



# Determining Country of Origin: Logistical Challenges and Practical Strategies for Supply Chain Professionals

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Presented by: **Mr. Jesse I. Goldman**  
Partner, International Trade & Investment  
One First Canadian Place, 34th Floor,  
Toronto, Ontario, Canada  
[goldmanj@bennettjones.com](mailto:goldmanj@bennettjones.com)  
416-777-6442



## Outline

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- Costs Associated with Rules of Origin Compliance
- Risks Associated with Rules of Origin Non-Compliance

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### 3. Practical Strategies and Solutions

- Steps to Utilize Preferential Trade Agreements and Minimize Risk
- Looking Forward: Opportunities



# 1. ISSUES AND CHALLENGES



## Rules of Origin (ROO)

- Method by which origin of a good is assessed to determine its tariff treatment upon import and for other purposes (anti-dumping duties, statistics, etc.)
- Both enable trade and impede it by favouring production within a territory, meaning non-originating goods can be disadvantaged
- Do not reflect reality of modern supply chains
- More than 300 overlapping Preferential Trade Agreements (FTAs) in force worldwide today, each with:
  - Different rules of origin
  - Different minimum operations
  - Different certification requirements
  - Different recordkeeping requirements
  - Differing levels of complexity



## Effect of ROO Compliance on Supply Chain Management

- Procedures are multiple, complex, and inconsistent
- Increases costs in the form of:
  - Compliance costs (time and resources)
  - Higher tariffs and duties paid because of underuse of preferential rates
  - Can dissuade firms from trading with partners in countries or regions where it would otherwise be economically advantageous
  - Can influence long-term supply chain structuring and investment decisions (e.g. where to locate a new factory)
- Supply chain managers must consider ROO requirements when making sourcing and investment decisions
  - Cost-benefit analysis
- Inefficiencies result in higher production costs – either absorbed by the firm (reducing profitability) or passed on to consumers (driving up prices)



## Effect of ROO on Supply Chain Management – Asia Pacific

- Asia is a global hub for trade in electronics, automobiles, textiles, parts and components
  - Complex and fragmented production chains across many countries & relatively little value added at each step in the production chain
    - Particularly vulnerable to shipping disruptions and trade costs
  - ROO issues therefore more acute
- Recent proliferation of Asian trade agreements has further compounded the challenges
  - As of July 2014: 278 FTAs in the Asia-Pacific region either in force or in development
  - At least 22 rules of origin in force among RCEP parties, of which only about 30% of tariff lines share common origin rules



## Effect of ROO on Supply Chain Management – Asia Pacific

- Example: Panasonic Corporation (electronics and appliances)
  - 334 companies in 45 different countries and regions worldwide, each with own ROO
  - Ships goods from its factories to importers directly, but invoices for the goods often prepared and switched in third countries
  - Assembling necessary information and putting together documentation to comply with 45 different origin regimes is demanding on employees; hampers the planning of logistics managers and overall supply chain efficiency
- Example: Denso Corporation (auto components)
  - Automobile industry has shifted to multi-tiered supplier networks – new wave of assembly and supplier markets in developing countries
  - One of the largest automobile component manufacturers, broad portfolio of products
  - Based in Japan, but relies heavily on its geographically distributed and coordinated regional production network throughout Southeast Asia



## Costs Associated with ROO Compliance

- A 2011 WTO report found that only 16% of imports from the 20 largest importing countries qualified as preferential trade. The report noted:

*"Onerous rules of origin procedures sometimes associated with free trade agreements have contributed to these low figures by making the costs of compliance requirements higher than the perceived worth of the underlying preference margins"*
- Quote from 2012 WTO Trade Policy Review for Thailand is representative:
  - *"Thailand, both unilaterally and through ASEAN, has continued to pursue a policy of negotiating free-trade agreements of varying scope with the focus on the Asia-Pacific area. In the absence of comprehensive multilateral agreement on trade liberalization, the focus on free-trade agreements is understandable but the complex web of agreements with different rules of origin means it can be hard for traders to benefit from them."*



## Costs Associated with ROO Compliance

- Costs of ROO compliance may run as high as 5% to 25% of the value of the finished goods
- Costs include:
  - Employee time
    - Researching and understanding the requirements under various FTAs
    - Understanding changes in HS codes and tariff classifications
    - Assembling necessary information
    - Preparing the necessary documentation for each shipment
    - Recordkeeping requirements
  - Risk of revealing of trade secrets through COO documentation requirements
  - Legal and administrative costs



## Risks Associated with ROO Non-Compliance

- Liability for irregularities in documentation – can result in fines, additional tariff/duty assessments, and in cases of fraud, criminal charges
  - 2013 – Toyo Ink entered into US\$45 million settlement for misdeclaring country of origin for ink pigment
  - 2014 – Fraud charges laid against US honey importers for circumvention of anti-dumping duties through transshipment and misdeclarations of origin
  - 2007 – Ford Motor Company assessed a US\$42 million penalty by USCBP for failure to produce supporting records for past certificates of origin, even though the records were in the control of the foreign exporter (case was later settled)



## Risks Associated with ROO Non-Compliance

- Other risks:
  - Loss of investment in preparing/obtaining certificates of origin
  - Debarment from government procurement
  - Revocation of certifications retroactively
  - Commercial/civil liability for damages
- Exporters usually must certify origin, while importers bear the liability of non-compliance – incentives to ensure compliance can be skewed



## 2. RULES OF ORIGIN IN PRACTICE



## Rules of Origin in Practice – Overview

- Two types of ROO:
  - Preferential
    - Set out in trade agreement
    - For the purpose of determining application of Preferential Trade Agreements (FTAs)
    - Seeks to determine regional value content of goods
  - Non-preferential
    - Established by each country
    - For the purpose of implementing non-preferential trade policy instruments such as import/export statistics, anti-dumping/countervailing duties, labeling and marking requirements, trade sanctions, etc.
    - Seeks to determine where goods are "from" (more detailed task)
    - Becoming increasingly important in the consumer sphere (environmental/ethical concerns, "buy local" etc.)



