STANDARDIZATION OF RULES OF ORIGIN

Report to the Committee on Ways and Means, U.S. House of Representatives on Investigation No. 332-239 Under Section 332 of the Tariff Act of 1930

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PREFACE

On September 2, 1986, Chairman Dan Rostenkowski of the Committee on Ways and Means of the U.S. House of Representatives, on behalf of the Committee, requested that the United States International Trade Commission institute an investigation under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)) for the purpose of developing relevant criteria for a standard U.S. and international rule of origin for customs purposes. The Commission's report was to address the need for harmonization and rationalization of rules of origin, the criteria that should underlie the development of a standard rule of origin suitable for domestic and international adoption, and U.S. industry concerns regarding rules of origin.

On October 20, 1986, the Commission instituted its investigation No. 332-239, a notice of which was published in the Federal Register on October 29, 1986.

A preliminary report was issued on January 7, 1987, for the purpose of soliciting comments regarding the above cited investigation. The Commission held a public hearing both on this investigation and on investigation No. 332-243 (Origin Rule for Proposed U.S.-Canada Free Trade Area) on January 23, 1987.

For purposes of this investigation, rules of origin are those laws, regulations, and administrative practices that are applied to ascribe a country of origin to goods in international trade. Origin rules include those applicable for purposes of obtaining most-favored-nation (MFN) tariff treatment, the benefits of other preferential tariff programs, and marking statutes, as well as for statistical reporting. The need for rules of origin arises from the fact that, when trade regulations are applicable on a country basis, it is necessary to be able to identify one and only one country of origin for imported articles, notwithstanding the fact that more than one country was involved in the manufacture of particular goods. Accordingly, rules of origin are required for each trade program and for most trade regulations to assure that such program or regulations are appropriately applied.

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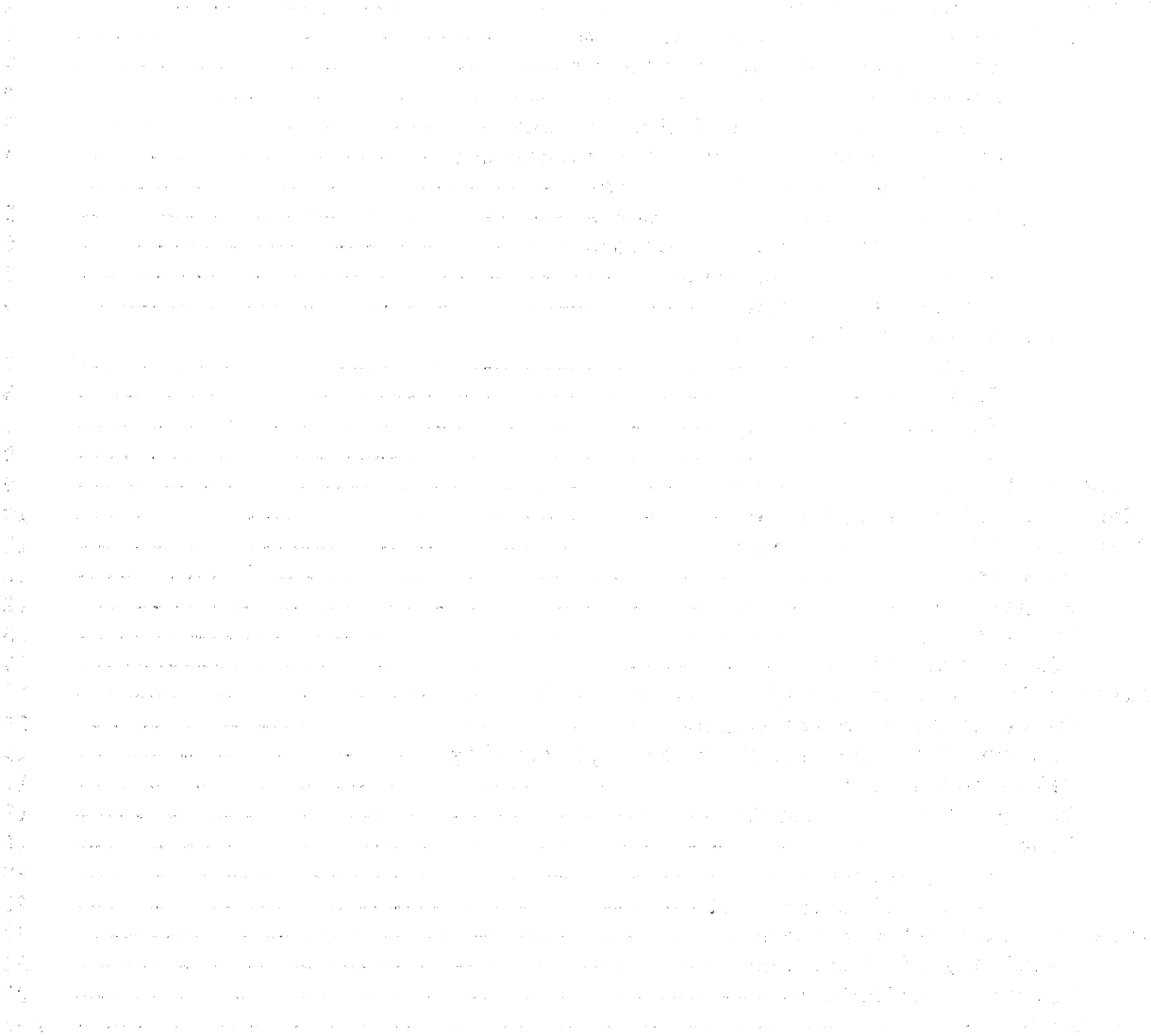

