheading (6-digit) level.
- Most rules have been *made more flexible* allowing more non-originating input to reflect new economic realities and progressive integration of EU industry with the global value chains, while ensuring that a significant processing is conducted in a Party. The reform of EU preferential rules of origin involved extensive consultations with the stakeholders and finding an appropriate balance between the various interests.
- For most *processed agricultural products*, the EU relaxed the rules allowing some percentage of non-originating materials in the weight of a final product. For high sugar content products, the threshold for non-originating sugar has also been expressed in *weight*.
- Generally, in case of *industrial products*, manufacturers can source now up to 50% of non-originating materials expressed as a percentage of the ex-works price of the product in comparison to 25-40% allowed under the rules before the reform of EU preferential rules of origin.

[9] OJ L 54, 26.2.2013

- In addition, the EU in its recent Free Trade Agreements increasingly uses an approach whereby origin is conferred through fulfilling one of two or more *alternative* criteria, e.g. if a product does not exceed 50% of non-originating materials *or* it has changed tariff heading as a result of processing. The new approach applies in several key industrial sectors, including machinery and electronics, paper, aircraft and optical instruments. This is intended to facilitate compliance with rules of origin for economic operators, particularly small and medium-sized enterprises.
- In the case of textiles and clothing, the so-called '*double transformation*'[10] was maintained as it was found to strike the right balance of interests between different actors. However, also in this sector some specific, more flexible elements were introduced in order to reflect the developments of the EU industry, for example some finishing operations such as coating, laminating, metallizing, flocking or rubberising, important for niche market textile products, are now sufficient to confer the origin.
- The EU also takes into account the *development level* of the partner country. Beneficiaries of the Generalised Scheme of Preferences can source up to 50% of non-originating materials and for certain products up to 70%. Least Developed Countries are provided with greater possibilities for sourcing up to 70% of non-originating materials and single transformation for clothing.

The new rules of origin introduced in the 2011 reform of rules of origin for Generalised Scheme of Preferences have been used progressively as a reference model in recent Free Trade Agreement negotiations. The Commission has also streamlined the drafting of product specific rules to make it more user-friendly for economic operators.

The Commission aims to ensure the greatest possible coherence between rules of origin in different EU Free Trade Agreements. At the same time, it is important to note that while the rules of origin of the 2011 Generalised Scheme of Preferences were adopted unilaterally by the EU, rules of origin in EU Free Trade Agreements are an outcome of a negotiation process between partners that have sometimes diverging interests and approaches to rules of origin.

The Commission uses as a basis for negotiations the preferential rules of origin reformed in 2011 with some adjustments in specific cases. The adjustments may reflect the partner's development level (e.g. whether a trading partner is a beneficiary of the Generalised Scheme of Preferences), the regional context, specificities of some sectors, new developments in the market for some products, and the experience from previous Free Trade Agreement negotiations.

Rules of origin applicable in EU Free Trade Agreements are published on the EUROPA websites.[11] The information provided includes legal texts, general explanations of the provisions and terminology used, as well as guidance documents with some detailed clarifications on how the legal provisions should be applied, accompanied with some practical examples. EU economic operators can also consult the Market Access Database to check a rule of origin for a specific product in EU Free Trade Agreements.[12] Economic

[10] The double transformation for clothing means that at least two substantial stages of production need to be carried out to confer origin. For textiles generally spinning and weaving needs to take place. For clothing the weaving of fabric and making up into clothing needs to take place.

[11] E.g. https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin_en.

[12] http://madb.europa.eu/madb/indexPubli.htm.

operators wishing to export to the EU market can also consult similar information at the EU Trade Helpdesk.[13]

4. MORE EFFICIENT AND SIMPLIFIED ORIGIN PROCEDURES

4.1. Claim for preferential tariff treatment

When the importer claims a preferential tariff treatment for goods, the customs authorities of the importing country require documentary support. There are two types used in the EU preferential rules of origin:

- *Official certificates* issued by the exporting country's authorities or an accredited organisation (e.g. EUR 1 for a number of EU Free Trade Agreements), or
- *Self-certification by the exporter* – any exporter may make out the statement on origin ('*self-certify'*) on an invoice or any other commercial document for a consignment of less than 6000 EUR. For higher values the exporter needs to be '*approved*'[14] or '*registered*'[15] by an EU Member State. In some EU Free Trade Agreements, such statement is called *'origin declaration'* or *'invoice declaration'*.

The EU traditional system is based on two alternatives: official certificates or self-certification by approved exporters. It is applied e.g. in the Pan-Euro-Mediterranean area, in the Economic Partnership Agreements with African, Caribbean and Pacific countries and in the current Free Trade Agreements with Chile, Mexico, Central America and Colombia-Peru-Ecuador. Since 2006, EU Free Trade Agreements that rely on official certificates include a '*Budget Clause on the Management of Administrative Errors*', which provides for a procedure to address errors leading to losses of import duties that should have been collected.

Over the last years, the EU has been moving away from governmental certificates towards a system entirely based on *self-certification* in view of (i) the increasing volume of preferential trade and the need for the facilitation of origin-related procedures, (ii) the recommendations of the European Court of Auditors to improve the protection of the EU's financial interests.[16]

The EU-Japan Trade Agreement gives for the first time also a possibility for the importers to self-certify the origin (so called '*importer's knowledge'*), which contributes to facilitation of trade for the related companies. Equally, an exporter may make out a statement on origin for

[13] http://trade.ec.europa.eu/tradehelp/.

