

IMPACT ASSESSMENT ON RULES OF ORIGIN FOR THE GENERALISED SYSTEM OF PREFERENCES (GSP)

EXECUTIVE SUMMARY

Context: the future of the preferential rules of origin

In 2005 the Commission adopted a communication entitled "The rules of origin in preferential trade arrangements: Orientations for the future"¹. It favoured: (i) appropriate rules for the determination of origin; (ii) appropriate management and control procedures; and (iii) a secured environment for legitimate trade. It aimed to make the rules simpler and more development-friendly, while at the same time improving management and control procedures. It envisaged that GSP should be the first application and this impact assessment supports a proposal for the reform of GSP rules of origin.

The communication acknowledged that the use of a single method based on value added to determine origin needed further evaluation. This impact assessment provides this as well as an assessment of the impact of the other changes favoured by the communication.

The communication followed an earlier Green Paper. There have since been conferences with beneficiary countries representatives, consultations by the Commission services, plus, as part of the impact assessment, studies by outside consultants on the use of a value-added method. The Member States were regularly informed of developments and asked for their comments.

GSP and the purpose of rules of origin

GSP² grants reduced or zero import duty to products originating in 179 developing countries. It aims to facilitate their full insertion into the world economy, supporting their economic and social development through better access to the Community market and strengthening regional economic integration. It includes the "Everything But Arms" (EBA) arrangement, which grants duty- and quota-free access for almost all products originating in LDCs.

Rules of origin serve to ensure that the benefit of the tariff preferences goes to the intended beneficiaries and to prevent abuse. They consist of two parts: substance and procedures. "Substance" means the conditions for goods to be considered as originating in the beneficiary country. "Procedures" means the system of administrative cooperation for the management and control of origin.

Statistics show relatively low use rates by many LDCs. Many factors affect this, but one reason is that rules of origin may act as a barrier to trade, because they are complex and/or too stringent. Rules of origin do not affect all sectors or beneficiaries equally. The utilisation rates for agricultural and fishery goods are high but there is a problem in the industrial sectors. The sector with the lowest utilisation rates is the clothing industry.

Goods which are not "wholly obtained" in a beneficiary country must be "sufficiently worked or processed there. There are currently over 500 different list rules used.

¹ COM(2005) 100, 16.3.2005.

² Currently implemented by Council Regulation (EC) No. 980/2005 (OL L 169, 30.6.2005, p. 1).

The rules of origin should reflect the aims of GSP, i.e. development. They should be simple to understand and apply and permit real access to the preferences on offer. Rules of origin were drawn up in the 1970s. They were based on the need to protect Community industry and on the premise that beneficiary countries should be encouraged to build up their own industries. Today production is globalised, but rules of origin have not been adapted.

Preferential margins are much smaller than they used to be. When combined with high administrative and compliance costs, it is no longer worthwhile to use the preferences.

Cumulation is a facilitation of the normal rules, which allows the processing required to confer origin to be carried out in a group of countries instead of a single one.

Control procedures of rules of origin are both burdensome for operators and administrations and weak in terms of breakdown of responsibilities. The current system relies on certification by the authorities of the exporting country for every consignment. This gives the importer a false sense of security, since he assumes checks have been made when they have not. A series of ECJ judgements has led to a rising number of "good faith" claims by importers. Indeed, the latest³ implies that in most cases where there is no reply to a request for subsequent verification from the authorities in the Community, recovery of duties will be impossible. The financial burden falls instead on the Community taxpayer.

Objectives

The main objective is to contribute to promoting the sustainable economic development of beneficiary countries, particularly LDCs, by facilitating exports (including using cumulation) through appropriate rules of origin which are resistant to fraud. New rules should be simple in presentation and application with an appropriate administrative burden and costs.

Management and control could be improved by an appropriate division of responsibilities between exporters, importers and administrations. The compliance by the authorities of beneficiary countries with their obligations must also be ensured.

