



Rules of Origin and EPAs: What has been agreed? What does it mean? What next?

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SUMMARY

Rules of Origin (RoO) describe the local processing requirements necessary for a good to be considered as being of local origin and hence qualify for preferential market access under a given preferential trade agreement. As such, the Cotonou Agreement's RoO have been a core determinant of preferential market access under EU-ACP trade relations. As part of the EPA negotiations, a number of aspects of the RoO were changed; others continue to impose a significant burden on stakeholders engaged in trade between ACP countries and the EU. However, these changes apply only to signatories of interim or full EPAs, while the remaining ACP States are now subject to the more onerous market access provisions of the GSP and EBA arrangements.

Key findings of the report are:

- The EU had initially intended to overhaul its preferential RoO, based on a value-added approach, but technical and administrative difficulties as well as time constraints resulted in the EPA RoO to be largely similar to the Cotonou RoO.
- The EU implemented revised RoO on its part at the beginning of January 2008 by way of Council Regulation, thus ensuring a measure of continuity for ACP countries engaged in trade with the EU. However, these revised requirements apply only to signatories of interim or full EPAs, leaving non-signatories to be governed by the rules underlying the GSP and its EBA offshoot. Both are overall less favourable than the revised EPA RoO.
- Changes to the RoO were only implemented in a few sectors, including textiles and clothing, fish, and certain agricultural products. With the exception of textiles and clothing, the changes to the rules do not represent a major departure from the previous RoO regime with respect to the majority of IEPA / EPA signatories.
- While the Cotonou Agreement specified that no ACP country should be worse off under a new bilateral agreement with the EU, the current situation whereby only 35 countries have initialled an agreement means that the previously broad cumulation provisions for the ACP are no longer in place, while the objective of regional economic integration is undermined by the somewhat fragmented coverage of interim EPAs as well as the lacking overlap with existing regional integration initiatives. The present situation is the result of a number of factors, and not least a casualty of the process to date.
- Revised RoO at this stage apply only to ACP EPA signatories' exports to the EU. While signatories of the interim or full EPAs are under an obligation to give effect to the RoO (for imports from the EU) through the necessary legislative process on their part, the RoO applicable to bilateral trade will be those attached to the agreements. This provides all parties with the opportunity to continue a process of amending the RoO in a manner that is conducive to growing international trade, development and regional economic integration.

Key recommendations are:

- Revised RoO should be seen as part of the whole EPA "package", including any agreement on investment rules and service-sector provisions where applicable, and changes and improvements leveraged accordingly. Agreeing to and implementing provisional RoO prior to agreement on a complete EPA in whatever form may from a strategic perspective not be in the ACP States' best interest.

- The IEPA RoO make provision for a technical review of the RoO beginning no later than three years after signature, to allow technical amendments and improvements but likely also to accommodate the EU's objective of overhauling its preferential RoO regime. While a built-in review clause is desirable, it should not be taken to imply that the RoO will be replaced by an altogether new regime. In this regard, the value-based methodology proposed by the EC previously is potentially problematic unless implemented with great caution and following extensive consultation with industry
- While textile and clothing rules have seen positive changes, the positive impact of others remains doubtful. The changes to the RoO for fish are not sufficient to provide a significant improvement for the ACP fishing industries, and the region-specific concessions granted to the Pacific States remain an objective of the majority (if not all) other ACP States. ACP countries should continue to engage on improvements of the rules applying to this key sector. Other changes to the rules, for example the alternate rules applicable under the Appendix on derogations, are not far-reaching and appear to perpetuate EU sensitivities.
- Cumulation provisions remain relatively restrictive. A fresh approach to the concept of cumulation should be pursued in EU-ACP negotiations – within the framework of technical limitations associated with cumulation – to extend to other EU preferential trade partners as well as to products (and materials) generally where EU import duties are at a very low threshold or have already been abolished. An objective should be to abolish the product exclusions and related administrative provisions relating to ACP cumulation with South Africa, as these are not aligned to development prerogatives of the Southern African region in particular, and counter regional economic integration.
- The opportunity to engage further on a suitable outcome to the RoO negotiations remains in place and should be considered by all parties as an ongoing opportunity to ensure a development-friendly outcome to the EPA process.

Why Rules of Origin?

Key objectives of Rules of Origin in preferential trading arrangements

Rules of Origin (RoO) set out the conditions under which goods traded between preferential trade partners can be considered as ‘originating’ in a specific country. They constitute a core part of bilateral trade arrangements and hence the regulation of preferential trade. By setting the conditions on which the economic nationality of a product is based, subject to having been substantially transformed in the exporting country, RoO have a strong bearing on international trade and ultimately also on investment and production decisions. Given that production is becoming increasingly globalised, with producers often required to source materials from various sources globally in order to be internationally competitive, RoO are of major relevance to all stakeholders in the production and export process.

The core objective of RoO is to set conditions which ensure that goods are substantially transformed in the exporting country, rather than having been simply channelled through the customs territory of a country from a third country having less favourable access to a given export market. Such trade would be referred to as “transshipment”: little if any value is added locally and the higher duties normally levied on exports of the original source country are circumvented through this diversion. Left unchecked, the benefits of preferential trading arrangements (PTAs), as well as differentiated tariff regimes globally, are severely undermined.