[14] *Approved exporter'* is an exporter who has met certain conditions imposed by the customs authorities. The customs authorities can withdraw the status if the exporter misuses or abuses the authorization. The procedures attached to granting "approved exporter" status depend on national provisions.

[15] '*Registered exporter'* is an exporter who has to be registered in a database maintained by its country's authorities. Once registered, the exporter has the obligation to communicate to his competent authorities all changes to his registered data. Registration can be revoked e.g. if the company ceases to exist or if the registered exporter commits fraud.

[16] The European Court of Auditors' 2014 special report "*Are preferential trade arrangements appropriately managed*?" https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1535207188601&uri=CELEX:52014SA0002.

multiple shipments of identical products, which dispenses with the need for statements for each and every consignment.

4.2. Verification of origin

Verification of origin is initiated by the customs authority of the importing Party in order to check whether a product imported and claiming preferential tariff treatment is originating in the other Party. The process is based on risk assessment methods.

The traditional EU verification system is based on *administrative cooperation* between customs authorities of the exporting and the importing country and visits by the exporting country's customs authorities to the exporter/producer. The final determination of origin is made by *the exporting Party*. However, in order to improve the protection of the EU's financial interests in case EU customs would have evidence that the product is non-originating even though the customs authorities of the exporting Party confirm the origin in the verification, in its recent Free Trade Agreements the Commission has introduced changes to the verification system.[17] Starting with the EU-Canada Trade Agreement, *the importing Party* takes the final decision on the determination of origin and related measures.

5. EXPERIENCE WITH IMPLEMENTATION OF RULES OF ORIGIN IN EU PREFERENTIAL ARRANGEMENTS – SURVEY ON RULES OF ORIGIN

In summer 2018 the European Commission carried out a survey on rules of origin as part of a broader effort to better understand the role and the impact of rules of origin in the implementation of EU Free Trade Agreements. The 1011 responses received from EU exporters of various sizes, active in various product categories, established in all EU Member States point to several factors that may influence the use of Free Trade Agreement preferences.

- A vast majority of the participants of the survey (80%) has 10 years or more experience in exporting and 69% of the respondents have already benefited from preferential exports under EU Free Trade Agreements. Only 9% of the respondents do not use preferences, for example due to low preference margins, Most Favoured Nation duty free market access or lack of knowledge about how to apply for preferences or other factors.
- Overall, 76% of the respondents can meet the rules of origin (even though in some agreements they find it easy to meet, in some others it is more difficult). Only a limited percentage of 13% of the respondents said that they cannot meet rules of origin in EU Free Trade Agreements. Several respondents highlighted the importance of ensuring coherent rules of origin across EU Free Trade Agreements.
- Despite the extensive experience of the respondents, 67% of the respondents consider that they would need more information on rules of origin. The respondents provided several suggestions on how to improve the available information (e.g. practical examples, glossary, information in mother tongue and easier access to legal texts).

[17] The European Court of Auditors' 2014 special report "*Are preferential trade arrangements appropriately managed*?"

37% welcomed an interactive online tool that would help a self-assessment of compliance with the rules.

- Economic operators seek information on rules of origin primarily on the websites of Member States' customs authorities and on the website of the European Commission. 60% of the respondents using the European Commission's websites considers it easy or very easy to find information on rules of origin while 40% find it difficult.
- 70% of the respondents is aware that information on rules of origin can be found in the European Commission's Market Access Database.
- 21% of the respondents do not have problems to comply with procedures on rules of origin. 24% of the respondents have mainly difficulties to obtain supplier declarations.

Overall, the survey provided useful input for ongoing efforts by the European Commission to help European exporters to take fuller advantage of EU Free Trade Agreements. Facilitating access to information on rules of origin and making it more user-friendly, particularly for small and medium-sized enterprises, stands out as one of the most important actions that the European Commission and EU Member States should be able to do in the short term. The Commission is currently working to improve information available at EUROPA websites to help economic operators to assess the compliance with preferential rules of origin.

6. CONCLUSIONS

The overview of rules of origin presented in this report suggests that while the main concepts of preferential rules of origin remain relatively stable in EU Free Trade Agreements, in the last 10 years product specific rules (in particular for industrial products) and the origin procedures have evolved to reflect new market realities, increased international trade, international specialisation and growing integration of EU industry in the global value chains. One of the challenges for the EU is to ensure that with the increasing number of EU Free Trade Agreements, the rules agreed with the different partners should remain the same as much as possible to avoid that the cost of compliance with different preferential rules of origin hinder the use of preferences, particularly for small and medium-sized enterprises. Although it is unavoidable that the final outcome in each negotiation differs given that the interests of our partners differ, the Commission attaches great importance in the negotiations to ensuring the highest level of convergence possible. Such convergence is further facilitated when the respective industries of the negotiating partners share a common position, which could also contribute to greater sectoral harmonisation of the rules.

The survey on rules of origin conducted in summer 2018 clearly indicated that at the stage of implementation more user-friendly access to information and better communication on rules of origin is required, not only for exporters but also across the supply chain in the EU. The Commission took note of this request and already took action to increase the information available on its website; however, EU Member States would also need to contribute to these efforts of facilitating the access to information to the EU industry. Moreover, enhanced cooperation with Free Trade Agreement partners in preparation for and during the implementation phase can help to monitor the use of preferences and to effectively address possible issues.