EXECUTIVE SUMMARY

This study, instituted at the request of the Committee on Ways and Means, U.S. House of Representatives, examines issues relating to country-of-origin rules that were not included in the scope of the Commission's previous study, investigation 332-192. 1/ Specifically, the Committee requested that the Commission address relevant criteria for a standard U.S./international rule of origin, the need for the harmonization and rationalization of origin rules, and U.S. industry concerns regarding rules of origin.

Many different standards are currently utilized by various countries to determine the country-of-origin of imported goods that are not wholly grown, mined, or produced in a single country. These rules have multiple governmental purposes--namely, to permit the assessment of appropriate customs duties (including antidumping and countervailing duties), to assure the correct marking of foreign goods as to their origin, and to restrict the application of country-specific trade measures to articles that are considered to be the product of the countries concerned.

The report notes that there is no accepted international standard for determining origin even for statistical purposes. It recognizes that origin problems have arisen largely during the last thirty years as the practice of multiple-country manufacturing has grown and as country-specific preferential agreements and trade restrictions have been implemented. The report identifies a number of advantages to harmonizing origin rules, including simplifying customs considerations in business planning, reducing the opportunity for trade deflection, facilitating greater understanding of country-specific trade information, creating the opportunity to develop a single and fundamentally reliable standard (thereby possibly avoiding the current proliferation of multiple standards), and providing a generally useful benchmark standard which does not currently exist.

1/ The Impact of Rules of Origin on U.S. Imports and Exports: Report to the President on Investigation No. 332-192, USITC Publication 1695, May 1985.

The United States and its major trading partners maintain several rules of origin for different programs. The report summarizes the principal rules in use--the substantial transformation test, the change of tariff heading rule, and the value-added test--and provides an analysis of each in terms of their major strengths and weaknesses.

Any new standard rule of origin should be designed so as to obviate many of the problems presented by the various rules now in use. In the case of substantial transformation, these deficiencies include unpredictability of result and complexity of application, in large part because the language of the rule permits wide interpretation. In the case of the value-added concept, the flaws derive largely from the need to apply it on a transaction-by-transaction basis, the unpredictability in its application caused by changes in exchange rates, difficulties in assessing appropriate costs, and problems in verifying accounting records. With the rule known as change of tariff heading (used by the European Community for some imports), the faults include its failure to deal adequately with assembly operations and its reliance on a nomenclature not drafted with the purpose of making origin determinations in mind.

The report identifies the criteria that should be satisfied by an origin rule. The rule should be capable of uniform application, be simple to understand, provide predictable results, and be effectively administrable.