While the prevention of transshipment is arguably the only legitimate function of RoO, the requirements associated with RoO have often served the dual purpose of functioning as a discretionary trade policy instrument. This can be interpreted broadly as including instances where preferential RoO are used as a leverage for gaining concessions and advantages in other areas covered by PTAs, or where the RoO requirements are devised in a manner to provide effective levels of protection (from competition) to domestic producers. This is clearly more likely to occur in PTAs between unequal trading partners, being those of vastly different economic size or levels of development, as well as in non-reciprocal trading arrangements where preferences are granted unilaterally.

The methodological basis for EU Rules of Origin

Various principles and methodologies can be used as a basis to determine the economic nationality of a good. As no binding agreement or international standard governing preferential RoO exists, it is left to the contracting parties to determine a suitable methodology. EU preferential RoO utilise a range of methodologies, and are largely consistent across all its PTAs.

Under EU RoO, goods produced solely from domestic materials, or in the case of agricultural and mineral products that are grown and extracted exclusively in the home country, are considered “wholly obtained” there and therefore have automatic ‘originating’ status. All other goods, namely those that consist of both local and imported materials, must meet the relevant provisions that determine whether a good is substantially transformed in the exporting country. Three tests determine this status: the ‘change in tariff heading’ (CTH) test, which considers a product to meet the RoO if its materials are classified within a different heading to that of the product¹; the ‘value-added’ (VA) test which confers origin on products that meet specific local value addition thresholds, and the ‘specific processing’ (SP) or technical requirement which sets specific

¹ The CTH or “tariff jump” test is based on the Harmonised System Nomenclature used to classify international trade in goods

processing requirements to be complied with for a product for it to be considered as being of local origin.

The absence of an unambiguous and universally applicable methodology to capture all eventualities equitably is one of the reasons why the EU RoO (as do various other regimes) employ all three methodologies in different measures. Each has its own drawbacks and advantages, although it could be argued that the technical requirement is in equal measures probably the most appropriate to cover specific sector dynamics yet at the same time the most susceptible to the influence of political economy elements, protectionism and unfair exploitation when negotiated between substantially unequal trading partners. This is an issue that has long been a particular criticism of EU preferential RoO, where ACP countries have considered the RoO provisions applicable to certain sectors to be prohibitively restrictive and trade suppressing.

Recent ACP-EU developments on Rules of Origin

For over three decades, ACP countries' preferential market access to the EU has been governed by the EU Generalised System of Preferences (GSP) as well as the Cotonou Agreement. Cotonou was more favourable, granting duty-free and largely quota-free market access subject to the applicable RoO. The RoO contained in Cotonou since 2000 (and its predecessors, consecutive Lomé Conventions) were largely the same as the RoO under the GSP, with Cotonou RoO containing a few improvements. With the expiry of Cotonou preferences at the end of 2007, RoO that were previously non-reciprocal were to become a part of the reciprocal Economic Partnership Agreements (EPAs). This necessitated a renegotiation of the RoO governing future bilateral EU-ACP preferential trade.

The EU has entered a parallel process to revise its preferential RoO. The original intention was for new rules to be introduced first into EPAs and later the GSP (the latter being subject to a periodic review and extension). This process formally began with the Green Paper² discussion document published in 2003, and subsequent policy documents spelling out the EC's vision for an across-the-board VA-based methodology as a basis for determining origin³.

Slow progress on the part of the EU to formalise its new RoO proposals was due to various reasons, including widespread criticism (from internal and external stakeholders) of the basis on which to base the proposed VA thresholds, and questions around how to implement a new methodology in an equitable and reasonable manner. In addition, the EU was continuing internal consultations on the appropriate revision of sector-specific origin requirements and related policy. The ACP group likewise was unable to articulate a clear and united vision for new ACP-EU RoO, which ultimately led to the objective of a comprehensively overhauled RoO regime being abandoned for now in favour of a more pragmatic revision of sector-specific "problem areas".

As a result, the revised RoO governing ACP-EU relations are for now based on the earlier Cotonou RoO, with certain changes. They apply to all ACP countries that have initialled the Interim EPA (IEPA) during November and December 2007, being those countries listed in Annex I to the Agreement (and attached to the Council Regulation referred to further down). Appropriate legal

² European Commission (2003), *Green Paper on the future of Rules of Origin in preferential trade arrangements* – COM(2003)787 final

³ See also European Commission (2005). *The rules of origin in preferential trade arrangements: Orientations for the future. Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee*, COM(2005) 100 final, as well as European Commission (2005). *Justification of the choice of a value added method for the determination of the origin of processed products*. Working Paper TAXUD/1121/05 Rev.1 – EN.

provisions have been put in place to give effect to the RoO with the EU by way of a Council Regulation⁴ implementing the revised RoO on its part from 01 January 2008. For now, the revised RoO therefore apply only to exports from the 35 ACP countries listed in Annex I⁵ into the Member States of the EU.