## Rules of Origin in Practice – Methodology

- Goods are either (1) wholly obtained or (2) produced in multiple countries
- For multiple countries, origin is the place where the last substantial transformation occurred
- Three methods to measure substantial transformation:
  - Tariff Shift / Change in Tariff Classification (CTC)
  - Value-Added / Regional Value Content (RVC)
  - Specified Input



## Rules of Origin in Practice – Other relevant concepts

- Tolerance/*de minimis*
- Cumulation
- Absorption/Roll-up
- Drawbacks
- Outward Processing



## Rules of Origin in Practice – Case Studies

- Difference between ROO approaches can be significant
- Example: Apple iPhone
  - Final assembly takes place in China, but value added in China only accounts for ~1.8% of the final consumer price of the product
  - However, the applicable US rule of origin (tariff shift approach) confers origin on China
- Example: Bangladesh T-Shirts
  - Second largest garment exporter, but imports approx. 80% of its yarn
  - Yarn-forward rules mean that apparel goods made up in Bangladesh often do not originate there, and therefore do not qualify for preferential treatment under FTAs.
  - Result is low utilization of trade preferences for apparel
- Some countries and FTAs have special ROO designed to facilitate development of less developed countries (LDCs)
  - E.g. Canada's General Preferential Tariff and LDC Tariff
  - E.g. APTA, SAFTA, ASEAN-India



## Rules of Origin in Practice – North America



- North American Free Trade Agreement (NAFTA)
- Primary method is tariff shift, but other methods for certain products
- Regional value content is generally 50%. RVC is used extensively for automotive and chemical products
- Contains a *de minimis* allowance up to 7% FOB value of goods (but not for textiles, certain agricultural products)
- Recognized as a particularly difficult-to-manage FTA
  - E.g. for automotive, all parties have different definitions of automotive parts with respect to HS codes



## Rules of Origin in Practice – North America



- NAFTA has reshaped long-term North American supply chain infrastructure
- [Point on procedure for certification of origin]
- [Point on compliance – different administration across members]
- Lessons from NAFTA
  - Devil is in the details
  - Notwithstanding uniformity, administration differs widely in U.S., Mexico, Canada
  - ROO used to protect some industries (e.g. Yarn forward rules for textiles), and increase investment in others (autos)
  - ROO for many products have become outdated – difficult to get consensus on changing and simplifying



## Rules of Origin in Practice – European Union

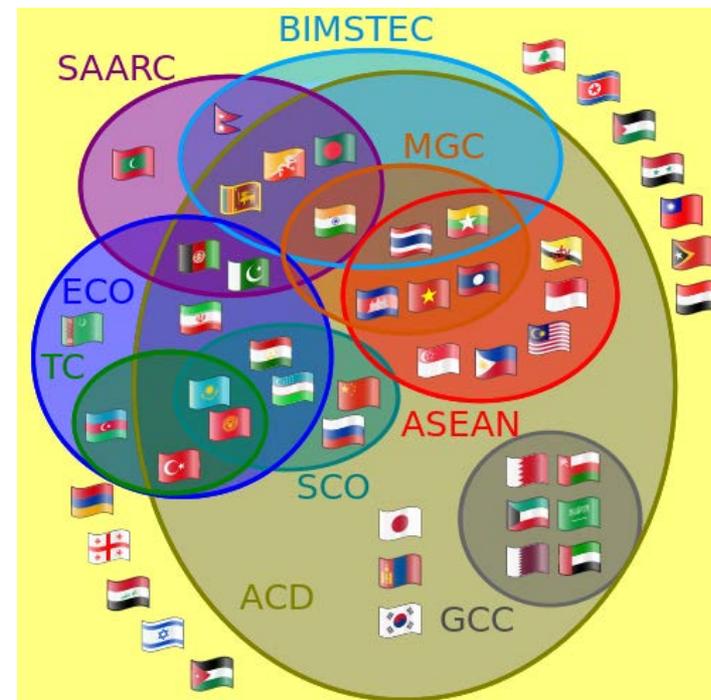


- Generally uses tariff shift, with an extensive product-specific list that requires specified input or content percentages
- Utilizes the absorption principle
- Contains a tolerance allowance up to maximum of 10% ex-works price (textiles are carved out)
- ROO have been one of the preferred tools of the European Commission to obtain concessions in FTA negotiations with non-EU states
- Lessons from negotiations for Canada-EU Comprehensive Economic and Trade Agreement (CETA)
  - Too early to tell, but scope is more ambitious than NAFTA and phase outs faster
  - Complications and ROO failures from NAFTA experience after 20 years played a role in re-setting concepts of ROO in CETA



## Rules of Origin in Practice - Asia

- Asian FTAs:
  - ASEAN Free Trade Area (AFTA)
  - ASEAN-China FTA
  - ASEAN-Korea FTA
  - ASEAN-India FTA
  - South Asian Preferential Trading Arrangement (SAPTA)
  - South Asian Free Trade Area (SAFTA)
  - Asia-Pacific Trade Agreement (APTA)
  - Singapore-Japan FTA
  - Singapore-Korea FTA
  - Singapore-New Zealand FTA
  - Singapore-Australia FTA
  - Thailand-New Zealand FTA
  - Australia-New Zealand CER
  - Trans-Pacific Economic Partnership Agreement
  - Japan-Malaysia Economic Partnership Agreement
  - India-Thailand FTA
  - India-Sri Lanka FTA
  - ...and more



Source: Wikipedia



## Rules of Origin in Practice - Asia

- ASEAN – either 40% value-added or change in tariff heading, with full cumulation
  - Change in tariff heading rule is used primarily for wheat flour, wood products, aluminum products, iron and steel
  - ASEAN-China agreement includes product-specific rules for certain sectors, such as textiles, footwear, iron and steel
- APTA – 45% value-added (35% for less developed countries), with full cumulation
- SAFTA – Combination of change in tariff heading AND value-added, with diagonal (regional) cumulation
- Peculiarities:
  - ASEAN-India, APTA, SAPTA, SAFTA, bilateral Sri Lanka FTAs – allow blocking of imports of products with components from states with which one of the FTA members does not have trade relations
  - Singapore-NZ RTA – requires that the last process be carried on in one of the parties



### 3. PRACTICAL STRATEGIES AND SOLUTIONS



## Steps to Utilize Preferential Trade Agreements and Minimize Risk

- Proactive and cost-effective customs management involves:
  1. Opportunity planning
  2. Risk management and compliance



## Steps to Utilize Preferential Trade Agreements and Minimize Risk

- Opportunity Planning:
  - Develop an internal database of FTA information
  - Consider Tariff Classification / HS Codes
  - Consider use of special economic zones (SEZ) & bonded areas for assembly, manufacturing or other production
  - Consider outward processing to integrate third parties into preferential ROO
    - Singapore and Korea are major hubs
  - Consider special preferences for less developed countries
  - Make use of cumulation
  - Make use of duty drawbacks
  - Make use of trade promotion initiatives
    - E.g. ASEAN Industrial Cooperation Scheme



## Steps to Utilize Preferential Trade Agreements and Minimize Risk

- Risk Management and Compliance
  - Obtain advance rulings on origin where possible
  - Consider impact of ROO alongside non-tariff issues: Regulatory issues, licensing requirements, valuation, etc.
  - Perform regular self-audits, or selective BP audits
  - Connect supply chain procurement with compliance – level the playing field
  - On further consideration...
    - How reliable is supply chain information
    - Opportunity cost of ROO
    - Find balance