Policy options

Determining what is "sufficient working or processing"

There could be a single criterion, based on the value added in the beneficiary country concerned. A threshold of 60% would on average be equivalent to the current rules. For relaxation thresholds of 45% and 30% (for LDCs) could also be considered. Alternative or additional criteria might be required for certain sensitive sectors (agricultural and fisheries products, textiles and clothing). Other options are: maintain status quo; change of HS tariff heading or sub-heading; and improve the current rules on a product-by-product basis.

Conditions for vessels catching fisheries products outside the territorial waters

The criteria could be flag, registration and simplified conditions regarding ownership, with the crewing conditions being removed. Other options would be the status quo or to allow cumulation of the conditions.

³ Judgement of the Court of 9 March 2006 in case C-293/04 "Beemsterboer"

Cumulation of origin

The need for and the scope of it depend on the decision taken on sufficient working or processing. The stricter the normal rules, the greater the need for cumulation. Conversely, the more relaxed they are, the less cumulation may be relevant.

Management and control procedures

Statements on origin could be provided directly by exporters. To facilitate controls there could be a prior registration or approval requirement.

Compliance of the authorities with their obligations

This could be improved by the establishment of a systematic monitoring system along with the provision of appropriate information, training and technical assistance.

Impacts

For many products the preferences are not relevant, because they are subject to zero duty anyway, or because it is cancelled out by compliance costs. The products where rules of origin can make a difference are those where the preferential margin is larger. These are mainly the sensitive products on which developing countries tend to concentrate their efforts, namely agricultural and fisheries products, textiles and clothing.

The social impact is not just about the number of jobs, but also about wages and living and working conditions, which depend on the nature of the manufacturing operations involved. To be of real, long-term benefit the employment needs to be permanent.

There must always be an appropriate cost-benefit balance between the rules for determining of origin and the procedures necessary for their control. Too costly or too complex procedures may dissuade operators from using the preference, while administrations do not have limitless resources. If control is weak, that can lead to an increase in abuse or fraud.

Insofar as preferential tariff treatment results in economic development, it cannot but have an effect on the environment. However pollution would exist wherever an industry was located.

With regard to the sufficient processing of goods which are not wholly obtained, under Option 1 (status quo) the existing problems would remain. Countries which can already comply would continue to do so, but the others would in all probability never succeed.

As regards Option 2 (a single, across-the-board criterion, based on value added), the major indicator of success of reformed rules of origin is the utilisation rate of the preferences. The figures confirm that any change in rules of origin has a differentiated impact on different sectors of production. The effects are focused on the textile and clothing sectors. The trade creation effect in these sectors for GSP constitutes about half but for LDCs it accounts for nearly the whole effect. However the effect on industry in the Community should be minimal.

With respect to Option 3 (a single criterion, based on a change of HS tariff heading (CTH) or sub-heading (CTSH)), CTH (or CTSH) is simple, being already used for customs purposes. However, the HS was designed for the classification of goods and not for origin purposes. It would result in relaxation in some cases, but stricter rules in others. It would not be possible to tailor it to suit the needs of individual countries or groups of countries, such as LDCs.

Option 4 (adopt the current rules on a product-by-product basis) would be a piece-meal approach. Operators, who would have a familiar legal basis, but all the disadvantages of the current system would be perpetuated.

As regards the conditions for wholly obtained fisheries products, neither flag nor registration is sufficient on its own to indicate a genuine economic link. The ownership of a vessel is the factor most likely to do so. It is illogical to allow regional cumulation of origin for materials, while at the same time refusing the possibility for the conditions relating to fishing vessels.

With regard to cumulation of origin, the conditions for regional cumulation could be relaxed, but it cannot work unless there is a real will to cooperate on the part of the countries involved. Moreover, it depends on the decision taken on degree of relaxation decided for sufficient working or processing.