While the overall architecture of the IEPA RoO remains essentially the same as under Cotonou, the new regulations contain a number of changes. These include changes to the treatment of certain sectors, changes to the definition of what is considered a “wholly obtained” product, a range of permanent ‘derogations’ from the primary rules, as well as certain other technical amendments. These are summarised in the table below.

The revised RoO go beyond commitments made by the EC in other agreements, but only in a number of respects as outlined later. The EU has in the past maintained a large degree of consistency between its PTA RoO, and the Cotonou Agreement was no different in this respect (other than the presence of a few fairly minor technical differences, and broader cumulation).

Table 1. Summary of key changes to the ACP-EU RoO*

Component	Section	Key changes
Definition of “wholly obtained”	Article 3	<ul style="list-style-type: none"> □ expands definition to include “products of aquaculture, including mariculture, where fish is born and raised there” □ removes requirement that crew of qualifying vessels must be at least 50% local / EU nationality □ removes crew requirement from conditions involving charter vessels
General basis for sufficiently processed products	Under Article 4	<ul style="list-style-type: none"> □ maintains general 15% value tolerance provision but specifically excludes textile and clothing products of Chapters 50-63 □ introduces special provisions relating to fish from Pacific countries (see sectoral issues below)
Definition of insufficient processing operations	Article 5	<ul style="list-style-type: none"> □ expands list of insufficient operations relating to cereals and rice, sugar and fruit, nuts and vegetables □ removes classification relating to mixing of certain products
Derogations	Appendix 2A	<ul style="list-style-type: none"> □ introduces alternative / optional RoO for a range of agricultural products □ alternative requirements based mainly on the CTH / VA (maximum thresholds stipulated for non-originating materials) methodologies
Textiles and clothing	Appendix 2	<ul style="list-style-type: none"> □ substantially revises Cotonou RoO, changes broad requirement from ‘two-stage processing’ to ‘single-stage processing’
Fish	Article 3; Article 4; Appendix 2	<ul style="list-style-type: none"> □ simplifies conditions relating to vessels (where fish is caught beyond territorial waters) □ permits the use of non-originating fish by Pacific countries if further processed locally (for products of Chapter 16) □ introduces 15% “non-originating” tolerance applicable to Chapter 3 (fish)
Cumulation	Article 6; Appendix 7, 8, 9, 10 and 11	<ul style="list-style-type: none"> □ provides for cumulation of production between EU and ACP □ provides for cumulation between ACP States that have initialled EPA / IEPA and listed in Annex 1 □ excludes and delays cumulation possibilities for certain products, especially with respect to cumulation with South Africa
* Based on provisions contained in EC Council Regulation No 1528 / 2007 (of 20 December 2007)		

⁴ Council Regulation (EC) No 1528/2007 (of 20 December 2007), applying the RoO arrangements for products originating in ACP States

⁵ Annex I, Council Regulation (EC) No 1528/2007, ‘List of regions or states which have concluded negotiations within the meaning of Article 2(2)’

□ **Wholly obtained provisions**

The changes to the “wholly obtained” provisions provide some additional flexibility to the RoO by removing the requirement (that is common in all other EU PTAs) that crew and captain are subject to restrictions around nationality. While Cotonou and the Trade and Development Cooperation Agreement between South Africa and the EU require at least 50% local or EU representation, the norm in other EU agreements (including the GSP) has been 75%. The IEPA waiver of this condition means that ACP operators in the fishing sector are no longer as restricted in their human resource requirements.

□ **Value tolerance provisions**

Current EU agreements contain a general value tolerance provision, which allows producers to use a certain level of non-originating materials irrespective of any technical requirements imposed by the RoO. The only proviso is that the general across-the-board threshold may not replace or undermine any specific VA threshold applied to specific products where relevant. EU Agreements generally set the value tolerance provisions at 10%, while under Cotonou and the TDCA it was set at 15% based on the ex-works (factory door) price of the product. The IEPA continues with a 15% general threshold, but specifically excludes textiles and clothing of Chapters 50-63 (there being no such exclusions under Cotonou). However, this apparent tightening of the rules should be seen in the context of far more flexible specific RoO applicable to Chapters 50-63, which now consider a single stage transformation (for example, the local conversion of non-originating yarn to fabric, or fabric to garment) as sufficient to confer origin. Under the Cotonou RoO, the requisite local value add to confer origin was far more onerous to comply with and equated to a much higher local processing threshold.

□ **Processing considered “insufficient to confer origin”**

Article 5 lists a number of operations that individually or in combination with other ‘insufficient operations’ will not confer originating status on the product to be exported, irrespective of whether such products otherwise qualify for preferential treatment under the main RoO. These processes, sometimes also referred to as a “negative list” as they provide exclusions to the RoO, ensure that substantial local transformation takes place locally in the letter and spirit of the RoO provisions.