## Looking Forward: Opportunities in New FTAs

- Trans-Pacific Partnership (TPP)
  - Among 12 Asia-Pacific countries: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.
  - Intention is to simply ROO; key will be entangling TPP from existing FTA's
  - Potentially unmanageable if parallel ROO analysis required for TPP and FTA's, and will discourage exports
  - Special interests abound... results uncertain
- Regional Comprehensive Economic Partnership (RCEP)
  - Among the 10 members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam) and the six ASEAN bilateral FTA countries (Australia, China, India, Japan, Korea, and New Zealand)
  - ROO on the table
  - Coexistence of Asian FTA's with RCEP uncertain
  - Will regional rules replace bilateral rules
  - Bilateral negotiations and RCEP negotiations simultaneous



Thank You

**Mr. Jesse Goldman**  
**goldmanj@bennettjones.com**  
**Toronto, Ontario, Canada**  
**+1 (416) 777 6442**

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Jesse I. Goldman

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### I. Introduction

Rules of origin are the method by which countries determine where a good is "from" for purposes of international trade. Such rules are necessary for a variety of administrative purposes, including determining the tariff treatment of goods upon import, assessing whether country-specific contingent trade remedies apply (i.e. anti-dumping duties, countervailing duties, or safeguards), and tracking trade statistics. Rules of origin are also used to assess whether a certain traded product may enjoy advantages conferred under a free trade agreement.

Rules of origin are therefore necessary to enable trade in a very practical sense. However, depending on how rules of origin are designed and administered, they can also present significant trade barriers. Such barriers can become particularly acute in the case of modern,

integrated multi-jurisdictional supply chains, which are a phenomenon that traditional rules of origin were never designed to handle.<sup>1</sup>

Compounding the problem of antiquated origin methodologies, in recent decades, a rapid proliferation of free and preferential trade agreements ("FTAs") has led to a staggering array of international trade opportunities – and an equally staggering mountain of paperwork required to take advantage of those opportunities. Today there are estimated to be more than 300 overlapping preferential trade agreements in force worldwide.<sup>2</sup> In the Asia-Pacific region alone, there were 119 free trade agreements in force as of July 2014, with an additional 159 either proposed, under negotiation, or signed but not in force.<sup>3</sup> Each FTA has its own distinct set of origin rules, including different minimum operations required to confer origin, different methods of measuring these minimum operations, different certification and documentation requirements, and different retroactive record-keeping obligations.

This entanglement of global rules of origin and origin administration is frequently described as a "noodle bowl".<sup>4</sup> Asia-Pacific nations seek to harmonize rules of origin in the "mega FTA"

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<sup>1</sup> As noted in a 2012 report by the World Economic Forum on global value chains, free trade agreements "are based on an antiquated understanding of where goods are 'from' – hence the Byzantine networks of 'rules of origin'." World Economic Forum, *The Shifting Geography of Global Value Chains: Implications for Developing Countries and Trade Policy* (2012) at 9.

<sup>2</sup> Brian Staples and Laura Dawson, *Made in the World: Defragmenting rules of origin for more efficient global trade*, Canadian Council of Chief Executives (June 2014) at 10. In comparison, there were only 70 FTAs in the early 1990s.

<sup>3</sup> Asian Development Bank, Asia Regional Integration Centre, *FTAs by Status (Cumulative)* (July 2014), online: <http://aric.adb.org/fta-trends-by-status>.

<sup>4</sup> See e.g. Erlinda M. Medalla, *Rules of Origin: Regimes in East Asia and Recommendations for Best Practice*, Philippine Institute for Development Studies Discussion Paper Series No. 2008-19 (July 2008) at 1.

negotiations over the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP). However, squaring the circle will be a challenge.<sup>5</sup>

This paper will provide an overview of rules of origin challenges for global supply chain managers and discuss practical strategies to maximize opportunities and avoid pitfalls. It will also address the potential for future rules of origin synergies in the Asia-Pacific Region under the TPP and RCEP.

## II. Issues & Challenges for Supply Chain Professionals

### A. Effect of Rules of Origin on Supply Chain Management

Supply chain managers must consider rules of origin requirements when making sourcing and investment decisions. This often requires a cost-benefit analysis comparing the burden of compliance versus potential gains from preferential tariff treatment.<sup>6</sup> Complex rules of origin increase production costs in the form of either cost of compliance or higher duties through underuse of preferential tariff rates. Restrictive methodologies and laborious documentation requirements can cause firms to divert trade flows from partners in countries or regions where it would otherwise be economically advantageous to do business.<sup>7</sup> These cost inefficiencies are either absorbed by the firm, reducing profitability, or passed on to consumers, driving up prices.<sup>8</sup> They can also influence long-term supply chain structuring decisions and infrastructure

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<sup>5</sup> For example, among RCEP parties there are at least 22 rules of origin in force, of which it is estimated that only about 30% of tariff lines share common origin rules. Staples and Dawson, *supra* note 2 at 5 citing Richard Baldwin, *WTO 2.0: Global governance of supply chain trade*, Centre for Economic Policy Research, Policy Insight No. 64 (December 2012), 2012.

<sup>6</sup> As Van de Heetkamp and Tusveld note, "[o]rigin issues are intertwined with compliance, cost-benefit analysis, and sourcing options". Anne van de Heetkamp and Ruud Tusveld, *Origin Management: Rules of Origin in Free Trade Agreements* (Springer: 2011) at 183.

<sup>7</sup> Colleen Carroll, Dylan Geraets and Arnoud R. Willems, *Reconciling Rules of Origin and Global Value Chains: The Case for Reform*, Leuven Centre for Global Governance Studies Working Paper No. 137 (April 2014) at 9.

<sup>8</sup> Carroll, Geraets and Willems, *supra* note 7 at 9.

investment, such as motivating a firm to locate a plant in a FTA member territory despite the fact that it might not be the best or most efficient location from a logistic or economic perspective.<sup>9</sup> Similarly, changes in rules of origin or their administration can undermine existing infrastructure planning.

Asia is a global hub for trade in electronic goods like integrated circuits, textiles, automobiles, and components. These types of products increasingly involve fragmented production chains where goods travel across several jurisdictions before reaching their final form, with relatively little value added at each step in the chain. Such integrated production networks are extremely vulnerable to shipping disruptions and trade costs.<sup>10</sup>

Panasonic Corporation is a good example of a company with a labyrinthine multi-jurisdictional supply chain.<sup>11</sup> Panasonic manufactures a wide range of consumer electronic products including hundreds of components and equipment across nine categories of goods.<sup>12</sup> The group has 334 companies in 45 different countries and regions worldwide, with customers all over the world.

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<sup>9</sup> Biswajit Nag and Debdeep De, *Rules of Origin and Development of Regional Production Network in Asia: Case Studies of Selected Industries*, Asia-Pacific Research and Training Network on Trade Working Paper Series No. 101 (May 2011) at 3-4.

