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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

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EXECUTIVE SUMMARY

- From the replies to the consultation process launched by the Green paper of the Commission on the future of rules of origin in preferential trade arrangements, there are specific expectations with regard to these arrangements and rules concerning both their objectives and their formal presentation.

- Those expectations – often contradictory - have to be matched with international commitments and orientations already submitted by the Commission, in particular the recent Communications on the future of textiles and the new scheme for the Generalised System of Preferences (GSP).

- In the context of the Doha Agenda for Development, ensuring a better integration of developing countries into the world economy, in particular though improved access to the markets of developed countries remains the top priority of Community trade relations and shall inspire the revision of its preferential rules of origin. That implies the necessary changes to the substance of the rules and conditions should be accompanied by an adaptation of the procedures for their management and control, in order to make sure that the preferences actually benefit those who need them.

- Against this background, actions should be taken in three areas:

<u>A revision of the conditions for a product to be considered as originating in a country</u>

To make rules simpler and, where appropriate, more development-friendly, the Commission would support:

– a simplification of the concepts and methods used for the purpose of determining origin, including the wording of the corresponding provisions; such simplification should improve clarity, aid comprehension of the rules and support their application and enforcement; the impact of such a simplification should be fully assessed to ensure that the overall objectives are met and, if not, the Commission will adopt a different approach.

– an adjustment of the conditions imposed on production processes to confer originating status, insofar as development policy and developing countries are concerned, with a view to guaranteeing easier access to the Community market through preferential tariff treatment corresponding to the real production and export capacity of the beneficiary countries, in particular for the least developed and smallest countries;

– an additional relaxation of the conditions to apply cumulation of origin within coherent regional groupings, subject to appropriate mechanisms in place for administrative co-operation between the partners to cumulation.

A change in the customs procedures necessary for the proper implementation and the control of the use of the preferences by the economic operators:

In order to better-balance the responsibilities between economic operators and public authorities and to protect the legitimate interests at stake, the Commission would favour a system based on the following components:

- the establishment of the originating status by the exporters themselves, subject to prior registration by the authorities of the exporting country based on pre-established common standards;
- an improvement in the exchange of information between the exporters and the authorities of the exporting countries on the use of the preferential arrangement and the reinforcement of controls by these authorities on the exporters, which we can rely on;
- a clarification of the basic rights and obligations of the importers claiming preferential treatment on the basis of statements on origin made out by their foreign suppliers;
- the inclusion of special clauses on compliance with origin requirements in commercial transactions between exporters and importers, including the possibility to transmit proofs of origin by electronic means;
- the reinforcement of the exchange of information and administrative co-operation between the authorities of the exporting and importing countries when verifying origin, based on clear obligations and procedures.

The development of instruments ensuring that the beneficiary countries comply with their obligations:

To ensure compliance from public authorities with their obligation to properly apply the arrangements and the rules of origin and to fully co-operate in preventing and fighting against abuses, the following actions are proposed:

- technical assistance to beneficiary countries (mainly the least developed and smallest countries), which need support with regard to the correct application of preferential arrangements in order to maximise their benefits;
- a targeted monitoring of the functioning of preferential arrangements based on an action plan;
- the appropriate use of precautionary measures and safeguard mechanisms in the event of insufficient control or the failure to provide co-operation.

- The revision of the rules of origin along these lines will constitute an important component for new GSP scheme.
- This new approach to the rules of origin and administrative co-operation should shortly also be proposed, as a matter of priority, for the Economic Partnership Agreements (EPAs) being negotiated with six regional groups of African-Caribbean-Pacific (ACP) countries, in full respect of the current benefit of the Cotonou Agreement. It could then progressively be extended to existing Free Trade Agreements. This would support a sufficient level of

harmonisation of the rules in the framework of a given set of preferential arrangements with a regional coherence, including the grouping into a single framework (a regional convention, for instance) of rules which are common to a given region.

- In proposing new arrangements to trade partners, the Commission will seek to ensure that matters which have already been settled in on-going negotiations are not put into question, and to approach new negotiations in a constructive and open spirit.