The IEPA RoO adds three conditions to those that were included under Cotonou. These are paragraphs (i) ‘*Husking, partial or total bleaching, polishing and glazing of cereals and rice*’; (j) ‘*Operations to colour sugar or form sugar lumps; partial or total milling of sugar*’; and (k) ‘*Peeling, stoning and shelling, of fruits, nuts and vegetables*’. The IEPA removes (former) paragraph (e), namely ‘*simple mixing of products, whether or not of different kinds, where one or more components of the mixtures do not meet the conditions laid down in this Protocol to enable them to be considered as originating in an ACP State, in the Community or in the OCT*’.

□ **Provisions relating to fish**

Changes to the conditions for originating status for fish are contained in the product-specific rules, as well as in Article 3 (‘wholly obtained’) and Article 4 (general conditions for ‘sufficient processing’). The RoO applicable to fish differentiate between fish caught within the 12 mile territorial waters of a country (including fish from inland waters), and fish caught beyond this zone. The wholly obtained provisions of the IEPA remove a key provision relating to the crew of vessels used in the fishing effort, with the requirement falling away that at least 50% of the crew (master of ship and captain included) be nationals of the beneficiary country (or the EU). Ownership provisions, which specify that vessels used be registered and sail under the flag of the ACP State (or the EU), and be at least 50% owned by nationals of the ACP (or EU) remain firmly in place, both in the EC Council Regulation as well as the IEPA texts.

Article 4 also contains special provisions relating to fish, but these apply *only* to Pacific ACP States and relate to processed fish of headings 1604 and 1605. While most ACP regions have long called for a relaxation of the rules restricting the use of non-originating fish if further processed locally, only Pacific States were granted this change to the rules, presumably due to the fact that the region's distance from the EU makes it less interesting to EU-owned fishing fleets (the possible motivation that Pacific Island States are more susceptible to the seasonal and somewhat less predictable nature pertaining to movements of pelagic fish would apply equally to any other coastal country). In essence the provisions permit ACP States to source 'non-originating' fish provided it is landed and further processed by a Pacific ACP State. Further somewhat onerous notification provisions to the EU have been implemented, requiring *inter alia* an indication of the development benefits to the fisheries industry in the respective Pacific State, information on the species concerned and an indication on the quantities involved, as well as compliance with EU sanitary and phytosanitary measures.

Appendix 2 containing the product-specific rules (sometimes referred to as the 'list rules'), changes have also been made to fish products listed under Chapter 3. This entails that for all fish that is further processed (for example, fish fillets, shelled crustaceans in brine) a non-originating allowance of 15% (based on the ex-works price of the product) applies to the use of materials of Chapter 3.

However, it is unclear how this provision can be interpreted as an improvement to the RoO. Seen in the context of the general value tolerance provision (under Article 4, see discussion above) that remains in place and likewise existed under Cotonou, a nominally equal limitation (of 15%) on the value of non-originating fish material should by definition be worth less than the general value tolerance applying to *all* materials (packaging, brine, preservation and other materials included). It should be noted that the agreed general value tolerance may not through its application exceed specific tolerances.

□ **Provisions relating to textiles and clothing**

The RoO applicable to textiles and clothing have undergone a substantial change. Having remained largely unchanged since Lomé I, EU textiles and clothing rules were the subject of frequent criticism and were widely regarded as being out of touch with global dynamics prevailing in this sector. EU RoO have traditionally considered textiles and clothing production in a very structured and somewhat outdated manner, for example considering garments to be substantially transformed only when the production of fabric and garments has taken place locally. This took no account of general value-chain dynamics prevailing but also largely ignored the significant value-adding activities that can take place *within* the various industry segments (for example, processes that materially change the technical and visual attributes of fabric).

Whereas Cotonou (and other EU agreements) typically considered two distinct stages of transformation as sufficient to confer origin, the RoO contained in the IEPAs (and implemented by the relevant EC Council Regulation) significantly reduce the burden on producers by moving to a single transformation requirement as a general basis. This is a fundamental and important change compared to the Cotonou RoO.

□ **Specific derogations contained in Appendix 2A**

The IEPA RoO contain a new Appendix on derogations from the list of working or processing required to be carried out on non-originating materials. These may apply instead of the main rules (contained in Appendix 2) while any proof of origin made out in relation to the goods listed under Appendix 2A (and hence complying with the alternative rules) must bear a statement to that effect.

Products contained in Appendix 2A can all be classified as agricultural goods, and fall under Chapters 4, 6, 8, 11, 12, 13, 15, 18, 19, 20, 21 and 23. However, the derogations do not apply to all products within each Chapter (the specific goods being specified in the Appendix). A general theme runs through the list of products offered a derogation: generally, only those products within the relevant Chapter containing low amounts of non-originating sugar (“materials of Chapter 17”) are offered alternative RoO. Products qualifying for a derogation are mostly subject to a CTH or VA rule, the latter with a threshold of 60% pertaining to the use of non-originating materials.