<sup>10</sup> Nag and De (2011), *supra* note 9 at 4. Deep regional integration of supply chains can also stunt broader global integration. For example, North American integration of the auto industry under NAFTA made it difficult for Canadian negotiators of the Comprehensive Economic and Trade Agreement (CETA) to create benefits for Canadian exporters to the EU market. Staples and Dawson, *supra* note 2 at 4; Baldwin, *supra* note 5 at 14.

<sup>11</sup> The company's experience was outlined in a presentation made by Yoko Uenoyama of Panasonic Corporation to the World Customs Organization in 2014. See Yoko Uenoyama, "Promoting FTA Utilization", Presentation to the World Customs Organization, Brussels (21 January 2014), summarized in Carroll, Geraets and Willems, *supra* note 7 at 12.

<sup>12</sup> The categories are appliances, digital AVC, housing equipment, factory automation equipment, rechargeable batteries, solar batteries, medical instruments, industrial equipment, and components.

Each of the 45 countries and regions has its own origin requirements, representing various permutations of the various origin methodologies.<sup>13</sup>

Automotive is another sector for which rules of origin compliance can represent a significant burden. Originally the automobile industry was characterized by vertical integration within major producers. However, since 1970s (largely driven by Asian automakers), the industry has shifted to multi-tiered supplier networks.<sup>14</sup> This has opened new wave of assembly and supplier markets in developing countries. For example, Denso Corporation, one of the largest automobile component manufacturers with affiliates worldwide, is heavily reliant on its highly integrated regional production network throughout Southeast Asia.

## **B. Cost of Compliance**

In many cases, exporters may choose to use default "most-favoured nation" tariff rates instead of taking advantage of lower preferential tariffs under FTAs. This can make perfect economic sense; profit-maximizing firms will naturally choose not to utilize preferential tariffs if the cost of complying with rules of origin requirements exceeds the benefit obtained from preferential access.<sup>15</sup> A 2011 WTO report found that of a sample of imports from the 20 largest importer

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<sup>13</sup> Although Panasonic ships goods from its factories to importers directly, invoices for the goods are often prepared and switched in third countries – an operation that can cause problems with origin under FTAs. Assembling the necessary information and putting together the documentation to comply with 45 different origin regimes is also demanding on employees, logistics personnel in particular.

<sup>14</sup> Biswajit Nag and Debdeep De, *Integration of small and medium-sized enterprises in international production networks: the automotive industry in Asia*, Macao Regional Knowledge Hub Working Paper No. 12 (December 2008) at 6.

<sup>15</sup> See Maria Donner Abreu, *Preferential Rules of Origin in Regional Trade Agreements*, World Trade Organization Economic Research and Statistics Division, Staff Working Paper ERS-2013-05 (22 March 2013).

countries, only 16% of imports qualified as preferential trade. The report cited rules of origin as one of the reasons for this surprisingly low FTA utilization rate.<sup>16</sup>

Costs associated with origin compliance may take a number of forms. First is the employee time required to develop and maintain familiarity with all FTAs that may affect a multi-jurisdictional supply chain. This includes researching origin definitions, cross checking similarities and differences in product definitions. This cost particularly affects logistics managers since key logistic decisions and strategies may be shaped by FTA considerations.

Second is (1) understanding and (2) monitoring the changes to the World Customs Organization's Harmonized Commodity Description and Coding System (HS). HS codes are complicated and difficult to interpret. Although they are the primary means by which changes in tariff classifications for rules of origin purposes are measured, the system was not designed with this purpose in mind; it was designed to facilitate standardized trade data collection. Adding to the complexity is the fact that the HS is amended frequently and revisions must be made to rules of origin that use the HS every time a new version of the HS enters into force.<sup>17</sup> Constantly checking to make sure that no changes to relevant HS codes have occurred is a demanding task

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<sup>16</sup> "Onerous rules of origin procedures sometimes associated with free trade agreements have contributed to these low figures by making the costs of compliance requirements higher than the perceived worth of the underlying preference margins." WTO, *The WTO and preferential trade agreements: From co-existence to coherence*, World Trade Report 2011 at 44. Along similar lines, a 2013 World Bank study of African textile exports to the US and the EU concluded that making rules of origin more flexible and pragmatic had the potential to increase export volumes four times greater than what could be achieved by mere tariff removals. See Jaime de Melo and Alberto Portugal-Perez, *Preferential Market Access Design: Evidence and Lessons from African Apparel Exports to the United States and the European Union*, World Bank Policy Research Working Paper 6357 (February 2013) at 21.

<sup>17</sup> Carroll, Geraets and Willems, *supra* note 7 at 11; Won-Mog Choi, *Defragmenting Fragmented RTAs: A Benefit and Cost Approach*, Paper presented at the Asian International Economic Law Network Inaugural Conference (27 July 2009) at 8.

that can impede logistics managers' ability to use advanced transit processes or require them to adjust business models to accommodate delays.<sup>18</sup>

The third type of cost is the cost of gathering the information required to process certificates of origin. Each FTA has different origin certificate forms with different information fields, so keeping track of what is required in each case can be complicated. Also, the technical information required to certify origin is often only obtainable from the foreign manufacturer, which can result in communication and time zone-related delays.

The fourth cost of compliance is the time required to prepare and submit the documentation once all the necessary information has been gathered. Fifth is the administrative burden of recordkeeping that is required by most customs regimes, along with the costs associated with compiling the necessary documentation and responding to the government in the event of an audit. Finally, there may be administrative or filing fees related to submitting origin certifications, along with the fees of lawyers or trade consultants whose services may have been engaged at some point in the process.

These costs are not negligible. Under NATFA, rules of origin compliance costs can run from 5% to 7% of the value of the finished goods.<sup>19</sup> In the EU, this figure is estimated at around 8%,<sup>20</sup> and

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<sup>18</sup> Carroll, Geraets and Willems, *supra* note 7 at 12-13.

<sup>19</sup> Staples and Dawson, *supra* note 2 at 11, citing Stephen Tapp, *Understanding Rules of Origin: A Critical Review of the Literature*, Finance Canada Working Paper (June 2007); Céline Carrère and Jaime de Melo, *Are Different Rules of Origin Equally Costly? Estimates from NAFTA*, CEPR Discussion Paper No. 4437 (2004).

<sup>20</sup> Olivier Cadot *et al*, *Product Specific Rules of Origin in EU and US Preferential Trading Arrangements: An Assessment*, World Trade Review (2006) 199-224.

for goods traded within ASEAN, where trade in parts and components comprises a significant portion of intra-regional trade, costs could be up to 25% of the value of finished goods.<sup>21</sup>

### C. Risks Associated With Non-Compliance

In addition to the direct costs of planning for and preparing the documentation, liabilities associated with irregularities can be equally costly. For example, unanticipated delays at customs can harm the smooth functioning of the supply chain. Another concern is the risk of losing trade secrets, as some origin certification processes require significant disclosure regarding production processes, inputs and supplies that went into the product.<sup>22</sup> In some jurisdictions, firms with a history of non-compliance with customs laws are at risk debarment from eligibility to bid for government procurement contracts.

