

Trade-led Growth in Times of Crisis

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Paper title: Rules of Origin as an Instrument of Trade Protection: An Analysis of Theory, Empirical Evidence and Current State of Play

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Scheme of Presentation

- Global Scenario
- Rules of Origin (ROO): Meaning, Types and Methods
- Theoretical Economics of ROO
- Empirical Evidence
- Current State of Play
- Design of ROO
- Policy Implications

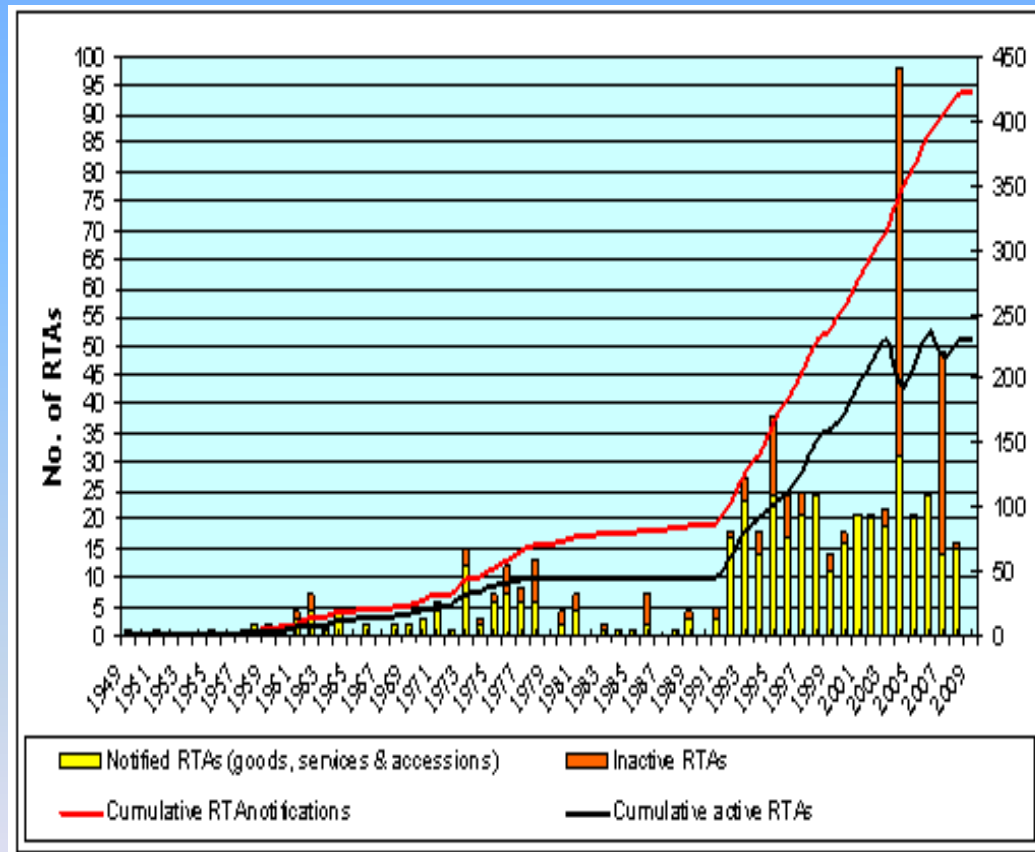


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Global Scenario

- Number of preferential trade agreements (PTAs) has increased at phenomenal pace.
- Half of the world trade passes through the channels of PTAs (World Bank, 2005).
- ROO are inherent part of PTAs



Rules of Origin (ROO)

➤ Meaning:

Criteria to determine the economic nationality of internationally traded products.

