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Preferential Rules of Origin and the Multilateral Trading System: Pro-Development Policy Options

With the proliferation of regional trade agreements since the late 1980s and early 1990s, preferential rules of origin have also proliferated. The discussion on these rules has gradually shifted from a purely technical discussion ("how to establish the origin of goods not wholly obtained in one country", and hence, "how to apply trade preferences in these cases") to a wider discussion also touching upon the transaction costs caused by having a "spaghetti bowl" of rules, and the actual or presumed neo-protectionist use that is being made of them. In the context of the discussion on possible policy options for developing countries simultaneously involved in (or negotiating) regional and multilateral trade agreements, this article will first give a brief overview of the findings of the recent empirical literature. Some indications are then presented as to what such policy options could look like.

Recent empirical work on preferential rules of origin (RoO) roughly falls into three categories:

- the development of analytical tools and mapping of different rules
- qualitative assessments and "guesstimates" on the costs and effects of rules
- statistical and econometric work on their effects.

Analytical Tools and Mapping

The rising complexity of preferential rules of origin has spurred the development of new tools, both conceptual and technical, to describe, assess and analyse the different sets of rules. The pioneering work done at the Inter-American Development Bank should be mentioned in this respect.[1] This methodological work on typologies and *ex ante* restrictiveness indicators has certainly brought some order into the spaghetti bowl and has allowed researchers to have a better grasp of RoO and to use the indicators in their econometric work on the effects of preferential rules. We are now also better equipped to communicate about RoO and inform policymakers about different policy options and their consequences.

From the mapping exercise, two important RoO clusters emerge as dominating the current landscape: the pan-Euro cluster and the NAFTA cluster, each configurated around a specific regulatory model.

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[1] L. J. Garay, A. Estevadeordal: Protección, desgravación preferencial y normas de origen en las Américas, in: Integración y Comercio, January-April 1996; L. J. Garay, L. F. Quintero: Characterization and structure of the rules of origin of the G-3, NAFTA and ALADI: Their relevance to the case of Colombia, IDB, Washington, DC 1997, mimeo; L. J. Garay, R. Cornejo: Rules of Origin in Free Trade Agreements in the Americas, in: M. Rodríguez, P. Low, B. Kotschwar (eds.): Trade Rules in the Making. Challenges in regional and multilateral negotiations, Washington, DC 1999, OAS and Brookings Institution Press; L. J. Garay, R. Cornejo: Metodología para el análisis de regímenes de origen. Aplicación en el caso de las Américas, INTAL-ITD-STA, Documento de trabajo 8, September 2001; L. J. Garay, R. Cornejo: Characterization and Comparison of Rules-of-Origin in the Americas, Divison of Integration, Trade and Hemispheric Issues, Inter-American Development Bank, Washington, DC 2001; L. J. Garay: El papel de las normas de origen en los acuerdos de libre comercio en el hemisferio americano, in: P. De Lombaerde (ed.): Integración Asimétrica y Convergencia Económica en las Américas, Universidad Nacional de Colombia – Antropos, Bogotá 2002, pp. 219-241; A. Estevadeordal, K. Suominen: Rules of Origin in the World Trading System, Paper prepared for the Seminar on Regional Trade Agreements & the WTO, Geneva, 14 November 2003; A. Estevadeordal, K. Suominen: Rules of Origin: A World Map, Paper presented at the seminar "Regional Trade Agreements in Comparative Perspective: Latin America and the Caribbean and Asia-Pacific", PECC – LAEBA, Washington, DC, 22-23 April 2003; A. Estevadeordal, K. Suominen: Rules of Origin in Europe and in the Americas: Issues and Implications for the EU-Mercosur Inter-Regional Association Agreement, INTAL-ITD Working Paper, No. 15, January 2004. A. Estevadeordal, K. Suominen: Rules of Origin in the World Trading System: Proposals for Multilateral Harmonization, in: Integration & Trade, Vol. 9, No. 23, 2005, pp. 7-52; A. Estevadeordal, K. Suominen: Mapping and Measuring Rules of Origin Around the World, in: O. Cadot, A. Estevadeordal, A. Suwa-Eisenmann, T. Verdier (eds.): The Origin of Goods: A Conceptual and Empirical Assessment of Rules of Origin in PTAs, Oxford 2006, Oxford University Press and CEPR, chapter 3.