The direct penalties associated with incorrect or faulty origin declarations can be steep, as can the cost of protracted retroactive verification proceedings. Certifications of origin may also be revoked retroactively if irregularities are discovered (e.g. during the course of an audit), requiring the firm to pay back taxes, penalties, and interest that represent potentially significant unbudgeted liabilities in the company's balance sheet.

For example, in 2013, Japanese company Toyo Ink entered into a US\$45 million settlement with the U.S. Department of Justice for allegedly misdeclaring country of origin for ink pigment imported to the U.S. in order to avoid paying anti-dumping and countervailing duties.<sup>23</sup> In February 2014, the U.S. government laid commercial fraud charges against importers of honey

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<sup>21</sup> Annette O. Pelkmans-Balaoing and Miriam Manchin, *Rules of origin and the web of East Asian free trade agreements*, World Bank Policy Research Working Paper 4273 (July 2007).

<sup>22</sup> Carroll, Geraets and Willems, *supra* note 7 at 12-13.

<sup>23</sup> U.S. Department of Justice, "Japanese-Based Toyo Ink and Affiliates in New Jersey and Illinois Settle False Claims Allegation for \$45 Million" (17 December 2012), online: <http://www.justice.gov/opa/pr/japanese-based-toyo-ink-and-affiliates-new-jersey-and-illinois-settle-false-claims-allegation>.

relating to fraudulent certification of origin. The charges allege that the origin of the honey was mischaracterized on declaration forms and/or that the product was transshipped through other countries to avoid \$80 million anti-dumping duties on Chinese honey.<sup>24</sup> This case included charges against 14 individuals.

Another problem is that in most customs regimes, the importer bears the full burden of liability for non-compliance while exporters are the ones who must certify origin. Incentives and ability to ensure full and accurate compliance can therefore be skewed. In 2007, Ford Motor Company was assessed a US\$42 million penalty by U.S. Customs and Border Protection for failure to produce supporting records for past certificates of origin, even though the records were in the control of the foreign exporter. The case was later settled out of court.<sup>25</sup>

### **III. Overview of rules of origin in practice**

There are two basic types of rules of origin: Preferential and non-preferential. Preferential rules of origin generally measure a good's regional content, while non-preferential rules of origin seek to determine where a good is "from", which is a more detailed task. Preferential rules of origin are necessary for the implementation of trade agreements in order to prevent trade deflection (i.e., shipping goods through a low-duty country that is a member of a FTA in order to gain access to higher-duty markets within that trade zone). Preferential rules of origin are generally negotiated and set out in the text of FTAs.

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<sup>24</sup> U.S. Department of Homeland Security, "ICE and CBP announce charges linked to major commercial fraud enterprise" (20 February 2013), online: <http://www.ice.gov/news/releases/ice-and-cbp-announce-charges-linked-major-commercial-fraud-enterprise>.

<sup>25</sup> Grunfeld Desiderio Lebowitz Silverman & Klestadt LLP, Government Abandons \$42 Million Recordkeeping Case, online: <http://www.gdlsk.com/knowledge/99-government-abandons-42-million-recordkeeping-penalty-case.html>.

Non-preferential rules of origin are the default rules used by each country in the administration of non-preferential trade policies. They are used to track trade statistics and measure compliance with contingent trade remedy measures (e.g. anti-dumping duties). Non-preferential rules of origin are becoming increasingly important in the consumer sphere as well, for example, to provide marking of national and enterprise-level origin demanded by consumers wishing to purchase goods from ethical, safe sources.<sup>26</sup>

#### A. **Tariff Shift, Regional Value Content, and Specialized Input Methods**

When a good is wholly produced or obtained within a particular territory, such as in the case of most agricultural products and raw natural resources, determining origin is simple. It quickly becomes more difficult when inputs for a particular good come from outside the territory, as is increasingly the norm in a world of globalized supply chains.

If a good was produced in multiple countries, origin is generally the place where the last "substantial transformation" occurred. There are three basic methods to measure substantial transformation: Tariff Shift, Regional Value Content, and Specified Input.<sup>27</sup>

The Tariff Shift or Change in Tariff Classification ("CTC") approach requires that the goods undergo a specified shift in tariff classification codes based on the Harmonized System. This method is entirely dependent on accurate tariff classification, which can be its own challenge. CTC rules may require a shift in HS chapter (2 digits), heading (4 digits), subheading (6 digits), or item (8-10 digits).

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<sup>26</sup> Staples and Dawson, *supra* note 2 at 5. In some cases, origin and origin marking requirements may also be used as a form of protectionism. An example is the United States' Country of Origin Labeling (COOL) requirement for beef, against which Canada and Mexico recently won a challenge at the WTO. See WTO Panel Decision WT/DS384/RW, *United States – Certain Country of Origin labelling (COOL) Requirements* (20 October 2014). The U.S. has indicated that it plans to appeal the decision.

<sup>27</sup> See the Kyoto Convention of the World Customs Organization.

The Value-added or Regional Value Content ("RVC") approach, which can be determined using various different calculation methodologies, requires that the domestic value-added content in a finished good exceed a specified percentage of the good's overall value (or that conversely, the value of foreign content does not exceed a specified threshold). RVC may also be measured as total value of parts of the finished product.

The Specified Input method requires that a good be produced in a certain way or that a specified input must be used in the good in order for the good to originate in the territory. The "yarn-forward" method of determining origin for textiles is one example, wherein a garment cannot qualify as originating unless the yarn that was used to weave the fabric originated in the region.

The differences between the various methodologies can be significant. Take the example of the Apple iPhone. Although the final product is assembled in China, the value added in China accounts for less than 4% of the value of the goods (or approximately 1.8% of the consumer price of the finished product).<sup>28</sup> The vast majority of the iPhone's value comes from research and development work in the United States and from components sourced from countries outside of China.<sup>29</sup> However, the tariff shift method, which is the applicable rule in the United States, confers origin on China. The result is an arguably artificial inflation of the U.S. trade deficit with China when the full value of every iPhone imported into the United States is counted as Chinese originating.

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<sup>28</sup> Yuqing Xing and Neal Detert, How the iPhone widens the US trade deficit with the PRC, ADBI Working Paper Series (May 2011) at 5.

<sup>29</sup> Kenneth L. Kraemer, Greg Linden and Jason Decrick, *Capturing Value in Global Networks: Apple's iPad and iPhone* (July 2011), online: [http://mansueto.files.wordpress.com/2011/10/value\\_ipad\\_iphone.pdf](http://mansueto.files.wordpress.com/2011/10/value_ipad_iphone.pdf).