➤ Types:

- non-preferential
- preferential ROO

➤ Methods:

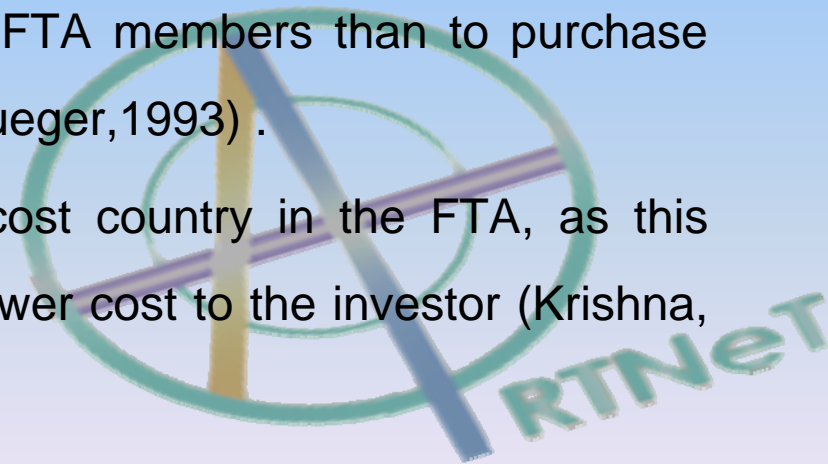
- Change in Tariff Classification (CTC) Rule;
- Domestic Content Rule;
- Specific Process Test; and
- a combination of above rules.



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Theoretical Economics of ROO (1)

- Economic impact of ROO is determined by the specific nature of the ROO input requirement, the market structure for the domestic intermediate produces, and the substitution possibilities for production by the final goods producers (Grossman).
- Producers of a final good in an FTA would find it advantageous to purchase higher-cost (protected) inputs from other FTA members than to purchase from lower cost ROW sources (Anne O Krueger, 1993) .
- ROO tend to lead to FDI in the lower cost country in the FTA, as this provides access to the FTA market at a lower cost to the investor (Krishna, Kala and Anne Krueger, 1995).



Theoretical Economics of ROO (2)

- FTAs are often not liberalizing (Ju, Jiandong and Kala Krishna, 1998):
 - ROO are hidden protection: they create what looks like tariffs on imported intermediate inputs and affect the price of domestically made inputs as well.
 - ROO are negotiated industry by industry, there is enormous scope for well organized industries to essentially insulate themselves from the effect of the FTA by devising suitable ROO.
- Developed countries are increasingly likely to employ policies that discriminate amongst imports on the basis of how they have been produced. This is equivalent to employing a ROO, and may be justified on the grounds of “protecting the environment” or “discouraging the use of child labour” (Rod Falvey and Geoff Reed, 2000).

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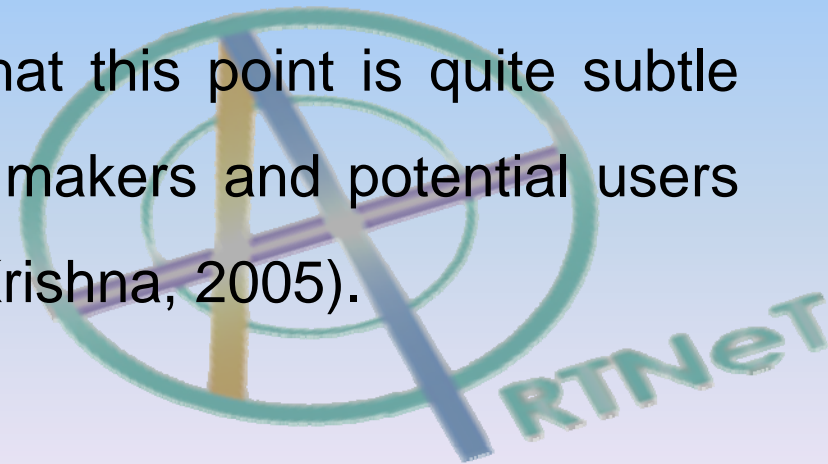
Theoretical Economics of ROO (3)

- Restrictive ROO will lead to increased investment in the FTA due to which production is reallocated among FTA members, and trade is diverted from non-members (Rodriguez, 2001).
- ROO has a direct bearing on the political economy of the FTA endorsement (Rupa Duttagupta and Arvind Panagariya's, 2003)