□ **Cumulation**

Cumulation refers to the RoO provisions that allow countries to jointly meet the stipulated RoO requirements. This is made possible by each of these countries having the same RoO and tariff regime with respect to a particular export market, negating the incentive for transshipment (which RoO are intended to prevent). The IEPA provisions on cumulation are essentially the same as those previously contained in Cotonou, with the exception that cumulation is now limited to countries having signed an IEPA and listed in Annex 1 of the Council Regulation implementing the RoO. Cumulation therefore continues to be possible between (a) countries listed in Annex 1, (b) between the ACP (per Annex 1) and South Africa (subject to similar limitations as previously, for example the value-added in the ACP State must exceed the value added in South Africa, and a large number of products are excluded as per Appendix 7) and (c) with specific “neighbouring developing countries⁶”. The conditions pertaining to this last group are amended slightly from Cotonou, with textile products no longer excluded from cumulation, although tuna products and rice remain on the list of exclusions.

Certain products are however excluded from cumulation, or subject to delayed cumulation provisions.

- Appendix 7: diverse agricultural and industrial products, for which cumulation with South Africa not possible
- Appendix 8: fish products, for which cumulation with South Africa “temporarily” not possible
- Appendix 10: for products listed here (mainly sugar, cocoa-containing, extracts of coffee, tea) cumulation between ACP States delayed to 2015, and cumulation with South Africa excluded
- Appendix 11: for products listed here (rice) cumulation between ACP States delayed to 2010, and cumulation with South Africa excluded

Implications for regional development

The EPA negotiating process has been subject to a number of challenges. Despite an external deadline of 31 December 2007 having been imposed on the process by the pending expiry of the Cotonou Agreement, and the fact that Cotonou itself was signed on the basis of being a temporary arrangement, progress has been slow amid disagreement over the nature and scope of the proposed EPAs. While the EU has favoured bilateral agreements that include goods and services commitments, most ACP States were not ready to make firm and binding commitments on services and have questioned the need for these with respect to the requirements under a WTO-compatible agreement. Some countries were likewise not ready to commit to the reciprocal liberalisation of

⁶ These are defined in Appendix 9 and include 5 countries in North Africa, and 9 countries in the Caribbean region.

goods trade with the EU. As a result, only 35 ACP beneficiaries (less than half of all ACP States) initialled the IEPA at the end of 2007.

The EU has repeatedly expressed the view that regional economic integration and development remain priorities under the proposed EPA. With respect to the RoO, this objective raises a number of issues. *Firstly*, under Cotonou all ACP States were considered as a single territory for the purpose of complying with the RoO⁷. This means that through the provisions on cumulation⁸, the working and processing required under the RoO could jointly be fulfilled by two or more ACP States. By in effect extending the size of the home market in terms of RoO compliance, this gave ACP States the opportunity – at least in theory – to benefit from production and resource complementarities that existed between them. Where ACP States are also part of a PTA or even customs union, these provisions were important both from an economic and political perspective.

This form of co-operation is made possible by the fact that under Cotonou a single set of origin requirements prevailed. Under the IEPAs, the opportunities for regional economic integration and development are at this stage far more limited, despite the fact that the IEPA RoO continue maintaining the broad principle of cumulation. While the RoO provisions apply to all ACP States that are listed as signatories in Annex I, which means that technically cumulation can continue to function in a similar manner as before, the large number of countries that have not initialled the IEPA means that cumulation is now only possible to a more limited extent. Moreover, for practical purposes the current configuration (and the limited signing of IEPAs) complicates cumulation and the implementation of tariff schedules, for example where a country is part of a customs union without all countries being party to an interim or full EPA arrangement. Examples include the situation in Southern Africa (not all SACU⁹ States having initialled an IEPA), in West Africa (Ivory Coast, a member of WAEMU¹⁰ having initialled) and in Central Africa (Cameroon, part of CEMAC¹¹, being the sole signatory of an IEPA).

Instead, non-signatories currently fall under the EU GSP, and do not benefit from the amendments to the RoO contained in the Council Regulation. Under the EU GSP, cumulation is also not possible to the extent that it was under Cotonou, being limited to certain regional groupings. This means that the status quo from this perspective does little for regional economic integration and development.

Secondly, the specifics of the RoO also affect integration and development. As recently as 2005¹², the EC appears to advance the view that RoO which reward local and regional sourcing and the vertical integration of production in favour of sourcing from other locations should be an objective of preferential RoO. In theory, this position is commendable, but in practice somewhat misplaced with respect to the RoO. Here it is important to highlight the fact that RoO should prevent transshipment and the dissipation of economic benefits that results from this. However, RoO that are developed with the intention of “serving” development and regional integration imperatives are likely to fail; rather, for regional development benefits to flow from RoO these should be conducive to investment and trade, and complement the dynamics prevailing in the respective sectors. It also matters little that cumulation provisions in theory permit joint compliance with the applicable RoO provisions, if ACP States face similar competitiveness constraints with respect to sourcing, production and material availability.

⁷ See Article 2 (2), Title II, of Annex V of the Cotonou Agreement Rules of Origin

⁸ See Article 6, Title II, Annex V of the Cotonou Agreement Rules of Origin

⁹ SACU: Southern African Customs Union

¹⁰ WAEMU: The West African Economic and Monetary Union

¹¹ CEMAC: Economic and Monetary Community of Central Africa

¹² For example, see 7 of: European Commission (2005). *Justification of the choice of a value added method for the determination of the origin of processed products*. Working Paper TAXUD/1121/05 Rev.1 – EN

RoO will not lead to local or regional sourcing, or vertical integration of industries, if for example the global dynamics in a specific sector require unfettered access to competitively priced materials from elsewhere or where buyer-driven value chain realities dictate that producers are able to be responsive to these specifics. A classic example remains that of the garment sector, where the ‘incentive’ (of duty-free market access to the EU) has not yielded the desired results of local or regional sourcing and development, and vertical integration. In fact, three decades of EU RoO that ostensibly rewarded local sourcing and development have in fact undermined the ability of the ACP clothing sector to export to the EU.