With these characteristics and criteria, and considering the origin rules now in use, the Commission has suggested a framework for a new rule of origin. Such a code could comprise an enumeration of industrial processes covering various product sectors that, if performed, would be deemed to confer origin on the situs country. Once created, this system would not be susceptible to widely varying interpretation or complex determinations or rely on indirect measures of contribution, such as value content. The tariff nomenclature could be utilized as a basis for segregating product sectors and deriving some of the processes to be enumerated. Also, explanatory material outlining processes that would be deemed sufficient or insufficient to confer origin could be provided. The process approach would thus attempt to deal with origin questions in a concrete, sector-specific manner, yielding results consistent with economic and business realities.

The Commission issued a preliminary version of this report with the goal of encouraging the submission of views on these issues; it also conducted a public hearing in conjunction with that of investigation No. 332-243, regarding an origin rule for the proposed U.S.-Canada Free Trade Area. In response, testimony from several individuals and written submissions from many others were received. These are summarized in some detail in this report. The comments are widely divided. Many express concern over the present state of U.S. origin rules, while others support a uniform origin rule. Some indicate displeasure at the practices currently being employed by the U.S. Customs Service in its origin determinations--principally at the concept of "substantial manufacturing." However, many domestic interested parties opposed any changes in present origin rules, saying that only the current system could provide adequate safeguards against competitive imports.

In light of the diverse and conflicting comments received during the course of this investigation, the report suggests that it may be useful to proceed toward developing a standardized origin code without regard to its application for economic programs but merely for determining origin for statistical purposes. Once completed and accepted, the rules of eligibility for specific programs could then be addressed independently of the origin rules.

Overview of Current Rules

The United States and other major trading nations utilize varied standards in making origin determinations for customs purposes. Though these were explained in detail in the Commission's report in the earlier investigation, No. 332-192, 1/ brief descriptions of significant rules are appropriate as a foundation for the analysis being undertaken in this report.

United States rules for particular programs

Most-favored-nation treatment.--Under the terms of general headnote 3 to the Tariff Schedules of the United States (TSUS) (19 U.S.C. 1202), the different rates of duty set forth in columns 1 and 2 are applied on the basis of the country of origin of each imported article. That is, the duty assessed by Customs officers at the ports of entry is in part determined by the country of which the article is considered to be a product. If an imported article is not entered under any claim of preferential tariff treatment, and is found not to be a "product of" a Communist country enumerated in TSUS general headnote 3(d), it will be assessed the appropriate column 1 (most-favored-nation (MFN)) rate of duty, according to general headnote 3(f) to the TSUS. An article for which preferential treatment is denied is likewise dutiable at the MFN rate, whereas an article deemed to be the "product of" such a Communist country is dutied at the generally higher column 2 (statutory) rate.

Thus, once the proper tariff classification for an article has been ascertained, the article's country of origin affects the rate of duty to be imposed, from the two or more rates that may appear for the tariff item. If the article is wholly derived from one country, its origin is clearly that country. If not, then it must be determined '. . . if as a result of processes performed in that country a new article emerges with a new name, use or identity' (Belcrest Linens v. United States, 2 CAFC 105, 741 F.2d 1368, 1371 (Fed. Cir. 1984)). 2/ Where imported--or a combination of imported and domestic

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1/ See Impact of Rules of Origin . . . Investigation No. 332-192, USITC Publication 1695, May 1985.

2/ While the appellate court declined to define the term "substantial transformation" as it would apply in all circumstances, given the fact that regulations implementing different tariff measures interpret the term differently,

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domestic components or materials are substantially transformed as described in Belcrest, they acquire origin in the country of processing or manufacturing. The Belcrest decision noted that substantial transformation (ST) can occur even where the components and the ultimate product are classifiable in the same tariff item, so that a change of tariff classification is not essential to the finding. 1/ The ST rule is also used where a previously imported article of foreign origin is exported from the United States and a claim for a refund of customs duties (drawback) is made under section 313 of the Tariff Act of 1930 (19 U.S.C. 1313). For example, where so-called "same condition" drawback is sought, the merchandise cannot undergo production or manufacturing operations in the United States--which would generally result in the conferral of U.S. origin--but can undergo only certain incidental operations such as packing. 2/

Marking.--Pursuant to section 304 of the Tariff Act of 1930 (19 U.S.C. 1304), every article of foreign origin, or its container, not exempted from the requirement must be ". . . marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such manner as to indicate to an ultimate purchaser in the United States the English name of the country of origin of the article." The Secretary of the Treasury is empowered to regulate the methods of marking and other matters to prevent deception about the origin of goods, including the implementation of the exceptions set forth in section 304. Failure to comply with the marking requirement results in the imposition of marking duties of 10 percent ad valorem.