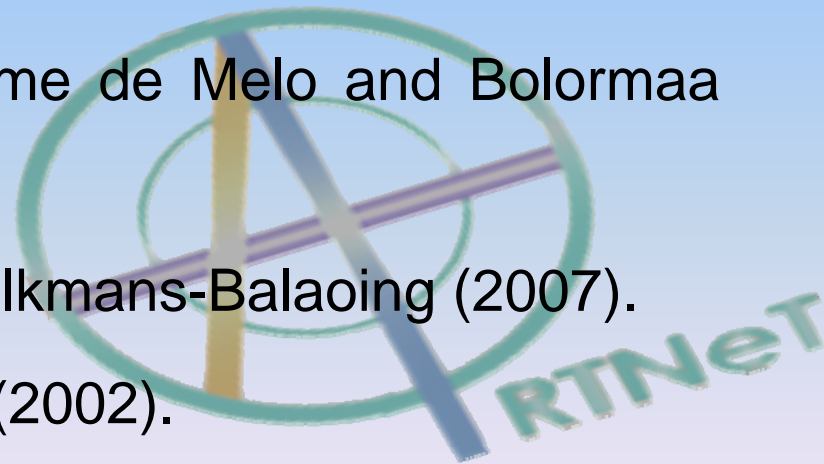
Theoretical Economics of ROO (4)

- First, ROO can insulate an industry from the consequences of an FTA and it can provide hidden protection.
- Second, the precise form of the RoO matters.
- Third, the time period matters.
- Four, having more restrictive RoO may result in higher not lower imports. She emphasised that this point is quite subtle and provides a warning to policy makers and potential users that RoO may well backfire (Kala Krishna, 2005).



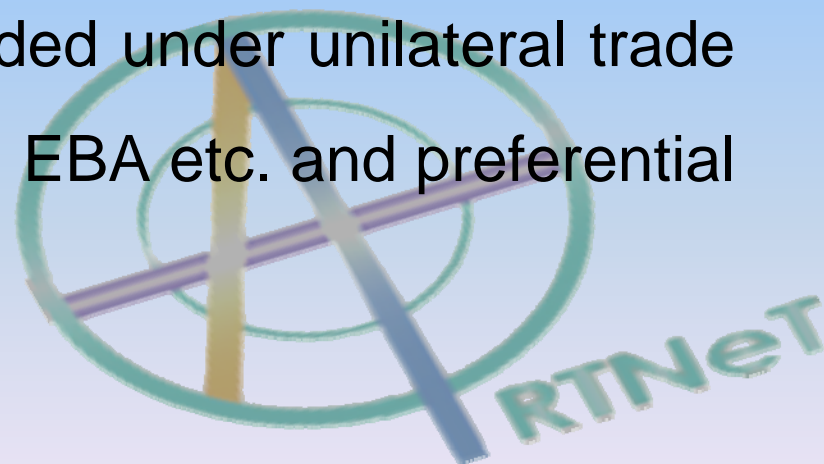
Empirical Evidence (1)

- Aaditya Mattoo, Devesh Roy, and Arvind Subramanian (2002).
- Alberto Portugal-Perez (2008).
- Paul Brenton's (2003).
- A. F. Ghoneim's case study of Egyptian-European Partnership Agreement (2007).
- Olivier Cadot, Céline Carrère, Jaime de Melo and Bolormaa Tumurchudur (2005).
- Miriam Manchin and Annette O. Pelkmans-Balaoing (2007).
- Paul Brenton and Miriam Manchin (2002).



Empirical Evidence (2)

- More restrictive and stringent ROO add-up substantial cost to the producers and the governments in the form of increased production and administrative costs.
- Restrictiveness of ROO adversely affects the utilization rate of trade preferences provided under unilateral trade schemes such as GSP, AGOA, EBA etc. and preferential trade agreements.