In the pan-Euro model, for each Harmonised System (HS) tariff heading it is defined what should be considered as sufficient working or processing for non-originating materials to qualify as originating goods. Contrary to previous protocols,[2] a general rule is not provided. In many cases (about 25% of HS tariff headings), two criteria are proposed, of which at least one should be fulfilled. The first criterion can be a change of tariff classification (CTC) (change of tariff heading (CTH) for more than 60% of HS tariff items), import content or a technical criterion. If there is a second criterion, it is import content. The pan-Euro RoO include a "soft rule of origin" provision that allows the use of inputs at the same heading when the RoO requires a CTC at a heading-level or at a chapter-level, reducing the degree of stringency of the requirement. The pan-Euro model includes provisions on *de minimis* operations, a (conditional) *de minimis* rule of 10% (e.g. non-originating materials up to 10% of the ex-works price do not alter the origin of the good), but with some exceptions like textiles and clothing products. There are also roll-up rules and restrictive provisions on outward processing. Duty drawback is precluded at least 2 years after signing the FTA. Bilateral and diagonal cumulation is foreseen. Full cumulation was limited to the European Economic Area (EEA). The EU's method of certification of origin provides two alternative procedures: a two step procedure in which RoO are certified by the government's agency once a certificate has been issued by the exporter or a competent agency, and an invoice declaration provided by exporters which have been approved as frequent exporters by the custom authorities.

In the NAFTA model the required CTC varies from one good to another: a change in chapter, heading, subheading, or even tariff item may be required. The model is based on a multiplicity of criteria, which prevents any one criterion from being singled out as the guiding principle for determining origin. In part, this multiplicity reflects the high degree of detail and selectivity contained in the new generation FTAs. The NAFTA model often offers a variety of alternate rules for determining a good's origin, without each rule necessarily being based on a single qualification criterion. NAFTA and new-generation regimes tend to use net cost and transaction value as a method of calculating regional or national content. Estimating the value of regional content using the net cost method requires detailed records of, and information on, merchandise promotion and sales costs. *De minimis* clauses are foreseen to facilitate the regional integration of production processes by allowing the cumulation of regional components in calculating regional content values and streamlining the origin certification process by enabling exporting companies to issue their own certificates. In addition, enforcement provisions such as verification, control and sanction procedures with greater detail and precision are foreseen.

In terms of restrictiveness the *ex ante* degree of restrictiveness of the NAFTA RoO regime is on average higher than that of the EU, except in a few sectors such as live animals, vegetable products, electrical equipment and optics,[3] but both models are significantly more restrictive (*ex ante*) than first-generation RoO (LAIA, Indian Ocean model, see below) both on average and at the sectoral level.

The NAFTA model is, however, not representative for RoO regimes on the American continent. Taking pre-existing preferential trade arrangements into account, the Americas show quite some diversity. At the other extreme of the spectrum of rules the LAIA, Andean Community, Mercosur and CACM regimes show much lower levels of *ex ante* restrictiveness than the NAFTA regime.[4] They are generally characterised by the use of the CTC (generally applied across the board at HS four-digit level) or, alternatively, a given level of regional content. Only in some exceptional cases is a combination of criteria used for specific lists of goods. In these RTAs, when the choice of more than one rule to classify a good is foreseen, it is applied in a uniform way and each rule is based on a single qualification criterion. LAIA, Mercosur and the Andean Community require the use of the FOB or CIF transaction value of the merchandise to be used as a method of calculating its regional or national content. In this respect, the CACM regime stands midway between the two extremes of the spectrum in the sense that it uses two methods to determine regional content: transaction value, defined in accordance with the WTO's Customs Valuation Code, and normal price, calculated from the FOB price of the exported goods and the CIF price of third-country components.[5] This diversity of rules in the Americas has obvious implications for both intra-regional integration processes and inter-regional agreements and negotiations such as those with the EU.

The RoO regimes of the preferential trade areas in the rest of the world include ASEAN, ANZCERTA, SAFTA, ECOWAS, COMESA, SADC and the Namibia-

[2] L. J. Garay, P. De Lombaerde: Preferential Rules of Origin: Models and Levels of Rulemaking, op. cit.