INTRODUCTION

Objectives of this communication

- Rules of origin are an essential component of Community trade policy, especially where tariff preferences have to be granted to products only originating in given countries or groups of countries. Therefore, they must be consistent with the overall objective of those preferences of strengthening economic integration between the partners and in particular of facilitating the full insertion of developing countries into the world economy and supporting their economic and social development.

- Such rules should reflect the nature and the importance of the link that should exist between the products and the country concerned, in particular the level of processing on external inputs in a particular country, required for the products obtained to be considered as originating in that country. Customs procedures shall be established in order to show and check that these requirements have actually been fulfilled. The current situation, which combines, in a number of cases, complex rules with weaknesses in their enforcement, is not satisfactory.

- This communication aims at providing general orientations on the basic principles that the Commission intends to follow in improving rules of origin in the various Free Trade Agreements and autonomous preferential arrangements.

- Such an improvement will consist in simplifying and appropriately relaxing the concept of origin, tightening the related procedures and developing the tools needed to ensure compliance. For each of these three aspects, the Commission intends to promote transparency and to adjust the rules to the objectives of the arrangements.

- The need for such changes has been highlighted, in particular, in the context of the preparation of the new Generalised System of Preferences (GSP) for the period 2006-2015[1], the opening of the negotiations on the new regional Economic Partnership Agreements (EPAs) with the African-Caribbean-Pacific (ACP) countries, and the reflection on the future of the textile sector[2].

- According to its Communication "Developing countries, international trade and sustainable development: the function of the Community's generalised system of preferences (GSP) for the ten-year period from 2006 to 2015", the Commission intends to target GSP "*on the countries that most need it and must encourage regional cooperation between developing countries by various means. The GSP should assist these countries to attain a level of competitiveness which could make them self-supporting economically and full partners in international trade.*"

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1 Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee - COM(2004) 461, 7.7.2004.

2 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on the future of the textiles and clothing sector in the enlarged European Union – COM(2003) 649, 29.10.2003.

- In order to support this objective, the GSP will therefore provide the first opportunity to apply these general guidelines for improving rules of origin, subject to fine-tuning the details of their implementation. This will be done through amendments to the provisions laid down in the implementing provisions o the Community customs code[3].

Green paper on the future of rules of origin in preferential trade arrangements

- In the context of international trade liberalisation, the Commission has adopted a Green Paper[4] which provided:

– an overall assessment of the current problems of origin in preferential arrangements;

– a focus on aspects which require a consistent approach to bring them under control;

– an overview of the options available, particularly with regard to the systems for certification, declaration and control of the originating status of products and ways of refocusing the current system of administrative cooperation.

Results of the consultation process

- The consultation process on the Green paper ran from January 2004 until 15 March 2004 and involved international traders and competent authorities of the Member States, acceding and candidate countries and countries taking part in various preferential arrangements with the European Union.

- The Commission produced in September 2004 a summary report of the results of the consultation process, whose main objective was to give a clear view and summary of the opinions and comments made by the contributors.

- Having in mind the need to balance the various interests at stake, the contributions received represented a valuable source of material for the Commission in the preparation of this communication.

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3 Commission Regulation (EEC) No 2454/93 of 2 July 1993 (OJ L 253, 11.10.1993), last amended by the Act of Accession (OJ L 236, 23.9.2003).

4 Green paper on the future of rules of origin in preferential trade arrangements - COM(2003) 787, 18.12.2003.

BASIC PRINCIPLES FOR A NEW APPROACH TO PREFERENTIAL ORIGIN

As emphasised in the Green paper, any improvement of preferential rules of origin implies a combination of appropriate provisions, meeting the objectives of the arrangements and the needs of stakeholders, efficient procedures, allocating in an optimal way responsibilities in managing and controlling origin and strict compliance with legal obligations and conditions through enforcement instruments[5]. The overall approach of a revision could be summed up as follows: 'appropriate rules, efficient procedures, secured environment'.

