‘RULES OF ORIGIN’ AS THE MOST BURDENSOME BARRIER TO INTERNATIONAL TRADE AND NEED FOR ITS BETTER HARMONISATION

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Abstract *– The first and foremost goal of the World Trade Organisation (hereinafter WTO) is to liberalise international trade. It aims at eliminating discriminatory treatment of nations and reducing trade barriers. However, Free Trade Agreements (hereinafter FTAs), also known as Preferential Trade Agreements (hereinafter PTAs) act as significant barriers to international trade. With a rise in plethora of FTAs between different countries, Rules of Origin (hereinafter RoO) have invariably become a hindrance to international trade. Essentially, the rise in FTAs have led to a rise in ‘preference’. This cannot be ideal for the international trade community because FTAs indirectly discriminate countries on basis of ‘rules of origin’, violating WTO’s core principles of most-favored nation treatment and national treatment. Through this paper, I am to discuss the existing problems pertaining to FTAs in light of RoO and the need for their better harmonization. The first part of the paper introduces the concepts of RoO and FTAs. The second part throws light on RoO as barriers to trade within the ambit of FTAs. It is followed by an analysis on ‘spaghetti bowl phenomenon’, a famous metaphor used in the context of rising PTAs. The next part discusses the case of NAFTA (FTA between US-Canada-Mexico) as an example supporting the contention that RoO indeed act as significant barriers to trade. Lastly, FTAs are discussed from the perspective of third-world countries as they are the ones who suffer in due course. It is essential to safeguard the interests of third-world countries in light of increasing FTAs. This is necessary to ensure that the purposes and principles of WTO are not diluted.*

Keywords:*; WTO, PTA*

INTRODUCTION:

RoO are the principles applicable to countries to determine the origin of goods. Under the WTO law, Article 1 of the ‘Agreement on Rules of Origin’ (hereinafter ARO) defines Rules of Origin as;
“…rules of origin shall be defined as those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994.”
The Rules of Origin are further classified as Preferential and Non-Preferential Rules of Origin. “The preferential RoO are those applied in the context of PTAs such as customs unions, free trade areas or even non-reciprocal arrangements like the Generalised System of Preferences (GSP), whereas the non-preferential RoO are those used in non-preferential commercial policy instruments such as most- favoured nation tariffs, anti-dumping and countervailing duties, safeguard measures, origin marking requirements, and any discriminatory quantitative restrictions or tariff quotas.”[1] At this point, it is important to note that the ARO regulates and harmonises only non-preferential RoO.
Free Trade Agreements (FTAs) are contracts between two or more countries wherein goods and services are exchanged between member countries with reduced government tariffs, quotas, subsidies and other norms and regulations. FTAs are also referred to as Preferential Trade Agreements (PTAs) as they indirectly facilitate preferential access to markets between member countries. Countries which share borders and common social and economic interests prefer to enter

[1] Economic and Political Weekly, Dec. 17-23, 2005, Vol. 40, No. 51 (Dec. 17-23, 2005), pp. 5419-5427

into FTAs to simplify trade.[2] RoO are potentially the main agent of discrimination embedded in these FTAs.[3]

1. FREE TRADE AGREEMENTS VIS-À-VIS RULES OF ORIGIN:

The principles of national-treatment and most-favoured nation treatment are two very important cornerstones of the WTO. The principle of national treatment guarantees that all imported products are to be treated at par with the domestic products. Similarly, the principle of most-favoured nation treatment is based on the foundation that all countries are to treated as 'most-favoured' i.e. treated alike in matters concerning trade policies, benefits, reduction of tariffs, etc.
FTAs essentially are an exception to the rule of non-discrimination. FTAs are generally seen as an effort to improve efficiency in international trade. "FTAs allow participating countries to maximize economies of scale by concentrating their production efforts in areas in which they are most efficient, while trading with other participating countries for their remaining needs absent tariff costs."[4] Nonetheless, they act as significant barriers to trade. This is because it tends to promulgate the 'most-most-favoured' nation treatment. GATT[5] permits contracting parties to establish PTAs for purposes of customs unions or free trade which in turn allows reduction of trade barriers between parties. These FTAs exist despite the already existing non-discriminatory system because of a simple reason. '*Global welfare means little when compared to national welfare, especially when considerations such as power and influence come into play.*'[6]
"Rules of Origin are inherent to free trade agreements in which the member states' external tariffs diverge or in which the members wish to retain their individual tariff policies vis-a-vis the rest of the world."[7] This essentially means that RoO are an inevitable part of FTAs as the purpose of FTA is solely to liberalise trade in goods and services originating in specific countries. In other words, once the origin of a product is capable of determination, a country can extend the benefit of its free trade agreement to its trading partners and exclude non-partners.[8] "In principle, rules of origin are supposed to be straightforward and easy-to follow methods used to determine origin especially when a product is manufactured in one country, which rarely happens in reality."[9] Although RoO are playing an increasing role and are important for international trade, they are considered to be obstacles to international trade when they are used as protectionist apparatuses and when their stringency leads to trade diversion.[10]