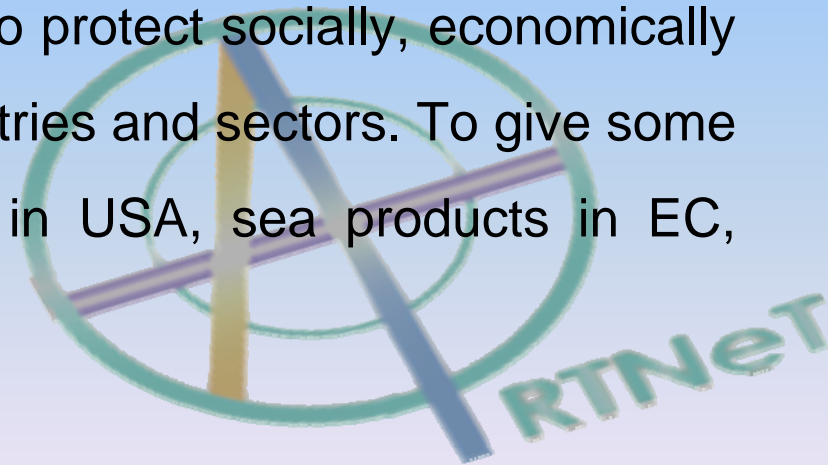


Cost Estimations of Compliance of ROO

S.NO.	STUDY	ESTIMATION OF COSTS OF COMPLIANCE OF ROO
1	Palmer (1993)	<ul style="list-style-type: none"> Cost of border formalities alone 3% of the value of the goods concerned. Total economic cost 5% of that value.
2	Olivier Cadot, Céline Carrère, Jaime de Melo and Bolormaa Tumurchudur (2005)	<ul style="list-style-type: none"> Administrative costs (i.e. considering only the paperwork involved but excluding the effect of RoO on the cost of inputs) approximately 1.9% for NAFTA and 6.8% for PANEURO.
3	Herin (1986)	<ul style="list-style-type: none"> Costs of documentation and administration of origin rules to be equivalent to some 3 percent of the value of the goods traded (EU-EFTA FTA).
4	Carrière and de Melo (2004)	<ul style="list-style-type: none"> Total compliance costs for Mexican traders exporting to the US averaged around 6 percent in 2001.
5	Tobit	<ul style="list-style-type: none"> compliance cost estimate of 3.9 percent for products where the utilization rate is below 100 percent.
6	Manchin (2006)	<ul style="list-style-type: none"> Costs of requesting preferences in the case of Cotonou preferential scheme for non-least developed ACP (African, Caribbean and Pacific) countries finds to be around 4 percent (assessing EU preferences).

Empirical Evidence (3)

- If differential between the MFN tariff rates and the preferential tariff rates under any preferential trade agreement or unilateral trade scheme is not sufficiently high then exporters/producers prefer to pay MFN tariff rather than complying with complicated ROO to enjoy preferential treatment.
- Countries use ROO as an instrument to protect socially, economically and politically sensitive products, industries and sectors. To give some non-exclusive examples, auto sector in USA, sea products in EC, textile sector in India etc can be noted.



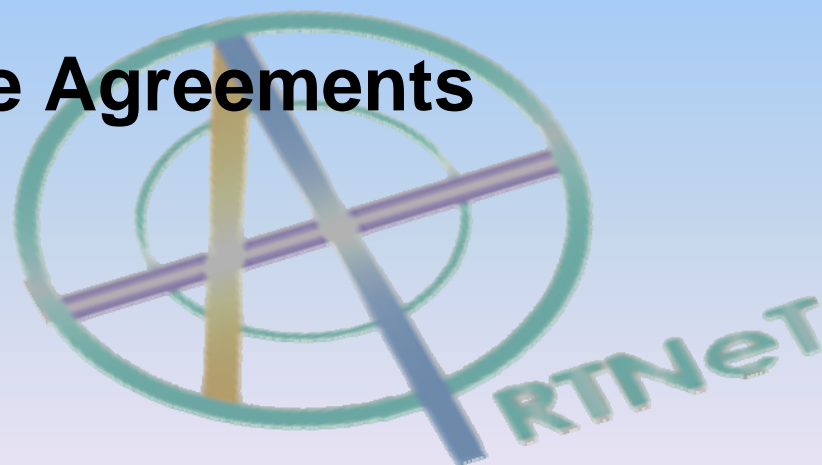
Current State of Play

- Different countries/FTAs use different set of combinations of methods of ROO.
- Design of ROO depends basically on the objective of any FTA/PTA.
- Commonality.