As far as management and control procedures are concerned, the exporter is the person who is in the best position to know the origin of the goods. Allowing him to make statements on origin himself would be a considerable reduction in red tape. The authorities would be able to concentrate on carrying out more effective post-export controls. Requiring exporters to register with the authorities would facilitate these. However such a system would require the setting up of a data-base, which could not be done immediately. Under the status quo there would continue to be a threat to own resources.

Comparing the options

Sufficient processing of goods which are not wholly obtained

The present rules are familiar but complex and difficult to apply for traders and administrations alike. Their continuation would only perpetuate the many difficulties of interpretation and application which exist. They were never designed with development in mind. "Cleaning" them could offer piece-meal opportunities for relaxation by targeting specific rules in sensitive sectors, but it would be tinkering at the edges. This leaves the two "radical" approaches, a value-added rule or a CTH rule. These would sweep away the current structures. They would also have the advantage of using familiar concepts.

CTH would be a major simplification and it is familiar, but the tariff was never conceived for origin purposes. There could not permit any differentiation between LDCs and other developing countries. It may also be seen as a step back into the past.

No businessman can fail to be aware of his costs. Administrations are also used to dealing with value. A method based on a comparison between the ex-works price and the value of the non-originating materials used is conceptually straightforward.

In order to be able to promote development, the rules must not only be simple but also flexible. The only across-the-board method that would allow this is one based on value added, because the degree of relaxation afforded could be easily changed by adjusting the threshold.

There could be a lower threshold for products originating in LDCs. For certain sensitive products in the agricultural sector, additional conditions are required in order to support development and avoid circumvention. However, the value added method would seem unsuited to the fisheries sector. A list of minimal operations which can never confer origin should be retained, so that the operations taking place are genuine, and to avoid transshipment.

Rules of origin do need to be changed. However, for the majority of sectors changing them will have no impact at all and to this extent they have to be considered as being neutral. Even relaxed rules should not create major negative impacts for operators in the Community.

Conditions for wholly obtained fisheries products

There must be a real link between the fishing vessel and country of export. The crewing requirement is widely seen as benefiting no one. Ownership best reflects a real economic link between vessel and country but this condition should be simplified. Cumulation of the conditions between countries of the same regional group should also be permitted.

Conditions for cumulation of origin

It is important to look first at the basic rules before considering cumulation. It needs to be based on rules which both offer a sufficient incentive to source within the zone, and at the same time reflect a genuine economic activity. If the sufficient working or processing rule is liberal, then the cumulation threshold would have to be so low as to be a pointless complication. A list of minimal operations would be sufficient.

Procedures for management and control of rules of origin

The need for robust procedural rules to combat fraud is the same, whether the rules of substance are changed or not. The present procedural rules suffer from several weaknesses.

No system can ever be completely fraud-proof. A system that is as resistant to fraud as possible requires that the rules are clear, evidence of origin is given by the person in the best position to know, the roles of all parties are clear and the authorities are able to act effectively. The introduction of statements on origin by registered exporters with the contemporaneous introduction of a comprehensive data-base is the most suitable way to achieve this.

Instruments to ensure compliance by the authorities of beneficiary countries with their obligations

The Community provides information through its web-site on rules of origin. It also carries out some monitoring actions and provides some technical assistance, but this is done on an individual basis and is reactive, not proactive.

There needs to be a systematic, permanent monitoring programme. No change in the law is required for this but it would be more transparent to include it. This should be backed up by information, training and technical assistance.

Overall conclusion

The three areas covered by the communication are closely linked. Simplification and appropriate relaxation of the rules for determining origin need to be supported by adequate management and control procedures, all parties need to know exactly what is required of them and it is necessary for there to be confidence in administrations. Conversely, efficient management and control is facilitated by rules which are easy to understand and apply. The changes to the three areas all need to be made, even if they cannot start to apply at the same time. To propose procedural changes on their own, without also offering simpler and more relaxed rules on the substance, would be ill perceived by partner countries.