2. THE 'SPAGHETTI BOWL' PHENOMENON:

Jagdish Bhagwati, a renowned scholar once famously referred to the rise of PTAs in the world as a "spaghetti bowl" phenomenon, "wherein the diversity of trade arrangements between nations and regions makes for a confusing and convoluted mess."[11] "The metaphor is apt, he argued, because the increasingly fragmented nature of these varying accords means each transaction must be traced from its origin through a twisting maze of diverse regimes before ever arriving at its destination."[12] Essentially, with the proliferation of preferential FTAs, the international trade community faces the

[2] Mitsuo Matsushita and Y S Lee, 'Proliferation of Free Trade Agreements and Systemic Issues' (2008) 1 Law & Dev Rev 23
[3] Kati Suominen, 'Rules of Origin in International Trade' (2009) 8 World Trade Rev 616
[4] Jonathan M. Cooper, NAFTA's Rule of Origin and its Effect on the North American Automotive Industry, 14 Nw. J. Int'l L. & Bus. 442 (1993-1994)
[5] GATT 1994, art XXIV, clause 4
[6] Brad Kloewer, 'The Spaghetti Bowl of Preferential Trade Agreements and the Declining Relevance of the WTO' (2016) 44 Denv J Int'l L & Pol'y 429
[7] ibid, Suominen (n 3)
[8] Bashar H Malkwai, 'Rules of Origin under U.S. Trade Agreements with Arab Countries: Are They Helping and Hindering Free Trade' (2010) 51 Acta Jur Hng 273
[9] ibid
[10] Hatem Mabrouk, 'Rules of Origin as International Trade Hindrances' (2010) 5 Entrepreneurial Bus LJ 97
[11] Brad Kloewer (n 6)
[12] ibid

problem of confusing and slower trade regimes. A rise in the number of PTAs with lack of check and control on them makes them increasingly tangled, leaving very little room for their harmonisation.

3. NAFTA- A CASE STUDY:

'Although FTAs may reduce tariffs and non-tariff barriers, the sheer complexity of trade agreements should be a clear indicator that they impose many caveats and exceptions on countries' trading relationships.'[13]

The North American Free Trade Agreement (NAFTA) (hereinafter the Agreement) is a trilateral free trade agreement between the United States, Canada and Mexico. The purpose is to eliminate trade barriers between its members and facilitate a healthier free trade regime. Articles 401-407 under Chapter 4 of the Agreement elucidates the 'Rules of Origin'. RoO define the processes to be performed and/or inputs to be incorporated into a final product within a particular preferential area in order for the exported product to qualify for preferential tariff treatment.[14] Goods originating in the North American region are given a preferential tariff treatment. Keeping in mind the high regional content requirements of manufactured goods, the drafters of the Agreement cautiously designed the detailed RoO requirements to ensure that the benefits are accorded only to goods produced 'substantially' in the North American region."[15] "Substantial transformation" means fundamental change in form, appearance, nature "or" character of article which adds to value of article an amount or percentage which is significant in comparison with value which article had when exported from country in which it was first manufactured, produced or grown.[16] The purpose it to avoid trade deflection and to prevent firms and businesses from countries outside the free trade region from simply assembling their final products in one area of the free trade region and ask to qualify for preferential tariff treatment.[17] The interpretation of the 'substantial transformation' test is left to the custom authorities of the importing country which rules differently on a case-to-case basis. This makes it a grey area leading to a lot of unpredictability and uncertainty.