Current State of Play (2)

- **ROO in Americas**
- **ROO in Europe**
- **ROO in Asia Pacific Trade Agreements**



Design of ROO (1)

- Japan-Malaysia EPA defines Change in Chapter (CC) except from Chapter-7 (tomato) and Chapter 20 (tomato puree) as rule of origin for tariff line-2103.20 (tomato ketchup).
- Japan-Mexico EPA defines Change in Chapter (CC) except from 51.06 to 51.13, 52.04 to 52.12, 53.07 to 53.08, 53.10 to 53.11, Chapter-54, 55.08 to 55.16 or Chapter-60 provided that cut (or knit to shape) and sewn or otherwise assembled in one or both parties as rule of origin for tariff line-6110.11/6110.20 (pullovers).

Design of ROO (2)

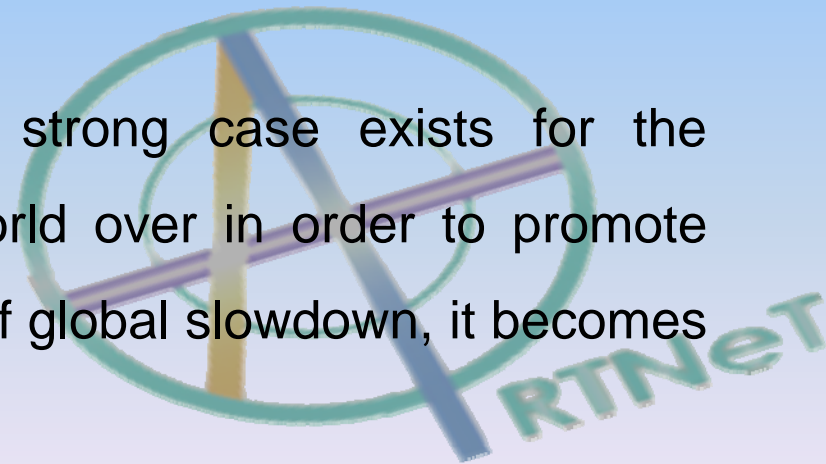
- Triangulation problem an example:-
 - Economic Complementation Accord (ECA) between Venezuela and Argentina defined Change of Chapter (CC) rule for chocolate products. Under this rule, if Argentina wishes to export cocoa paste or powder to Venezuela, it cannot use non-originating, say Mexican, cocoa beans (Heading 1801). However, it could use Mexican beans to manufacture cocoa paste (1803) to export to Paraguay under any preferential regime, or even as non-origination. From the paste, cocoa powder is manufactured in Paraguay (1805) and exported to Venezuela as originating, as the rule between Venezuela and Paraguay is a Change of Heading (CH) rule. As a result, the cocoa beans that Venezuela would not allow Argentina to use as an input for products of the chocolate industry enter Venezuela tariff-free anyway through triangulation via Paraguay Rafael (Cornejo and Jeremy Harris, 2007).

Policy Implications (1)

- Although applied tariff rates, on an average and ignoring tariff peaks, have come down substantially in last two decades under the aegis of the WTO regime.
- During the same period, PTAs have also proliferated at amazing pace where ROO are used as a surrogate measure of trade policy and trade barriers to protect the socially, economically and politically sensitive products, industries and the sectors as a whole. Rules of Origin have been resorted to for this purpose without exception by all most every country. However, there may be difference of degree.

Policy Implications (2)

- Secondly, presence of ROO undoubtedly adds up to the cost of production, which in turn impacts the utilization rate of trade preferences provided by unilateral or bilateral preferential trading arrangements. Stricter the ROO greater would be the cost of compliance and hence, most likely, lesser utilization rate of trade preferences.
- Policy implication of this is that a strong case exists for the simplification of ROO regimes the world over in order to promote international trade. In the perspective of global slowdown, it becomes even more imperative.



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