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it did state that '. . . it is clear that a "substantial transformation" occurs when as a result of a process an article emerges, having a distinctive name, character or use, in essence the definition of manufacture quoted above [citing several earlier rulings].' 2 CAFC at 109-110. The decision uses the term ST in several instances and states that, in determining whether ST has occurred, '. . . the issue has been the extent of the operations performed and whether the parts lose their identity and become an integral part of a new article.'

1/ Belcrest at 1372, citing Rolland Freres Inc. v. United States, 25 CCPA 81 (1935).

2/ See sec. 313; 19 CFR sec. 191.141(a); Anheuser-Busch Assn. v. United States, 207 U.S. 556 (1932).

Customs regulations 1/ define "country of origin" for purposes of section 304 to mean--

> the country of manufacture, production or growth of any article of foreign origin entering the United States. Further work or material added to an article in another country must effect a substantial transformation in order to render such other country the "country of origin" within the meaning of this part [19 CFR Part 134].

Thus, where an imported article is not the product of one country, the same rule--ST--has traditionally determined the country of origin for both duty and marking purposes in most cases, unless preferential tariff treatment is sought. That principle is likewise employed to determine whether a manufacturer is the "ultimate purchaser" for purposes of section 304. Where a U.S. manufacturer substantially transforms imported components (according to the regulation, 2/ ". . . even though the process may not result in a new or different article"), he need not mark the final product with the imports' country of origin. It is apparent from the quoted definition, as well as from judicial decisions, 3/ that apparent inconsistencies and undefined terms make marking a difficult and controversial area.

Generalized System of Preferences.--The U.S. Generalized System of Preferences (GSP) 4/ program maintains additional origin criteria that serve to limit preferential duty-free treatment to products of designated beneficiary developing countries (BDC's), while minimizing opportunities for developed nations to operate pass-through operations in the BDC's. To qualify for such tariff treatment, an article must be provided for in a TSUS item covering articles designated as eligible for benefits of the GSP program and, by statute, shipped directly from the BDC to the United States. If it is wholly made in a

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1/ 19 CFR sec. 134.1(b).

2/ 19 CFR sec. 134.1(d)(1).

3/ For example, in Yuri Fashions v. United States, No. 86-33, 20 Cust. B. & Dec. 40 (CIT Mar. 24, 1986), the court held that the country of origin for particular sweaters completed in the Northern Marianas Islands could be different for quota and marking purposes.

4/ The GSP affords nonreciprocal tariff preferences to developing countries to aid their economic development and to diversify and expand their production and exports. The U.S. GSP, enacted in title V of the Trade Act of 1974 and renewed in the Trade and Tariff Act of 1984, applies to merchandise imported on or after January 1, 1976, and before July 4, 1993. It provides duty-free entry to eligible articles imported directly from designated beneficiary developing countries. See 19 U.S.C. 2461 et seq., as amended.

BDC or members of a designated association of BDC's, it is then eligible to receive duty-free entry. If not, it must also meet the other criteria provided by law and by Customs regulations. That is, it must also be a "product of" a BDC, pursuant to the regulations. By statute, the total of (1) the cost or value of materials produced in a BDC or in BDC members of a designated association thereof, and (2) the direct costs of processing operations performed therein, must be not less than 35 percent of the article's appraised value upon entry into the United States. For goods where non-BDC content is being counted toward the 35-percent value threshold (because the BDC contribution alone does not reach that level), Customs regulations require a dual ST finding as to the third country contribution. That is, the components or materials imported into the BDC must first be substantially transformed there (such as raw materials into parts or semi-manufactures), and then those goods must be substantially transformed into the ultimate article being exported to the United States. Special Customs forms in addition to ordinary entry papers must be properly completed and presented to certify all such information, and they are subject to verification and/or rejection.