Thirdly, the current geographic configurations of ACP negotiations have raised questions with respect to regional economic integration. The situation is most pronounced in East and Southern Africa, where overlapping memberships of *existing* integration initiatives have undermined the ability of countries to engage with the EU in a meaningful and constructive way. EPA configurations do not follow existing configurations: for example, individual SADC States are negotiating as part of the SADC EPA, ESA EPA, EAC EPA and Central African EPA. In addition, the Southern African Customs Union (SACU), which includes South Africa, received a differentiated market access offer into the EU hence undermining regional economic integration through the effective implementation of artificial trade controls between South Africa and the remaining SACU States. Elaborate cumulation requirements further undermine the objective of regional development in that region, as South Africa (irrespective of it not initialising the IEPA at the end of 2007) was subject to a differentiated outcome in the RoO. These provisions, while ostensibly targeted at South Africa’s status as a more developed country vis-à-vis its customs union partners, are to the detriment of South African *and* regional producers and exporters, who are constrained in using South African materials for further processing into EU export goods.

Implications for future multilateral and bilateral commitments

Due to the absence of a binding WTO agreement on RoO, or even of enforceable principles pertaining to preferential RoO, the provisional outcome of the EU-ACP RoO negotiations would not appear to have major implications for future multilateral or bilateral commitments.

In a sense, the main implications for further (bilateral) commitments apply to the EU rather than the ACP. The EU has previously indicated its desire to maintain harmony in its preferential RoO regime. This is evident from the process underway to revise its preferential RoO, which formally began in 2003 with the publication of a Green Paper on preferential RoO¹³. From its own perspective, harmonised RoO reduce the administrative burden faced by its customs authorities, and of traders in the interpretation of RoO and the optimisation of production and international trade. However, this effectively also means that the EU’s preferential trade partners, including the ACP, face a difficult task in engaging with the EU on any real renegotiation of RoO, the EU being wary of extending to one region what it can not (or will not) extend to others. The regional approach to renegotiating the RoO that was ultimately pursued by the ACP arguably further weakened the latter’s ability to extract more meaningful concessions from the EU, despite the fact that the EU was never likely to make substantial region-specific concessions on RoO¹⁴. This has perhaps been highlighted by the fact that virtually the only – albeit significant – product-specific

¹³ European Commission (2003), *Green Paper on the future of Rules of Origin in preferential trade arrangements* – COM(2003)787 final

¹⁴ The exception being perhaps the region-specific concessions pertaining to certain processed fish products of Chapter 16 made to Pacific countries.

departure on RoO for industrial goods (of Chapter 25-97) has so far been with respect to textiles and clothing, although this change has arguably been long overdue.

One of the more contentious clauses contained in the IEPA relates to the Most-Favoured Nation (MFN) principle. With this, the EU is trying to ensure that any commitments on the part of ACP States included in the final EPA are not later surpassed by commitments made by the ACP in future PTAs with third countries. By insisting on the inclusion of such commitments, the EU is effectively insuring itself against an outcome that extracts lesser commitments from the ACP than might have been possible now or in the future. From the perspective of RoO and tariffs, this arguably reduces the policy space that ACP States have in their future negotiations with third parties, for example the South-South trading arrangements frequently advocated by some ACP States. On the other hand, it could be said that a MFN principle will allow the EU to accept 'lesser' concessions at this stage without the risk of having second-best market access to the ACP (probably mainly with respect to new generation issues) than any major competitor country might have at a future date.

It would also appear that the RoO provisionally agreed to between ACP signatories and the EU have taken place in a somewhat confined policy space. This is due to the fact that the European Commission is currently reviewing the EU GSP RoO, and its general RoO policies. Going forward, concessions to the ACP will invariably lead to expectations and precedents with respect to the EU's further commitments within the various GSP programmes (although EPAs will essentially override the GSP and related RoO provisions, and not continue to function as an alternative for those countries having concluded an EPA), as well as with respect to the general review of EU preferential RoO. This seeks to introduce RoO based on the VA methodology in all EU agreements in the near future; commitments made to the ACP at this stage invariably changes the "point of departure" for any future amendments and renegotiation, and from a future negotiating perspective may be holding back the EU in its current commitments. However, despite the EU's objective to replace the current "Cotonou-plus" type RoO with an altogether new RoO system, this remains subject to negotiation and mutual agreement between the EU and countries that have concluded an EPA and is therefore not a unilateral decision.