Another example of how certain methodologies rules of origin can be disadvantageous is the case of T-Shirts from Bangladesh.<sup>30</sup> Bangladesh has one of the largest textile industries in the world (it is the world's second largest garment exporter after China).<sup>31</sup> However, approximately 80% of its yarn and fabrics are imported. Bangladesh has weak spinning, weaving and finishing subsectors, and it is geographically positioned next to two of the world's most competitive yarn and fabric producers, China and India. It is more economically efficient to import yarn rather than spinning it domestically. However, "yarn-forward" origin rules mean that apparel goods made up in Bangladesh often do not qualify as originating there, meaning that the garments do not qualify for preferential treatment under Bangladeshi FTAs. In 1995, the European Commission audited 9,000 certificates of origin for T-shirts from Bangladesh and found that 5,000 were invalid. Importers had to pay back-duties and penalties. Since then, the result is low utilization of trade preferences for apparel, which challenges Bangladesh's export competitiveness.

In order to address problems like the one faced by Bangladesh, many countries have introduced special tariff categories outside the ambit of FTAs for the purpose of promoting development in certain specified developing countries. An example is Canada's General Preferential Tariff (GPT) and Least Developed Country Tariff (LDCT), each of which has its own specially designed rules of origin that are favourable to the recipient countries.<sup>32</sup> The origin rules of these tariffs permit fabrics to qualify as originating, for example, if the yarn used in them originated in any other GPT or LDCT country. Many FTAs also contain more lenient origin requirements for countries

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<sup>30</sup> See Stefano Inama, *Rules of Origin in International Trade* (Cambridge University Press: 2009) at 365-371.

<sup>31</sup> World Trade Organization, *International Trade Statistics* 2014.

<sup>32</sup> *General Preferential Tariff and Least Developed Country Tariff Rules of Origin Regulations* (Canada), SOR/98-34.

that are designated as developing. For example, the Asia-Pacific Trade Agreement (APTA) and the South Asian Free Trade Area (SAFTA) both contain a 10% lower value-added threshold for less developed members (5% lower for Sri Lanka under the SAFTA).

## B. Other Key Concepts

In addition to the three major origin methodologies, there are a number of additional common mechanisms that may be built in to FTAs as a way for negotiators to achieve certain preference objectives:

- Tolerance – Many rules of origin regimes contain *de minimis* exemptions that allow foreign content that is difficult to source in the FTA zone to form up to a certain percentage of the finished product without affecting its origin qualification.
- Cumulation – Allowing a country to count inputs originating in the territory of its FTA partner(s) as domestic inputs for the purpose of origin requirements under that FTA. Canada has been a leading proponent of cumulation in its FTAs, including in particular "cross-cumulation", which allows the cumulation of all inputs and processes among common preferential trading partners so long as the applicable rules of origin between the final exporter and importer is satisfied within the territory of the common FTA parties.<sup>33</sup> The EU also makes widespread use of cumulation.
- Absorption – The absorption or "roll-up" principle is a common feature of rules of origin regimes in which a product that meets its own applicable rules of origin requirement is considered wholly originating for purposes of calculating origin of another product in which the first product was used as an input.

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<sup>33</sup> Staples and Dawson, *supra* note 2.

- Drawbacks – Some countries have duty drawback programs under which duties paid on imported goods can be refunded if the goods are used as inputs in other products that are subsequently re-exported from the country.
- Outward processing – Some countries or regions, such as Singapore, Korea and the EU, encourage outward processing schemes by providing relief from import duties on the value of the imports derived from domestically originating goods that were previously exported for processing (the "compensating value" of the imports).<sup>34</sup>

### C. NAFTA Rules of Origin

Under the North American Free Trade Agreement (NAFTA), change in tariff classification is default method of origin assessment,<sup>35</sup> with some products subject to specific regional content rules.<sup>36</sup> Where RVC applies, the local content requirement is generally 50%. RVC can be calculated using either transaction value (price actually paid or payable) or net cost (final value minus certain general expenses such as marketing, service fees, royalties).

NAFTA contains a *de minimis* allowance that permits inputs that are difficult or impossible to source within the trade zone to constitute up to 7% of the transaction value<sup>37</sup> of the finished goods and still count toward the local content requirement for purposes of origin. The value of

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<sup>34</sup> Pelkmans-Balaoing and Manchin, *supra* note 21 at 7.

<sup>35</sup> There are four ways in which goods can meet NAFTA rules of origin requirements: (i) goods wholly produced or obtained in the NAFTA region; (ii) Goods containing non-originating inputs that nevertheless meet the product-specific NAFTA tariff shift and/or regional value requirements; (iii) Goods produced in the NAFTA region entirely from originating materials; and (iv) Unassembled goods and goods classified in the same HS category as their parts that contain sufficient NAFTA content despite not meeting product-specific tariff shift rules (e.g. bicycles; this category is rare and doesn't apply to textiles). Inama, *supra* note 30 at 279-280.

<sup>36</sup> Inama, *supra* note 30 at 287. RVC rules are used extensively under NAFTA for automotive products and chemicals.

<sup>37</sup> Calculated on a free-on-board (FOB) basis. For beverages, spirits and vinegar classified in Chapter 22 of Canada's Customs Tariff, the *de minimis* allowance is 10%.

materials can be calculated two ways.<sup>38</sup> It is either the value for duty calculated per the *Customs Act*, or it can be determined according to Schedule VIII of the *NAFTA Rules of Origin Regulations*,<sup>39</sup> which sets out a sequence of applicable valuation methods similar to those used for calculation of value for duty.<sup>40</sup> If a good is subject to a regional value content requirement and the value of the non-originating materials exceeds the *de minimis* threshold, all of the non-originating materials must be taken into account for purposes of calculating the regional value content. There is also a long list of excluded goods for which the *de minimis* rule does not apply,<sup>41</sup> and there are special rules covering textiles and agricultural goods.<sup>42</sup>

Notwithstanding uniformity of the rules themselves, administration of NAFTA rules of origin differs widely in U.S., Mexico, and Canada. For example, each agreement partner has different definitions of automotive parts with respect to HS codes.<sup>43</sup> The NAFTA rules of origin regime is recognized as being particularly complex and difficult to manage,<sup>44</sup> in part because of the compliance challenge associated with inconsistent administration.

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<sup>38</sup> *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations* (Canada), SOR/94-23, s.11(2).

<sup>39</sup> *NAFTA Rules of Origin Regulations* (Canada), SOR/94-14.

<sup>40</sup> The sequence of methodologies is: transaction value method; transaction value of identical materials; transaction value of similar materials; deductive value method; computed value method; residual method.

<sup>41</sup> See NAFTA Article 405.

<sup>42</sup> *De minimis* does not apply to agricultural products covered by HS Chapters 1-27 unless the non-originating materials are classified in subheadings different from the subheadings in which the finished goods are classified. For textiles classified in HS Chapters 50-63, the *de minimis* rule is applied by weight, rather than by value.

<sup>43</sup> Carroll, Geraets and Willems, *supra* note 7 at 12.