[3] A. Estevadeordal, K. Suominen: Rules of Origin in the World Trading System, op. cit.; A. Estevadeordal, K. Suominen: Rules of Origin: A World Map, op. cit.

[4] A. Estevadeordal, K. Suominen: Rules of Origin in the World Trading System, op. cit., p. 35.

[5] L. J. Garay, R. Cornejo: Rules of Origin in Free Trade Agreements in the Americas, op. cit.

Zimbabwe FTA. These regimes are characterised by relatively simple rules, applied across the board. Usually a value content criterion is used, sometimes the CTH criterion. The maximum import content varies from 30 to 70%; the value content rule from 25 to 35%.[6] Because of their similarity and the fact that they refer to RTAs involving countries bordering on the Indian Ocean, rather than because of any institutional connections, these regimes have been referred to as the Indian Ocean model.[7]

The systematic mapping of RoO has also shed light on the dynamics of RoO regimes, their extra-regional expansion and influence. Two transmission mechanisms seem at work. The first channel, which is usually focused on, is "direct transmission", whereby the promoters of rules in RTAs (EU, USA) apply the agreed rules to agreements with third countries. The USA/NAFTA model has expanded southwards on the American continent due to its application in US FTAs and the use of the NAFTA-type rules in "new generation" agreements between other countries, including Mexico, although at the same time a tendency can be observed to simplify the new generation regime by reducing the cases subject to alternative rules, stressing the CTC as a predominant qualification criterion and reducing the degree of *ex ante* restrictiveness in relation to the NAFTA original origin regime. This use of the NAFTA model would have been further reinforced if the FTAA had succeeded. A similar tendency can be observed for the case of those FTAs that the USA negotiated with countries of other continents like Australia and Singapore. In contrast to the EU, the USA seems to have shown more flexibility regarding RoO, especially in the framework of extra-regional agreements. The US-Jordan and US-Israel FTAs, for example, rely basically on the value content rule.[8] The agreement with Israel therefore shows levels of restrictiveness significantly below the NAFTA level and resembles more the Indian Ocean model in terms of restrictiveness. The US-Singapore and Chile-Korea FTAs show more complexity. At the same time, the EU origin regime is finding application in FTAs concluded between the EU and countries such as Mexico and Chile, as well as countries elsewhere that negotiate FTAs with the EU.[9] Further expansion of these dominant models can be expected with the negotiation and conclusion of new agreements by the EU (Economic Partnership Agreements (EPAs) with the African Caribbean and Pacific (ACP) states, EU-Mercosur, EU-Central America, Gulf Cooperation Council (GCC)) and the USA (SACU and bilaterals with Thailand, Colombia, Peru, Ecuador, Panama …) The level of restrictiveness of the RoO contained in these agreements has already been signalled as one of the major determinants of the development effectiveness of these agreements.[10]

The second channel, "indirect transmission", concerns cases where sub-hubs (Mexico, EFTA, South Africa …) introduce rules similar to those contained in their agreements with the hubs in agreements with third countries. This was the case, for example, in the EFTA-Mexico and EFTA-Singapore agreements (although the latter is slightly less restrictive). The SADC case probably also falls into this category, as a case where a less restrictive regime undergoes the influence of the development of more complex (and restrictive) regimes such as those of the EU and/or USA/NAFTA. SADC rules initially consisted of a CTH, a minimum regional value content of 35%, or a maximum import content of 60% of total inputs. However, they were revised and now include more restrictive content requirements, and technical requirements have also been added.[11] The revision shows the influence of the rules embedded in the EU-South Africa agreement and the EU-ACP trade preferences.[12]

Qualitative Assessments and "Guesstimates"

A second category of empirical work on RoO concerns qualitative assessments and "guesstimates" of their costs and effects. These studies have shown evidence on administration costs of between 1.5 and 6% of export value, which are significant figures, taking into account that the total cost of RoO also includes the trade distortion effect. Prior to the efforts to harmonise European RoO the existence of divergent rules implied a major cost for the companies involved in international trade with the EU. This was especially the case for RoO in the Europe Agreements, which were regarded as quite restrictive.[13] The (small) CEECs depended heavily on imported inputs, so that the rules were often difficult to meet and the possibilities for cumulation were limited (within the Visegrad or Baltic countries).