The method to determine the 'origin' of the goods as per Article 401 of the Agreement is thus unclear to a large extent leading to multiple litigations in this area.[18] Further, there are a number of administrative requirements under the Agreement making the entire process quite cumbersome. Therefore, "*businesses prefer to let go the potential tariff preferences rather than complying with the frustrating and difficult rules of origin under the Agreement*."[19] The Agreement undoubtedly enhances extensive free trade and facilitates benefits to the contracting parties, nonetheless, the RoO need some clarity and transparency.

4. A THIRD WORLD APPROACH:

Third World Approach to International Law (TWAIL) is essentially a "political and intellectual movement" that aims at rethinking and restructuring the international law and order, balancing the rights of developed (first world) and the developing (third world) countries. It is relevant to discuss the perspective of a developing country in order to understand their genuine lack of power and influence while negotiating agreements in international trade as well as in the international community. It is logical to assume that developed countries usually sign FTAs with other developed countries. For instance, NAFTA is amongst North American countries specifically. This is because along with advantages in trade, the countries establish strong political and military relations. FTAs

[13] Blayne Haggart, 'Modern Free Trade Agreements Are Not About Free Trade', 2017, Centre for International Governance Innovation https://www.jstor.org/stable/resrep17312.6 accessed 4th November 2020
[14] Suominen (n 3)
[15] Tim Tatsuji Shimazaki, 'North American Free Trade Agreement: Rules of Origin – Free Trade or Trade Barrier' (1997) 25 W St U L Rev 1
[16] Malkwai (n 8)
[17] Cooper (n 4)
[18] Shimazaki (n 16)
[19] Shimazaki (n 16)

entered into with only particular countries tend to undermine the principles of free trade and overlooks the principle of non-discrimination. "The discriminatory treatment involved in FTAs create an imbalance in the competitive conditions among trading nations and thereby causes unfairness and inequity in trading relations."[20] "This is especially hard on developing countries outside FTA arrangements, which depend on foreign trade and the inflow of foreign capital."[21] Thus ironically, FTAs tend to restrict 'free trade' in the international community.

Developing countries are generally disadvantaged in negotiating FTAs with developed countries due to differences in economic resources and political influence.[22] Unlike negotiations in multilateral trade agreements such as those in the WTO, where developing countries form coalitions to present a united front *vis-a-vis* developed countries, negotiating FTAs is not that easy.[23] Further, one very significant issue that developing countries face while negotiating FTAs with developed countries is the stringent obeyance of environment protection measures imposed by developed countries. The developing countries find it difficult to comply with such trade embargoes as environment protection measures are expensive for the growing economies of developing countries.[24] Thus, the trading power as well as political power is concentrated in the hands of few powerful and influential countries creating a strong divide between developing and developed nations.

CONCLUSIONS:

The case of NAFTA is a classic example of an FTA wherein the 'substantial transformation' test for the determining the 'country of origin' acts a barrier to free flow of goods. *"Harmonizing and simplifying non-preferential and preferential RoO to be transparent, unbiased, predictable and objective, is the best solution to facilitate international trade and achieve an efficacious globalization."*[25] Harmonisation means that there should be proper rules in place governing FTAs in light of RoO otherwise they unnecessarily act as obstacles. The rules with respect to RoO should be properly defined and made transparent so that parties to the FTAs see it as an advantage rather than a burden. Therefore, there is a need to establish a coherent and transparent system of determining RoO to fully liberalise international trade and uphold the objectives of WTO.

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[20] Mitsuo (n 2)
[21] ibid, n-2
[22] id
[23] id
[24] Ibid, n-2
[25] Ibid, n-10

[9] Tim Tatsuji Shimazaki, 'North American Free Trade Agreement: Rules of Origin – Free Trade or Trade Barrier' (1997) 25 W St U L Rev 1

WTO Documents:

1. The General Agreement on Tariffs and Trade (GATT)
2. The General Agreement on Trade in Services (GATS)
3. The Agreement on Rules of Origin (ARO)