<sup>44</sup> See e.g. Sherzod Shadikhodjaev, *Duty Drawback and Regional Trade Agreements: Foes or Friends?* *Journal of International Economic Law*, Vol. 16, Issue 3 (September 2013), pages 587-612; Joseph A. LaNasa, *Rules of origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating them*, *American Journal of International Law*, Vol. 90, Issue 4 (October 1996), pages 625-640.

Claims of NAFTA preference for commercial shipments must be supported by a valid NAFTA certificate of origin signed by the exporter.<sup>45</sup> When it comes to determining origin under the complex NAFTA rules, the devil is in the detail. Although it is the responsibility of the person certifying origin to get the analysis right, it is the importer who will be liable for additional duties and penalties if a certificate turns out to be inaccurate. If the exporter is not the producer of the goods, the exporter may complete a certificate on the basis of: (i) knowledge that the good originates; (ii) reasonable reliance on the producer's written representation that the good originates; or (iii) a completed and signed certificate of origin for the good voluntarily provided to the exporter by the producer.<sup>46</sup> Certificates must be completed in duplicate, with one copy sent to the importer and the other retained by the exporter.<sup>47</sup> The person signing the certificate of origin is responsible for amending it where necessary to ensure it reflects correct information, and advising all persons to whom they have given a certificate of any changes. Importers are responsible for providing the certificate to the customs administration of the importing country, and submitting corrections where there is reason to believe that a certificate contained inaccurate information and paying the associated penalties.

During the NAFTA negotiations, rules of origin were used to protect some industries (for example, the yarn-forward rule for textiles), and increase investment in others (for example, the automotive industry). The rules of origin for NAFTA have become outdated for many products,

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<sup>45</sup> Where the value of a commercial shipment is low – under \$1,600 – a formal certificate is not required and a statement from the exporter that the goods are originating will suffice. The statement may be handwritten, stamped, or typed on the commercial invoices.

<sup>46</sup> See Canada Border Services Agency, Memorandum D-11-4-14, *Certification of Origin* (16 March 2006), online: <http://www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11-4-14-eng.html> at para. 8; U.S. Customs and Border Protection, *NAFTA: A Guide to Customs and Procedures, Chapter 6 - Certificate of Origin*, online: <http://www.cbp.gov/trade/nafta/guide-customs-procedures/cert-origin>.

<sup>47</sup> Where a producer completes and signs a certificate of origin for use by an exporter, the producer must also keep a copy in his records.

but have yet to be amended because of difficulties in obtaining the consensus needed to change and simplify the rules.

#### **D. European Rules of Origin**

Pan-European rules of origin stipulate that a product shall be considered as originating in a country if it has been either wholly obtained or undergone a sufficient working or processing in that country.<sup>48</sup> The primary method in the EU of determining origin is tariff shift, but it has an extensive product-specific list of rules of origin that requires specified input or content percentages in the case of certain goods. The EU also utilizes the absorption principle, and a tolerance allowance up to a maximum value of 10% of the ex-works price.<sup>49</sup>

Rules of origin have been one of the preferred tools of the European Commission to obtain concessions in FTA negotiations with non-EU states.<sup>50</sup> In negotiations between Canada and the EU over the Comprehensive Economic and Trade Agreement (CETA), complications and failures from the NAFTA experience also played a role in re-setting rules of origin concepts.

#### **E. Rules of Origin Under Asian FTAs**

Asian regional FTAs tend to put less emphasis on tariff shift than North American and European FTAs, preferring value-added rules as the primary origin assessment methodology, or using a combination of value-added and tariff shift. For example, the ASEAN Free Trade Area (AFTA) allows for origin to be conferred either by 40% value-added (with full cumulation) or a 4-digit

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<sup>48</sup> European Commission, *A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership*, OJ 2006/C 16/02 (21 January 2006) online: [http://ec.europa.eu/taxation\\_customs/resources/documents/handbook\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/handbook_en.pdf) at 25.

<sup>49</sup> Textiles under HS Chapters 50-63 are carved out from the tolerance rule. *User's Handbook*, *supra* note 48 at 39.

<sup>50</sup> Inama, *supra* note 30 at 236.

change in tariff classification (at the option of the importer).<sup>51</sup> AFTA also contains an annex with specific rules for certain products. The Asia-Pacific Trade Agreement (APTA) requires 45% value-added (with full cumulation) but the final process of manufacture must also have taken place within the territory.<sup>52</sup> The South Asian Free Trade Area (SAFTA) requires a combination of 40% value-added and a 4-digit HS tariff shift, with certain designated products that only require a tariff shift.<sup>53</sup>

*De minimis* exceptions appear in Asian FTAs as well. Under ASEAN, for example, *de minimis* non-originating inputs are permitted up to 10% of the FOB value of the finished goods.<sup>54</sup> However, like the EU and NAFTA rules, ASEAN does not allow the aggregation of *de minimis* with the regional value content requirement.

As mentioned above, there has been a dramatic proliferation of both regional and bi-lateral FTAs in Asia in recent years. According to the Asian Development Bank, as of July 2014 there were 278 Asian trade agreements either proposed, under negotiation, signed, or in effect (with 119 actually in effect). The following chart demonstrates the precipitous growth in FTA numbers:

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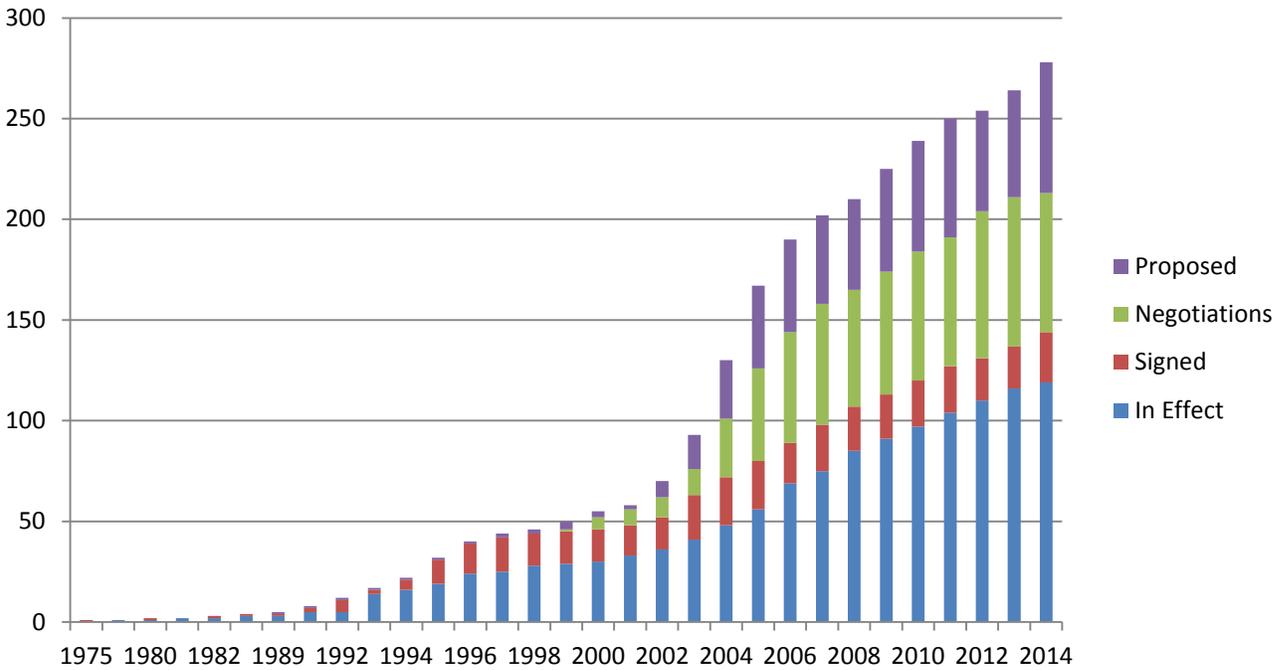
<sup>51</sup> ASEAN Trade in Goods Agreement, Article 28(1)(a).