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[6] A. Estevadeordal, K. Suominen: Rules of Origin in the World Trading System, op. cit., Table 6.

[7] L. J. Garay, P. De Lombaerde: Preferential Rules of Origin: Models and Levels of Rulemaking, op. cit.

[8] E. Moïsé: Rules of Origin, in: Regionalism and the Multilateral Trading System, OECD, Paris 2003, pp. 159-169.

[9] P. De Lombaerde: The EU-Mexico Free Trade Agreement: Strategic and Regulatory Issues, in: Journal of European Studies, Vol. 11, No. 1, 2003, pp. 100-118.

[10] World Bank: Trade, Regionalism and Development. Global Economic Prospects 2005, Washington 2005, p. 32.

[11] F. Flatters: SADC Rules of Origin: Undermining Regional Free Trade, Paper prepared for TIPS Forum, Johannesburg, 9-11 September 2002.

[12] M. Schiff, L. A. Winters: Regional Integration and Development, The World Bank, Washington, DC 2003, p. 8.

[13] B. Driessen, F. Graafsma: The EC's Wonderland: An Overview of the Pan-European Harmonised Origin Protocols, in: Journal of World Trade, Vol. 33, No. 4, 1999, pp. 19-45, here pp. 20-21.

The direct costs of administering the origin certification in the EC-EFTA FTA were found to be considerable. According to Koskinen,[14] these costs amounted to 1.4 to 5.7% of export value; according to Herin[15] they were between 3 and 5% of FOB export value. The move towards harmonisation clearly had a positive effect in terms of transparency and the possibilities of cumulating. Indeed, one of the outstanding features of the EU model is its high level of standardisation and harmonisation across the multiple FTAs signed since 1997, and the remarkable similarity and continuity since the first protocol published in 1973. Although it is recognised that significant progress has been made in terms of internal logic and sourcing opportunities compared to the pre-existing protocols, Driessen and Graafsma evaluate the EU RoO system as still complex. According to these authors, considerable trade deflection was likely in different production sectors given the origin criteria and the drawback prohibitions in trade with the CEECs.[16] The costs of administering the origin certificates in NAFTA have been estimated at around 1.8% of export value and the trade distortion effect of the RoO as equivalent to an average tariff at around 4.3%.[17]

In addition to these guesstimates, specific cases such as textiles and fisheries have been described in detail.[18]

Statistical and Econometric Work

The third category of empirical work are statistical and econometric studies. These studies can again be sub-divided into three sub-categories. The first sub-category focuses on the following relationships:

- relationships between degrees of restrictiveness and margins of preference (-)
- relationships between degrees of restrictiveness and the pace of tariff reductions (-)
- relationships between degrees of restrictiveness and extra-regional tariff protection (+).

These studies complement the previously mentioned case-studies and often confirm the use of RoO for protectionist purposes; they clearly show the linkages between RoO and the issue of market access. Estevadeordal and Suominen[19] have shown, for example, that the degree of restrictiveness of the EU RoO appears to be quite closely correlated with the pace of tariff reduction: the faster the tariff liberalisation schedule, *ceteris paribus*, the less restrictive the RoO. In other words the more restrictive rules are applied to products that previously benefited from higher levels of tariffs. Furthermore, the EU tends to eliminate tariffs faster for tariff lines in which the competitiveness of the EU's partner country is lower and/or its distance and transport costs for shipping to the EU are higher. This is the case for Chile, which obtained the fastest phase-out of tariffs among the latest extra-European FTAs (South Africa, Mexico and Chile). The NAFTA case also shows a correlation between the degree of *ex ante* restrictiveness of the rules and the tariff level applied to third countries.[20] For example, for nearly 80% of the tariff universe, the NAFTA RoO seeks to preserve, at least partially, the level of US protection against foreign competition by imposing more restrictive origin requirements on imports from Mexico when the US tariff applied to third parties is higher. In addition, there appears to be an inverse relationship between the degree of restrictiveness of the NAFTA RoO and the margin of preference that the US concedes to Mexico, but specifically for those items for which the Mexican tariff level is higher than the US tariff level to third countries.