1. SIMPLER AND MORE DEVELOPMENT-FRIENDLY RULES: DETERMINATION OF PREFERENTIAL ORIGIN AND CUMULATION OF ORIGIN

- Subject to the main objectives of given arrangements (reciprocal enhanced market access, development of poor countries, security, regional co-operation and integration), differences in the definition of the preferential treatment and also in the conditions for a product to enjoy such preference will be kept as this is in line with the ultimate substitution of such arrangements with a multilateral approach.

- The Commission supports both a formal simplification of the concepts and methods used for the purpose of determining origin, including the rewording of the appropriate legal provisions and relaxation in substance, in particular where developing countries are concerned. Simplification should improve clarity, aid comprehension of the rules and support their application and enforcement and boost development impact within and between regional trade blocs. Relaxation should allow better market access.

- Depending on the context and the objectives of the preferential arrangement, such an adaptation of the rules of origin can be achieved, through:

– a revision of the basic rules imposed on products, in order to be considered as originating because they are 'wholly obtained' in a country or 'sufficiently processed' there from external inputs, and

– a revision of the conditions for the cumulation of origin between countries belonging to economically-integrated regional entities.

1.1. Basic rules for the determination of preferential origin

1.1.1. Wholly obtained fishery products

- Insofar as 'wholly obtained products' are concerned, the main aspect which needs improvement is the determination of the origin of fishery products through the 'nationality' of the vessel: some of the current criteria may have to be reviewed in the light of new

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[5] COM(2004) 461 on GSP, point 6.6: *"The rules of origin lay down the main criteria for access to preferences but they were drawn up at a time when the international economy was very different from that of today and when goods were produced in a very different way. In the light of recent consideration of this question (see the Green Paper referred to at point 6.3), the need for change is widely recognised: in form (simplification), in substance (amendment of the origin criteria and cumulation rules) and in procedures (formalities and controls)."*

developments in the fisheries sector. The Commission considers that the origin of the fish should be based on the flag, registration and simplified yet adequate conditions regarding property, the crew conditions being removed.

- Moreover, in the context of a system of cumulation of origin, those conditions may be fulfilled in any of the countries belonging to that system.

1.1.2. Sufficiently worked or processed products

- The basic origin rules in the relevant preferential arrangements should reflect both the production capacity of countries and processing operations with a real added-value in the country.

- For that purpose, the Commission favours using a method of evaluation of sufficient processing based on a 'value added test' as the starting point. Under this method, a product resulting from the working or processing of imported non-originating materials would be considered as originating if the value added in the country (or in a region in the event of cumulation), amounts at least to a certain threshold (a minimum 'Local or Regional Value Content'), expressed as a percentage of the net production cost of the final product.

- The importance of the input required, shown through the percentage of value added demanded, must be fixed on the basis of a sound economic analysis and according to the objectives of the arrangement and, when it does not thwart these objectives, to the required degree of trade liberalisation.

- The likely impact of the value added approach against the guiding principles of simplification and development friendliness should be carefully evaluated. That could be achieved through simulations on valuation and percentages carried out on representative samples based on real situations of developing countries, especially the poorest ones, thus allowing a comparison with the present situation. It is imperative that developing countries' current levels of access to the EC market should not be reduced by this new approach.

- The percentage of added value required should in particular be fixed so as not to exceed the production capabilities of developing countries while at the same time discouraging the transhipment of products coming from non-eligible countries and only virtual or minimal processing. In addition, it should not represent an obstacle to improving efficiency and competitiveness by reducing production costs.

- Different percentages could be fixed in different sectors for that purpose and under GSP specific thresholds could also be established, for Least Developed Countries benefiting from Everything But Arms.

- Moreover, in a number of sectors including agricultural, fishery or textiles products, moving to a new method for the determination of origin will represent a major change whose impact needs to be properly evaluated in advance. Should this evaluation demonstrate that the value added approach would not deliver the expected results in terms of development and simplification for certain sectors, the Commission will adopt another approach to better achieve these objectives. Moreover, the value-added criterion may, where appropriate to prevent possible misapplication or circumvention of preferences, be supplemented with additional conditions or criteria supporting actual development.