The negotiation process to here and going forward: options prior to signature

Negotiations on RoO only commenced during 2007, the final year covered by the Cotonou Agreement, despite the various regional EPA roadmaps indicating a far earlier start to these critical areas. As indicated earlier, neither the EU nor ACP States were fully prepared for the negotiations. The EU on its part initiated a general review of its preferential RoO in 2003 (with the publication of a Green Paper), but by mid-2007 was unable to articulate a clear policy or suggestions for improvement to the RoO in key areas including textiles and fish products. Likewise, the all-ACP process was ultimately hamstrung by divergent regional positions and priorities, and a perceived general lack of capacity (with some exceptions¹⁵) in the regions to draw up clear proposals on revised RoO. Up until midway through 2007, the EC continued to propose wholesale methodological changes to the RoO that were to govern future EU-ACP trade relations under EPAs, despite concerns from within Europe (inside the European Commission and among various Member States), ACP States and civil society at large (including academics and NGOs) regarding the potential downside risks associated with the implementation of such changes without deeper analysis of their potential impacts.

¹⁵ For example, the ESA region submitted proposals modelled on its own region-wide RoO regime, while the Pacific region's proposals focused mainly on fish. The SADC and Caribbean configurations also prepared submissions, but not initially under the all-ACP umbrella.

Shortly prior to the signing of the IEPA in November 2007, revised RoO were agreed and subsequently published (on the part of the EU) in a Council Regulation in December 2007. This Regulation implemented the RoO from the start of 2008 and applies only to countries listed in the Regulation while ACP States are required to give effect on their part to the RoO by July 2008 through the applicable domestic incorporation procedures.

Despite the fact that RoO negotiations have officially been concluded, pending the proposed general technical review beginning within the next three years¹⁶, the opportunity remains for the ACP States and the EU to engage *further* on the RoO that will ultimately be implemented as part of the final EPA. This is evident from the Council Regulation giving effect to the RoO, for example in the opening remarks at point (8):

*“the rules of origin applicable to imports made under this Regulation should for a **transitional period** be those laid down in Annex II to this Regulation. Those rules of origin should be **superseded by those annexed to any agreement with the regions or states listed in Annex I when that agreement is either provisionally applied, or enters into force, whichever is the earliest**” (emphasis added)*

Due to the timeframes involved and the substantial task in assessing the RoO pending a possible change to a VA-based methodology, the focus at this stage should be to consider any shortcomings of the IEPA RoO as stipulated in the Council Regulation. This review should be guided by ACP States’ current and potential export interests, and to identify where Cotonou RoO may have in the past led to a suppression of trade.

Proposals for amendments to the RoO that should ultimately form part of the EPA must be done as a matter of urgency, prior to the signing of a full EPA and ideally prior to the new RoO provisionally being implemented on the part of the ACP States. For example, the list of derogations contained in Appendix 2A contains only certain agricultural categories and is relatively limited in its coverage of products, while the provisions relating to fish have not seen major improvements with the exception of those relating to Pacific EPA countries.

Some reflections and recommendations

The draft RoO published by European Commission Council Regulation No 1528/2007 on 20 December 2007 contain a small number of improvements on the previous ACP-EU RoO. Based largely on the Cotonou provisions, these “Cotonou-*plus*” were to ensure that no ACP IEPA signatory was to be worse off with respect to EU market access, a situation that may have been different had the RoO been revised in line with the EU’s earlier proposals of a VA-based methodology. However, given that less than half of the ACP have initialled an IEPA, the rest being subject to the EBA (or significantly less favourable mainstream EU GSP) regime, there are clearly a significant number of countries that are worse off. The changes to the regulations should however be seen in the context that EPAs are intended to be reciprocal, and with any changes to the RoO ultimately applicable to two-way trade between the ACP and EU operators, translating into a larger “burden” on the ACP than on the EU. A discussion around the merits and impacts of reciprocity is beyond the scope of this brief.

While further improvements to the RoO are possible, the current arrangements should also not be considered as being problematic in all respects. In fact, the majority of product-specific provisions appear reasonable and require a realistic amount of local processing to confer origin.

¹⁶ See Article 21 of the IEPA text relating to Rules of Origin

In essence, the IEPA RoO build on the earlier Cotonou RoO by introducing product-specific changes to a number of agricultural products (through a permanent derogation, hence offering the old rules in addition to a new rule), as well as to the treatment of textiles and clothing, and fish. The latter is dealt with both at the specific product level, as well as the provisions detailing when a product can be considered as wholly produced (and thus originating) in the exporting country. Other amendments are generally to the “fine print” of the RoO, for example minor changes to the conditions defining insufficient operations, or certain safeguard mechanisms relating to trade surges.