The second sub-category focuses on the relationships between the restrictiveness of RoO and the under-utilisation of trade preferences, on the one hand, and on the relationships between the multiplicity of RoO and the under-utilisation of trade preferences, on the other hand.[21] The cost of under-utilisation is thereby measured in terms of trade flows or in terms of rent transfers to exporters. Restrictive RoO have been linked, for example, to the under-utilisation of EU preferences, thus working against the development aims of some of the EU preference schemes.[22] Only about

[14] M. Koskinen: Excess Documentation Costs as a Non-Tariff Measure: An Empirical Analysis of the Effects of Documentation Costs, Working Paper, Swedish School of Economics and Business Administration 1983.

[15] J. Herin: Rules of Origin and Differences between Tariff Levels in EFTA and in the EC, EFTA Occasional Paper, No. 13, 1986.

[16] B. Driessen, F. Graafsma: The EC's Wonderland: An Overview of the Pan-European Harmonised Origin Protocols, op. cit., pp. 37-39.

[17] World Bank: Trade, Regionalism and Development. Global Economic Prospects 2005, op. cit., p. 70.

[18] For a recent assessment of RoO within preferential trade agreements with Africa, see P. Brenton, T. Ikezuki: The Value of Trade Preferences for Africa, Trade Note 21, International Trade Department, The World Bank, Washington, DC 2005.

[19] A. Estevadeordal, K. Suominen: Rules of Origin in Europe and in the Americas: Issues and Implications for the EU-Mercosur Inter-Regional Association Agreement, op. cit.

[20] L. J. Garay, L. F. Quintero: Characterization and structure of the rules of origin of the G-3, NAFTA and ALADI: Their relevance to the case of Colombia, op. cit.; L. J. Garay: El papel de las normas de origen en los acuerdos de libre comercio en el hemisferio americano, op. cit.

[21] O. Cadot, J. de Melo, A. Estevadeordal, A. Suwa-Eisenmann, B. Tumurchudur: Assessing the Effect of NAFTA's Rules of Origin, mimeo 2002.

[22] World Bank: Trade, Regionalism and Development. Global Economic Prospects 2005, op. cit., p. 52.

50-55% of EU imports from countries with which the EU has a preference agreement actually benefit from the preference.[23] Candau et al.[24] found that, in general, under-utilisation of preferences did not constitute an important protectionist barrier for non-EU exporters. They did find, however, that the utilisation is generally correlated with the tariff margins, suggesting that compliance costs are significant. They also found exceptionally low utilisation rates for textiles and clothing under the EU General System of Preferences (GSP) and Everything But Arms (EBA) schemes, and identify restrictive rules as the main causes of this. Brenton and Ikezuki[25] also confirmed that the low preference utilisation rates by the commercial partners of the EU in textiles can be linked to the restrictiveness of the RoO. With respect to the Africa Growth and Opportunities Act (AGOA), signed in 2000, Mattoo et al.[26] and Walmsley and Rivera[27] found that the medium-term effects of US trade preferences would be much more important without restrictive conditions on market access and that RoO are the most important category of these restrictions. Clothing again appears to be a particularly problematical sector.

More recent evidence seems to confirm the potential positive effect of less restrictive rules on trade in the Middle East and North Africa region.[28] Cadot et al.[29] simulate the potential negative trade effect of adopting EU or US style RoO for the ASEAN FTA.[30]

A third sub-category of econometric studies deals with the trade effect of cumulation provisions. Using gravity models, Gasiorek et al.[31] estimated that the absence of diagonal cumulation reduces bilateral trade volumes by 40-45%. A CGE analysis showed that RoO cumulation in the EU can be expected to lead to positive effects on intra-regional trade, output levels (+2 to 3%) and welfare (+ 0.5%). Estevadeordal and Suominen[32] also demonstrated that cumulation has a significant impact on intra-regional trade. Recent evidence on the effects of cumulation in ASEAN and ASEAN-China FTA includes Kuroiwa's work.[33]

Pro-development Policy Options

Moving now to the formulation of policy options, it seems that although clear policy prescriptions are lacking for both theoretical and operational reasons, a consensus is growing on the need for less restrictive RoO for developing countries. The arguments that are thereby used usually refer to the scale and development level of these countries and to the re-structuring of the globalised production processes characterised by trans-border production chains.