- Combining clarity, workability and flexibility in the establishment of percentages, this method would allow the level of processing on various products to be evaluated through a single unit of measurement and thus avoid inequitable treatment; it would also render superfluous the 'negative list' of insufficient operations and the use of tolerances in value.

1.2. Cumulation of origin as a component of regional integration

1.2.1. Scope for cumulation and conditions for its application and extension

- Cumulation should come into effect only within coherent regional groups or zones where:

– preferential trade and cumulation are part of an overall process of actual economic integration;

– cumulation is based on free trade agreements or results from autonomous arrangements;

– preferential treatment is granted to products according to the application of identical rules of origin

– a legal administrative framework has been developed in the countries involved and between them to administer and control, through appropriate administrative co-operation, the origin of products benefiting from cumulation.

The same conditions should apply to any extension of cumulation or to cumulation between different regions.

- With regard to reciprocal enhanced market access, there should be a focus on the regional (including a bloc-to-bloc as is the case under the Cotonou Agreement, whose benefits should be maintained) approach through cumulation of origin, without excluding the necessary adaptations in basic origin rules which are of mutual interest in terms of external sourcing and access to the respective markets of the parties.

- With regard to development, cumulation within coherent regional groupings would offer additional opportunities for developing countries, especially the least developed ones, to maximise the benefits resulting from a balanced relaxation of the basic rules.

- Currently, there are under GSP three regional groups corresponding to ASEAN, SAARC and a recent merger of Andean Community and Central America Common Market in a single group. The Commission is ready to examine any request for establishing new, merged or wider groups, insofar as economic complementarities exists, differences in preferential arrangements applicable to the various countries and the related risk of tariff circumvention are taken into consideration and the necessary structures and procedures for administrative co-operation for management and control of origin are put in place.

1.2.2. Regional conventions on origin

- Rules of origin common to a given group of trade partners associated in a cumulation zone should be laid down in a single international instrument, to which the various preferential agreements would refer.

- In the PanEuroMediterranean zone, such a single international instrument should take the form of a regional convention on origin between the trade partners. It should not only make

the management of origin easier but also contribute to enhancing the integration between the parties to various Free Trade Agreements through a single set of rules of origin allowing cumulation.

- The same approach should be favoured in order to support possible cumulation between other countries or regions subject to separate Free Trade Agreements.

1.2.3. Simplification and relaxation of conditions for cumulation

- For the sake of clarity and enforcement, juxtaposition of various forms of cumulation (bilateral, diagonal, full), involving the same countries in different preferential contexts, should be avoided.

- A progressive extension of full cumulation to the various preferential frameworks could be considered, insofar as traceability of the status of materials can be ensured. As far as possible and taking into account the various levels of preferences applied to the respective members of the group, full cumulation should entail putting in place a common origin for the group. Such requirements exclude however full cumulation in the context of GSP.

- With regard to GSP regional cumulation, it is proposed to replace the current double condition for the allocation of origin to a member country of a group (a more than insufficient operation and the highest value-added are required) by a single one, based on the same method (the value added test) as the one used to determine whether or not the processing on non-originating materials is sufficient. A product will be considered as originating in the country of the group where the final processing on materials originating in other countries of the same group has taken place, if the value added there is higher than a standard percentage.

- In order to support cumulation and regional integration, the percentage should in general be fixed at a level much lower than the one required for the same product where resulting from a processing of non-originating materials. However, to take into account specific situations in some sectors, for the same reasons as mentioned above, the cumulation value threshold may, where appropriate, be defined and/or supplemented with additional conditions or criteria, in order to prevent possible misapplication or circumvention of preferences.

2. EFFICIENT PROCEDURES: RESPONSIBILITIES OF ECONOMIC OPERATORS AND PUBLIC AUTHORITIES IN ESTABLISHING AND CONTROLLING PREFERENTIAL ORIGIN

- Whatever the specific objectives, preferential arrangements could not be properly reshaped simply through the revision of the legal conditions to be fulfilled in order to enjoy the preferential treatment. Such a revision shall be accompanied by setting up appropriate procedures, controls and methods of administrative co-operation between the competent authorities of the Parties to an arrangement, which ensure compliance with the conditions, prevent abuses and protect legitimate economic and financial interests at stake.