Caribbean Basin Economic Recovery Act.--The origin rules developed for the Caribbean Basin Economic Recovery Act (CBERA) 1/ program were based upon the GSP rules, though somewhat more liberal for the designated beneficiary countries (BC's). The CBERA rules include both a direct importation (though with a variation for certain Puerto Rican operations 2/) and a 35-percent value-content requirement. To be eligible for duty-free treatment under the CBERA, the

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1/ The CBERA affords nonreciprocal tariff preferences to developing countries in the Caribbean Basin area to aid their economic development and to diversify and expand their production and exports. The CBERA, enacted in title II of Public Law 98-67 and implemented by Presidential Proclamation 5133 of Nov. 30, 1983, applies to merchandise entered, or withdrawn from warehouse for consumption, on or after Jan. 1, 1984; it is scheduled to remain in effect until Sept. 30, 1995. It provides duty-free entry to eligible articles imported directly from designated Caribbean Basin countries.

2/ Where BC products are imported directly into Puerto Rico for processing or use in manufacturing in warehouse, the articles, upon withdrawal from warehouse, are treated as if such operations had occurred in a BC where other origin criteria are met.

articles must be a "product of," or be wholly produced or manufactured in, a BC; the statute precludes the conferral of origin on a BC where only enumerated nonmanufacturing operations occur therein (19 U.S.C. 2703(a)(2)). Also, for purposes of calculating the 35-percent figure, Puerto Rico and the U.S. Virgin Islands are treated as BC's, and up to 15 percent of the appraised value of the entered article (and part of the 35 percent) may be U.S. content. Moreover, the value content from all BC's can be cumulated in arriving at the 35-percent threshold.

U.S.-Israel free-trade area.--Pursuant to the agreement reached between the two Governments and in accordance with the implementing legislation (19 U.S.C. 2112 note), an article may qualify for preferential tariff treatment under the free-trade area if--

(1) it is either the growth, product, or manufacture of Israel or is a new or different article of commerce that was created there,

(2) it is imported directly from Israel into the U.S. customs territory,

(3) the sum of Israeli content plus direct costs of processing is 35 percent or more of the article's entered appraised value (including up to 15 percent U.S. content), and

(4) it did not solely undergo certain enumerated nonmanufacturing operations in Israel.

If an article is deemed to be a "product of" Israel, it can be afforded reduced duties or duty-free treatment under the TSUS upon entry. 1/

Canadian automotive products.--Under the Automotive Products Trade Act (19 U.S.C. 2001 et seq.), implementing an agreement between the United States and Canada, certain articles may be eligible for duty-free entry into the United States where--

(1) they are the "product of" Canada, meaning that they were produced with the use of Canadian or U.S. materials or that they do not contain third-country materials exceeding in aggregate value 50

1/ Preferential rates of duty in the Special column followed by the code "I" reflect the rates of duty applicable to products of Israel under the United States-Israel Free Trade Area Implementation Act of 1985, as provided in general headnote 3(e)(viii) of the TSUS. Where no rate of duty is provided for products of Israel in the Special column for a particular tariff item, the rate of duty in column 1 applies.

percent of the articles' entered appraised value in most instances (TSUS general headnote 3(c)), and

(2) they are "motor vehicles" or "original motor-vehicle equipment" (TSUS schedule 6, part 6B, headnote 2).

Insular possessions treatment.--Under general headnote 3(a) to the TSUS, with specified conditions, articles imported from insular possessions receive MFN duty rates unless they are either the growth or product of such possessions or are treated as such by Customs. In these two instances the articles are exempt from import duties. In addition, articles imported from an insular possession and designated as eligible for benefits of the GSP or CBERA receive ". . . duty treatment no less favorable than the treatment afforded such articles imported from a beneficiary [developing] country. . ." under provisions of the pertinent statutes. Thus, U.S. insular possession articles receive duty-free entry if they are (1) wholly grown, made, or produced in the possessions, (2) made entirely from materials or components grown, made, or produced in the possessions or in the United States, or (3) do not contain foreign (third-country) materials constituting by value over 70 percent of the total import value of the goods (50 percent for articles covered by the exclusions from the CBERA program). 1/ The headnote excludes from consideration as "foreign materials" any materials that may enter the U.S. customs territory free of duty. Other provisions of the headnote set out special criteria for specified articles such as watches. While the headnote on its face encourages the inclusion of U.S. content, its principal goal is to give every possible stimulus to export-oriented industries in the possessions.