The theoretical reasons for the lack of clear policy prescriptions are linked to the ambiguous results of the theoretical models (which are very sensitive to sector specificities), the possibility of optimal non-zero content requirements (i.e. FTA with RoO producing a net positive welfare effect), and the problem of identifying the right benchmark (a sub-optimal Common External Tariff?)[34] The operational reasons are linked to the existence of imperfect political markets and the inherent complexity of the RoO issue.

When exploring the policy options that might increase the gains for developing countries of their further insertion into the global and regional economies, one can distinguish between general (strategic) policy options and specific options related to the substance of the provisions.

General (Strategic) Policy Options

The work programme on non-preferential rules has been undertaken by the Committee on Rules of Origin and a Technical Committee on Rules of Origin, under the auspices of the Customs Co-operation Council (CCC), but little progress has been made and dead-

[23] European Commission: Green Paper on the Future of Rules of Origin in Preferential Trade Arrangements, Brussels 2003, COM(2003)787final.

[24] F. Candau, L. Fontagne, S. Jean: The Utilisation Rate of Preferences in the EU, Paper presented at the 7th Global Economic Analysis Conference, Washington, DC, 17-19 June 2004.

[25] P. Brenton, T. Ikezuki: The Value of Trade Preferences for Africa, Working Paper, International Trade Department, The World Bank, Washington, DC 2004.

[26] A. Mattoo, D. Roy, A. Subramanian: The Africa Growth and Opportunity Act and Its Rules of Origin: Generosity Undermined?, IMF Working Paper (WP/02/158), Washington DC 2002.

[27] T. L. Walmsley, S. A. Rivera: The Impact of ROO on Africa's Textiles and Clothing Trade under AGOA, Paper prepared for the 7th Annual Conference on Global Economic Analysis, Washington, DC, 17-19 June 2004.

[28] A. Dennis: The Impact of Regional Trade Agreements and Trade Facilitation in the Middle East and North Africa Region, World Bank Policy Research Working Paper No. 3837, 2006.

[29] O. Cadot, J. de Melo, A. Portugal-Pérez: Rules of Origin for Preferential Trading Arrangements. Implications for the ASEAN Free Trade Area of EU and US Experience, World Bank Policy Research Working Paper No. 4016, Washington, DC 2006.

[30] Cf. also D. Medvedev: Preferential Trade Agreements and Their Role in World Trade, World Bank Policy Research Working Paper No. 4038, Washington, DC 2006.

[31] M. Gasiorek et al.: Study on the Economic Impact of Extending the Pan-European System of Cumulation of Origin to the Mediterranean Partners' part of the Barcelona Process, DG Trade, European Commission, Brussels 2002.

[32] A. Estevadeordal, K. Suominen: Rules of Origin in Europe and in the Americas: Issues and Implications for the EU-Mercosur Inter-Regional Association Agreement, op. cit.

[33] I. Kuroiwa: Rules of Origin and Local Content in East Asia, IDE Discussion Paper No. 78, Tokyo 2006.

[34] P. De Lombaerde, L. J. Garay: Preferential Rules of Origin: EU and NAFTA Regulatory Models and the WTO, op. cit.

lines missed, due in no small part to a failure to agree on how to treat sensitive sectors such as agriculture, textiles and clothing.[35] A new work programme was agreed in July 1998 and focused on problematical areas, including: the analysis of the implications of the harmonised RoO on other WTO agreements, discussion on product-specific rules, outstanding issues on product-specific rules, definitions etc. The harmonisation work programme has been criticised on the grounds that a lack of human and technical capacity means that developing countries are not fully represented, with the result that their interests are not fully taken into account in the rulemaking process.[36] The new deadline in force for the Committee is December 2007. Ninety-three "core issues" were forwarded to the General Council in 2002; for these issues July 2007 was the deadline.[37] In recent meetings, the Committee on RoO also discussed preferential RoO and explored the possibilities of expanding the IDB mapping exercise towards incorporating all rules.[38] A convergence between the harmonisation process of non-preferential rules and a new initiative on regulating preferential rules is a possible scenario. This could lead to a multilateral agreement within the WTO on a common methodology for non-preferential and preferential RoO, as proposed by Garay and Estevadeordal.[39] Others like Schiff and Winters[40] and Estevadeordal and Suominen[41] have also called for harmonised RoO based on non-preferential rules. An alternative, but also workable scenario, would be to develop a new initiative on preferential RoO under the Committee on Regional Trade Agreements.[42]