- This could be achieved through a breakdown of responsibilities between the economic operators, responsible for the determination and declarations concerning the origin of products, and the customs authorities, which shall perform the necessary audits and controls, relying on appropriate administrative capacity and mutual assistance. In such a

new context, 'proofs of origin' would be replaced by 'declarations' and 'statements' on origin, to be either accepted or challenged.

2.1. Declaration of the origin by the importer claiming the preference

- The importer bears responsibility with regard to the particulars of his customs declaration and the possible customs debt incurred from an incorrect declaration, without prejudice to the non-recovery of duties justified by 'active errors' of the competent authorities. Like other elements to take into account where declaring goods to customs, a wrong statement on the originating status of products for which preferences are claimed would be part of the commercial risk borne by the importer.

- The basic rights and obligations of the importers claiming preferential treatment on the basis of statements made out by their foreign suppliers should be clarified. That includes the definition of:

– the conditions under which the customs authorities of the importing country can question the origin declared and request additional evidences;

– the burden of the proof in the event where the customs authorities challenge the origin declared;

– the obligation for these authorities, in such an event and on importer's demand, to request a subsequent verification by the authorities of the exporting country;

– the situations where the customs authorities are entitled to refuse the preferential treatment, without prejudice to appeal procedures available to the importer.

- These procedural elements, valid at the time where a preference is claimed, should be adapted to the event of subsequent controls of customs declaration under which preferences have already been granted.

- In order to assist the importer in securing his declaration of origin, special clauses on compliance with origin requirements should be introduced in commercial transactions between exporters and importers, including the definition of responsibilities in the event of failures and the possibility to transmit statements of origin by electronic means.

2.2. Statement on the origin by the exporter

- There should be prior registration by the authorities of the exporting country based, in order to identify those exporters entitled to operate under a given preferential arrangement. Registration of exporters should require access to relevant financial records and accounts. Without weakening controls, it should also prevent discrimination against small operators.

- The originating status should be established and a statement on origin made out by the registered exporters themselves.

- The exporter should be in a position to prove the importer that he is registered in the country of export.

- The statements should make clear why the exported products can be considered as originating in the beneficiary country, using standard forms or – where in electronic format – *e*-documents or standardised messages. The completion of these formalities should be made easier thanks to a simplification of the rules.

- The flow of information on preferential exports between the exporters and the authorities of the exporting countries should be enhanced in order to support proper monitoring of the exporter's activity and pave the way for subsequent controls.

- The customs authorities of the exporting country would be obliged to maintain an up-to date list of their registered exporters and to sanction, by a temporary or definitive exclusion from the list, those exporters who do not comply with the rules. This list should be made available to the customs authorities of the importing country, using secured electronic means in order to preserve confidentiality and to prevent abuse.

2.3. Control of the origin of the products and of the economic operators by customs authorities – Administrative co-operation

- Control on preferential imports by the authorities of the importing country should also be improved and targeted through risk analysis in order not to hinder legitimate trade flows.

- Based on the status of registered exporter and the appropriate communication of information on the preferential exports, controls on the exporters by the authorities of the exporting country should be reinforced and targeted through risk analysis.

- The exchange of information and the administrative co-operation between the authorities of the exporting and of the importing countries, in charge of controlling preferential origin, should be based on clear obligations and procedures and reinforced from a legal and operational point of view.

3. SECURED ENVIRONMENT: ENFORCEMENT OF THE RULES BY THE COMPETENT AUTHORITIES

- In return for the correct application of the rules and obligations,, the economic operators should benefit from a secured environment in the execution of their commercial operations under preferential arrangements.

- To ensure compliance by public authorities with their obligation to properly apply the arrangements and the rules of origin and to fully co-operate in preventing and fighting against abuses, the following actions are proposed:

3.1. Creating the conditions for compliance

3.1.1. Prior evaluation of the capacity of the beneficiary country/group of countries to administer the arrangement and the related rules and procedures

- Such a prior evaluation concerns countries with which a new arrangement or an extension or revision of an existing one has to be put in place. Satisfactory results shall constitute a pre-condition for setting up the arrangement with the country concerned. With regard to

new preferential agreements, the evaluation shall be integral part of the negotiation process.