The 35 ACP States that have signed an IEPA, as well as those that may be contemplating doing so, should realise that the RoO framework agreed thus far (and implemented on the part of the EU by way of Council Regulation) is not as yet final. A few issues, discussed earlier, relate:

- The IEPA RoO have at this stage been implemented by the EU, and apply only to the EU-bound exports from the 35 ACP States that have signed an IEPA (or Caribbean EPA);
- The final RoO will be those annexed to a final EPA; the current provisions can therefore still be amended / negotiated further¹⁷;
- The IEPA RoO have been implemented on the part of the EU by means of a Council Regulation. However, the provisions may lapse should the ACP States, on their part, not give effect to the provisions within a reasonable time¹⁸;
- ACP signatories are expected to apply the IEPA (including RoO) by July 2008¹⁹ through the appropriate domestic legislative measures;
- The IEPA RoO (and any future trade agreement, such as the full EPA) supersede the provisions of the GSP. Where any provision in the current regulations (as per Council Regulation) is less favourable than under the GSP, ACP LDC signatories may continue to benefit from the EBA provisions, but *for a limited period of time*²⁰;
- The IEPA RoO (as per Council Regulation on the part of the EU) gives the EU the right to make “technical amendments and decisions on the management of Annex II” (being the relevant chapter on RoO) in accordance to certain procedures (relating to the EU Customs Code Committee);
- The IEPA RoO improve the RoO in the textile and clothing sectors (the only industrial sector – considered those whose products fall into Chapters 25-97 – that has seen changes), as well as certain agricultural products;
- The derogation and alternative RoO for certain agricultural products is in the majority of cases very limited, and applies mostly to products containing less than a certain threshold of non-originating sugar;
- For fish products, only the crew requirement (relating to the definition of vessels that may catch “originating” fish) has changed, with a minor change to the product-specific rules that now contain a specific non-originating threshold. A general 15% non-originating threshold still exists, but is in fact now restricted by the product-specific threshold;
- For fish products, the IEPA RoO differentiate between Pacific EPA States and the rest of the ACP, with special concessions afforded to the Pacific States albeit subject to strict conditions;
- The European Commission has embarked on a process of re-assessing its preferential RoO, and changing the methodology used in determining origin. This process may have implications for ACP States in future as the IEPA makes reference to the technical review of the RoO (beginning within the next three years).

¹⁷ See Article 4, Chapter II of Council Regulation (EC) No 1528/2007

¹⁸ See also Note 5 at the start of Council Regulation (EC) No 1528/2007

¹⁹ See for example Statement of the Chief Negotiators on the initialling of the SADC IEPA

²⁰ See also Note 7 at the start of Council Regulation (EC) No 1528/2007

The following recommendations can assist with the current EPA negotiating process, as well as with the way forward:

- Revised RoO should be seen as part of the whole EPA “package”, including any agreement on investment rules and services. Agreeing to and implementing provisional RoO prior to agreement on a complete EPA may from a strategic perspective not be in the ACP States’ best interest;
- The IEPA RoO make provision for a technical review of the RoO beginning no later than three years after signature, to allow technical amendments and improvements but likely also to accommodate the EU’s objective of overhauling its preferential RoO regime. While a built-in review clause is desirable, overseen by a joint institution²¹, the clause should not be taken to imply that the RoO will be replaced by an altogether new regime. In this regard, the value-based methodology proposed by the EC previously is potentially problematic unless implemented with great caution and following extensive consultation with industry;
- The provisions giving the Commission the right to effect (ongoing) technical amendments and decisions on the management of Annex II (the RoO) should be considered with caution²²;
- The product specific changes to the RoO for fish are not sufficient to provide a significant improvement for the ACP fishing industries, and continue to be affected by other political and economic interests. The concessions granted only to the Pacific States remain an objective of the majority (if not all) other ACP States. Furthermore, the rule changes to Chapter 03 should be clarified, as they appear to be more restrictive (see in the context of the general value tolerance) than under Cotonou and other EU agreements;
- The derogations listed in Appendix 2A are limited in their scope and do not provide a significant improvement to producers and exporters;
- Cumulation provisions remain relatively restrictive, especially since they currently apply only to ACP States listed in Annex I. Since the EBA arrangements (GSP for least developed countries) also offers duty-free EU market access, there is no risk of transshipment were the cumulation rules to be extended to all ACP and EBA beneficiaries. There would also be very little risk of circumvention of the ACP-EU preferential RoO were the cumulation provisions extended to all preferential EU trade partners (including ordinary GSP beneficiaries) in instances where EU duties have either been removed or where applied rates are set at a low threshold (<10%). The administrative regulations involving cumulation should also be simplified, especially among ACP States;
- The product exclusions with respect to ACP cumulation with South Africa should be abolished, as these are not aligned to development prerogatives of the Southern African region in particular, and counter regional economic integration;
- The EC’s longer-term objective of changing its preferential RoO to a VA-based system should be considered with great caution, as this is likely to be associated with higher administrative compliance costs for producers, exports and customs officials but also contain a substantial risk of being less favourable for some industry sectors;
- Most importantly, there remains time to negotiate on RoO, as the provisions agreed at this stage are *interim* measures, and should be superseded by any RoO eventually attached to the final RoO provisions. While there remains the threat that the interim preferences could be withdrawn by the EU, this would appear politically not feasible in the absence of explicit indications on the part of ACP countries not to seek a WTO-compatible outcome, or a clear unwillingness to engage in administrative cooperation with the EC with respect to ensuring compliance with the RoO.

²¹ As provided for in Article 93 of the IEPA text

²² See Article 4(3), Chapter I of Council Regulation (EC) No 1528/2007