One issue which deserves to be explored is what the costs and benefits would be of a more ambitious and comprehensive effort to link the discussion on the origin of goods to the issue of origin in other areas of multilateral rulemaking such as services, trademarks, origin marking, anti-dumping, SPS etc.

Different scenarios lie open; the question is who will be the driving force(s) behind such an initiative to regulate preferential RoO. An interest driven multilateralisation process, as in the pan-Euro case,[43] can probably not be repeated on the global scale, although changes in the political-economy of RoO and in the attitudes of business interests in the economic centres (EU, USA) should not necessarily be excluded. The European Commission has recently done interesting work on rules and has presented some proposals,[44] but the process probably requires the pro-active involvement of the WTO and/or UNCTAD. This being said, the *de facto* proximity of the EU and NAFTA regimes should provide opportunities for convergence, and political-economy forces might well contribute in that direction. The role of the WTO and/or UNCTAD could be to provide independent information and analyses of RoO regimes and their effects, and to provide a negotiation platform. If working towards (harmonised) compulsary rules (with or without exclusion lists) turns out not to be feasible, the drafting of voluntary rules, to which RTA partners can adhere in the future, could be envisaged. The WTO could present best practices for this purpose and they could work in a similar way to the models for bilateral investment treaties (BITs) that are emerging.

Specific Policy Options

Specific policy options refer to the substance of the rules provisions in RTA agreements. The aim of new regulatory initiatives should be to enhance the transparency of the rules and reduce the protectionist use that is made of them. This requires less restrictive and ambiguous origin criteria and restrictions on the selectivity and multiplicity of rules.

In academic and policy circles in developing countries the change of tariff classification at the HS four-digit level (CTH) emerges as the preferred rule, for its simplicity and transparency.[45] However, the construction of a consensus on this rule as a sort of rule-of-reference has been complicated by the Communication of the European Commission of March 2005 where a (sector specific) value added criterion, based on minimum local content as a percentage of net production cost, is put forward as the

[35] M. Schiff, L. A. Winters: Regional Integration and Development, op. cit., p. 31.

[36] B. Lal Das: WTO: The Doha Agenda. The New Negotiations on World Trade, London 2003, Zed Books.

[37] WTO: Report of the Committee on Rules of Origin to the Council for Trade in Goods, (G/L/790), Geneva 2006.

[38] WTO: Minutes of the Meeting of 19 October 2006, Committee on Rules of Origin, (G/RO/M/48), Geneva 2006.

[39] L. J. Garay, A. Estevadeordal: Protección, desgravación preferencial y normas de origen en las Américas, op. cit.

[40] M. Schiff, L. A. Winters: Regional Integration and Development, op. cit.

[41] A. Estevadeordal, K. Suominen: Rules of Origin in Europe and in the Americas: Issues and Implications for the EU-Mercosur Inter-Regional Association Agreement, op. cit.

[42] Linked, for example, to the work on a Transparency Mechanism for RTAs. See WTO: Report by the Chairman to the Trade Negotiations Committee, Negotiating Group on Rules, (TN/RL/18), Geneva 2006.

[43] R. E. Baldwin: Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade, in: The World Economy, Vol. 29, No. 11, 2006, pp. 1451-1518.

[44] European Commission: Green Paper. The Future of Rules of Origin in Preferential Trade Arrangements. A Summary Report of the Results of the Consultation Process, Brussels 2004.