- The evaluation shall show that the country concerned has the organisation, the legal framework and the operational capacity to administer and control the functioning of the arrangement and to properly provide assistance and administrative co-operation.

- In the event of 'bloc-to-bloc' arrangements, the evaluation would focus on each region concerned, which would have to report on the capacity of the group and of each of its members to maintain their obligations resulting from the arrangement.

3.1.2. Information, training and technical assistance on preferential rules of origin

- Updated information and training about the preferential rules of origin, the conditions to fulfil, the opportunities offered and the obligations to be met are of the responsibility of the countries themselves. However, support to beneficiary countries can be provided from the regional level (when the country belongs to a regional group), from international level (WTO and WCO) and from Community level.

- The Commission has already put on the Europa Web site pages dedicated to rules of origin, where basic information, handbooks (on GSP and Pan European rules of origin) and links with legal texts are available. On the other hand the 'Expanded Exports Helpdesk' data base provides, by product heading, the rules of origin necessary which must be complied with in the context of a number of preferential arrangements .

- Insofar as technical support by the Community is concerned, it should mainly focus on those countries which need more assistance in the field of origin (LDCs and smallest countries and countries in political transition or reconstruction).

- To this end, technical assistance can be provided through the trade and customs components of existing programmes like MEDA, TACIS or CARDS, from the new instrument for the European Neighbourhood Policy or through instruments to be developed in the context of the new regional Economic Partnership Agreements with the ACP. A better co-ordination with the bilateral assistance provided by some Member States should however be ensured.

3.2. Monitoring compliance in partnership

3.2.1. Monitoring compliance by the public authorities to the obligations in the arrangements

- A proper functioning of the arrangements is of mutual interest to ensure fair trade between the Community and its trade partners. A proper monitoring of this functioning has therefore to be ensured in partnership.

- In order to keep an overview of the way the arrangements are working, a periodical reporting system by the beneficiary countries on their management and control of preferential origin should be foreseen in the arrangement concerned. A similar reporting should also be put in place from the Member States to the Commission in order to allow the Community to have an overview of the situation and to be in a position to report to its partners.

- A Commission action plan for the monitoring of preferential arrangements should be put in place, in co-ordination with the Member States. It should be based on gathering information regarding the use of preferential arrangements and the operation of procedures. This information should be directed to a central point to be analysed and processed in order to identify – possibly through an annual programme - those products and/or countries for which more in-depth monitoring appears necessary. This monitoring would be performed using contacts with the country concerned, questionnaires and, where necessary, monitoring visits in the country.

- Legal bases, technical modalities and funding of expenses involved in this monitoring exercise should be identified initially.

3.2.2. Ensuring compliance with the rules by economic operators – Fight against fraud and mutual assistance on fraud

- Anti-fraud action is mainly the responsibility of the competent authorities in the exporting and importing countries.

- However, joint actions are needed in a domain like preferential treatment and origin, where these authorities shall play complementary roles. To this end, mutual assistance in matters of fraud shall be fully used and an active contribution to Community investigations, from third countries benefiting from preferences, is expected.

3.3. Using safeguard mechanisms

- Precautionary measures and safeguard mechanisms shall be used as appropriate in the event of insufficient control or the failure to provide co-operation, including assistance in investigations against fraud.

- These measures include notices to importers, suspension of preferences where foreseen and possible financial responsibility of the failing country to be introduced.

- Preferential arrangements confer obligations on the official authorities regarding implementation and control of the fulfilment of the conditions for granting preferential treatment. Any non-observance by those authorities of their obligations is likely to involve their being financially responsible, whenever the non-observance of obligations by one of the parties impacts on the financial interests of the other party (loss of income from customs duties which cannot be recovered from the importer) and a causal link is established between the fault (or failure) and the resulting financial damage. Obviously, before introducing any external financial responsibility clause, the Commission and Member States should reach agreement regarding Member States' internal financial responsibility for their active errors.