<sup>52</sup> Asia-Pacific Trade Agreement, Annex II, Rule 3. The Singapore-New Zealand FTA also has this final processing requirement.

<sup>53</sup> Agreement on South Asian Free Trade Area, Annex IV, Rule 8. Rule 7 also contains a list of operations that are insufficient to confer origin status regardless of whether they result in a tariff shift (e.g. cleaning, affixing labels, packing, etc).

<sup>54</sup> See ASEAN Trade in Goods Agreement, Article 33.

### Asian Free Trade Agreements by Status



Data Source: Asian Development Bank (2014)<sup>55</sup>

#### IV. Practical Strategies and Solutions

Although rules of origin harmonization issues will ultimately need to be addressed at the global policy level, companies and supply chain managers must work strategically within existing frameworks. Companies that have a comprehensive origin strategy in place will be better positioned to take full advantage of the opportunities offered by trade agreements. Proactive and cost-effective customs management involves (1) opportunity planning, and (2) risk management and compliance.

##### A. Opportunity Planning

*Develop an internal database of FTA information.* This will require research into what FTAs exist and are applicable to your company's business, including an accounting assessment of the

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<sup>55</sup> *Supra* note 3.

potential tariff savings that each FTA offers if utilized. The second step is to compile a resource of information regarding the applicable rules of origin under each agreement and their documentation requirements.

*Consider tariff classification strategically.* Think about which HS codes have the most favourable duty rates under a particular FTA as part of sourcing decisions. For example, it may be less expensive to import components instead of assembled goods, or vice versa. Consider which jurisdiction is preferable for final assembly.

*Consider doing business in special economic zones.* Many countries have special economic zones (SEZ) designed to promote foreign investment. These zones have advantageous trade laws that differ from those in the rest of the country to encourage companies to locate their assembly, manufacturing or other production operations in the jurisdiction. Rules of origin for these zones are sometimes more lenient, and some FTAs also contain special treatment for products from SEZ.

*Consider outward processing and duty drawback programs.* Outward processing programs under the rules of origin of some countries and FTAs can allow for the integration third party states into preferential rules of origin. Of 192 regional trade agreements considered in a 2013 WTO study, 70 had either general or product-specific outward processing allowances.<sup>56</sup> Singapore and Korea are major hubs. Duty drawback programs similarly and inversely facilitate multi-jurisdictional processing arrangements by providing refunds on duties for goods that are subsequently re-exported after processing.

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<sup>56</sup> Abreu, *supra* note 15 at 14.

*Consider special developing country rules.* Assess whether any applicable FTAs or countries have special rules of origin that are more favourable to less developed countries, and consider ways to utilize these preferences in sourcing decisions.

*Consider cumulation allowances.* Cumulation is a common feature of FTAs that is designed to encourage and facilitate utilization of preferential rules of origin within the trading zone.

*Make use of trade promotion initiatives.* Other trade promotion initiatives may exist to encourage trade within FTA zones. An example is the ASEAN Industrial Cooperation Scheme which encourages technology investments in the ASEAN area by reducing tariffs on goods produced by companies partially owned by ASEAN citizens (minimum 30% equity), that are incorporated in an ASEAN country and is cooperating or sharing resources (such as technology or consolidated natural resource purchases) with another company in the region.<sup>57</sup>

## **B. Risk Management and Compliance**

*Obtain advance rulings on origin where possible.* Many countries have mechanisms through which importers may apply to the relevant customs authority for an advance ruling on origin. These rulings are usually binding on the authority issuing them, and will provide protection and predictability in the event of a customs audit.

*Consider the impact of rules of origin alongside non-tariff issues.* It is helpful to build a rules of origin assessment into a firm's other regulatory processes, such as product licensing requirements and customs valuation.

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<sup>57</sup> Nag and De (2011), *supra* note 9 at 19.

*Perform regular self-audits or selective third party audits.* Internal audits will help to identify problems early and limit the negative consequences of errors or omissions.

*Connect supply chain procurement with compliance.* Coordination across departments will facilitate utilization of preferential trade agreements, and allow a firm to compete on a level playing field with other firms within a free trade zone.

*Conduct a cost-benefit analysis.* Invoking rules of origin to claim preferential treatment under FTAs may be beneficial in many circumstances but not necessarily in all. It is important to consider all relevant factors, such as the reliability of supply chain information on which you would be relying for claims of origin and the opportunity cost of complying with rules of origin requirements, and to strike a balance between the cost and benefits of compliance.

### **C. Looking forward**

The negotiations currently underway for the Trans-Pacific Partnership (TPP)<sup>58</sup> and the Regional Comprehensive Economic Partnership (RCEP)<sup>59</sup> present significant opportunities to improve and harmonize rules of origin in the Asia-Pacific region. Under TPP, the intention is to simplify rules of origin, but the key will be disentangling TPP rules from the web of rules under existing FTAs. Rules of origin compliance will become a potentially unmanageable process if a parallel analysis is required under both the TPP and other FTAs, and will discourage preferential exports. Given the numerous special interests at work in the TPP negotiations, the outcome of the talks is far from certain. On the RCEP side, rules of origin are on the negotiation table as well, and again

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<sup>58</sup> Participating countries are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The countries participating in TPP negotiations collectively represent about 40 percent of the world's GDP and one third of global trade.

<sup>59</sup> Participating countries are the members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) and ASEAN's six bilateral trading partners (Australia, China, India, Japan, Korea, and New Zealand).

challenges are present in the form of overlapping FTAs. It is uncertain how the coexistence of current FTAs will work with RCEP, and whether regional rules will replace bilateral rules. However, if negotiators can overcome these challenges, these two regional behemoth trade agreements have the potential to untangle the Gordian knot of preferential origin rules in the region.