[45] Cf. also J. P. Simpson: Inside NAFTA, Vol. 4, No. 6, March 2007, for a similar proposal in the context of the FTAA.

preferred rule.[46] As is well-known, the use of value criteria in low-income countries is particularly problematical because of their sensitivity to exchange-rate variations, the perverse effect on the search for sourcing efficiency and the perverse effect of local production efficiencies and low wages. Furthermore, estimating the value of regional content using the net cost method, as in NAFTA and new-generation regimes, requires detailed records of, and information on, merchandise promotion and sales costs. Using the FOB or CIF transaction values of the merchandise as a calculation method for regional or national content is more appropriate as these values are well-known, and they require neither the exporter nor the customs authorities to keep special records or employ additional controls. As also suggested by tralac,[47] replacing the (minimum) value added criterion by a (maximum) foreign content criterion is also an option.

The use of more transparent and uniform rules could be combined with a sort of expanded *de minimis* rule, referring to the non-application of RoO below a certain tariff level, following Wonnacott.[48] This rule could even be agreed upon before any harmonisation of preferential RoO takes place.

Development-friendly rules should promote (diagonal, regional or full) cumulation and include roll-up clauses, with a double objective: to reduce the *ex ante* restrictiveness of rules and to support regional integration processes. The latter is already part of the EU philosophy behind cumulation clauses in its trade agreements with ASEAN, the Andean Community and SAARC, and in its GSP. It should be explored whether differential treatment should be considered in this respect and to what extent extra-regional cumulation should be foreseen (in order to stimulate South-South trade), going further than the EU position of restricting cumulation to "coherent regional groups".[49] The recent proposal from ACP circles to extend cumulation, in its trade arrangements with the EU, to the whole ACP "area" might be an interesting test case.

Finally, as far as the streamlining of certification processes and the drafting of enforcement provisions (verification, control, sanctions) are concerned, a (delicate) balance should be struck between administration costs (for both public and private agents), on the one hand, and the expected gains in terms of the effective implementation of rules. A package of capacity building and the development of information systems might also help to improve the conditions for compliance with the rules and provisions in developing countries, although the potential and reach of these packages should not be over-estimated.

Conclusions

Recent years have left us with more sophisticated tools for assessing the proliferation of preferential RoOs. In turn, these have made new statistical and econometric work possible, showing the existence of transaction costs related to their complexity and their protectionist use at the cost of developing countries.

Hence, developing countries have an interest in more transparent and less restrictive preferential rules.

At the general/strategic level a number of options are open. The linkage or convergence between the work on the harmonisation of non-preferential rules and the discussion on preferential rules seems necessary. The value added of initiating a broader (horizontal) reflection on origin concepts in different areas should be explored. If new compulsory rules are not a realistic option, voluntary rules or principles might be an option. Finally, the political economy of RoO should be looked at in more detail, in order to develop realistic expectations as to the role of different players in promoting this agenda. The role of the EU is somewhat ambiguous to the extent that although the Commission initiated an interesting discussion on preferential RoO, the European position also reflects European business interests. An initiative by the WTO and/or UNCTAD would be welcomed.

As far as the reduction of the multiplicity of rules is concerned, the change of tariff classification seems to qualify as a consensus rule of reference, although the recent European Commission document (favouring value added rules) seems to have added some complication to this debate.

Another issue is the promotion of cumulation provisions. It remains to be seen how far North-South agreements can go to benefit the Southern partners and stimulate South-South trade.

Finally, further work is needed on a series of related provisions. The challenge here is to strike the right balance between administration costs and effective implementation of the rules.

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[46] European Commission: Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: The Rules of Origin in Preferential Trade Arrangements. Orientations for the Future, 2005, COM(2005) 100 final, Brussels 2005, p. 9.

[47] E. Naumann: Rules of Origin Under EPAs: Key Issues and New Directions, tralac Working Paper No. 9, 2005.

[48] R. Wonnacott: Free Trade Agreements: For Better or Worse?, in: American Economic Review, Vol. 86, No. 2, 1996, pp. 62-66. The current *de minimis* rules are between 10-15 per cent in the EU FTAs and 7 per cent in NAFTA. See also A. Estevadeordal, K. Suominen: Rules of Origin in the World Trading System, op. cit.; L. J. Garay, P. De Lombaerde: Preferential Rules of Origin: Models and Levels of Rulemaking, op. cit.

[49] European Commission: Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: The Rules of Origin in Preferential Trade Arrangements. Orientations for the Future, op. cit., p. 10.