Government procurement.--The U.S. Customs Service issues advisory rulings and final determinations on country-of-origin questions for purposes of Government procurement in order to carry out "Buy American" restrictions, open bidding policies, or other procurement statutes and international obligations (19 CFR secs. 177.21-177.31). These rulings may be requested by foreign manufacturers, producers, or exporters; U.S. importers; domestic manufacturers, producers, or wholesalers; U.S. labor unions and associations; and U.S. trade or business associations. The applicable rule of origin for goods not wholly the product of one country relies on the ST principle with one variation: it permits customs union member countries to be treated as one country. Judicial

1/ General headnote 3(a) to the TSUS.

review to the Court of International Trade may be sought within 30 days of adverse rulings.

Foreign-trade zones.--In the U.S. foreign-trade zone program, foreign merchandise brought into a zone but not "manipulated or manufactured so as to effect a change in tariff classification" is treated as continuing to have the same country of origin as it did prior to zone entry (19 CFR sec. 146.21(a)). Where a change in an article's tariff classification occurs in the zone, the article acquires zone origin, unless the importer/zone manufacturer requests that the merchandise have "privileged status"--usually to reduce applicable customs duties. In such instances the article retains its original country of origin and is dutied based on its condition and classification upon entry into the zone, rather than upon entry into the customs territory. 1/

Foreign rules of origin

Canada.--Canada maintains several rules of origin, under different programs, for goods not wholly made in one country. Canadian customs officials provided the following explanation of Canada's origin rules, which like U.S. rules have been the subject of considerable interpretation. For tariff application purposes, a basic principle used is that the article must be completed in the form exported to Canada in the country claiming origin, with not less than 50 percent of the cost of production or 60 percent of the ex factory price, depending on the tariff treatment, attributable to that country and other others entitled to the same tariff treatment. For preferential programs, cumulation of the costs traceable to beneficiary countries of the particular program is permitted. Direct shipment is also required, with conveyance without transshipment required for one program.

For purposes of country-of-origin marking, the country of origin is that country wherein the goods were substantially manufactured--that is, where the chief part of production of the article has been carried out by the industry in that country. Generally the country where the article essentially took the form in which it is imported into Canada is the country of origin.

1/ See The Implications of Foreign-Trade Zones for U.S. Industries and for Competitive Conditions Between U.S. and Foreign Firms: Report to the Committee on Ways and Means in Investigation No. 332-165, USITC Publication 1496, February 1984.

2/ See the Commission's report in investigation No. 332-192 at page 41.

Japan.--Japan uses the country of processing as the origin of goods not manufactured in one country, for purposes of preferential tariff programs, and the country of ST for other purposes--with some exceptions. Certain goods must also meet "change of tariff heading" (CTH) (discussed generally below) and other requirements, including foreign-content limits and direct shipment requirements.

European Community.--The European Community (EC) has detailed regulations defining origin, with many different standards applied under different preferential and nonpreferential programs. Four criteria, requiring case-by-case decisions and interpretations, are generally used; CTH (with product-specific exceptions) is an important factor in origin determinations for textile products and articles from countries receiving preferential tariff treatment. 1/

Nonpreferential origin determinations are made to determine whether particular goods will be dutied at MFN rates, subject to quantitative restrictions or other regulations, and required to be accompanied by certificates of origin. Under Article 5 of Regulation 802/68, articles made in more than one country--

> . . . will be regarded as originating in the country in which the last substantial process or operation that is economically justified was performed, having been carried out in an undertaking equipped for the purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture.

Accessories and tools for and parts of such articles have the same origin as the articles if delivered therewith.

Where this rule cannot be applied, "secondary" regulations permit the Commission of the European Communities to adopt any special provisions that are needed. Such provisions include enumerations of processes employed with respect to many products, particularly textiles and apparel, and two exceptions lists related to certain textiles, List A and List B. In addition, value-added criteria have been adopted for some products.

The EC's preferential programs are not governed by the above regulations; they instead have individualized standards designed to limit the conferral of benefits to particular products. Among these programs are the EEC-EFTA agreement, agreements with Mediterranean countries and with the Lome countries and

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1/ The EC's origin standards were discussed in detail in the Commission's report in investigation No. 332-192, cited above.

the Overseas Countries and Territories, and the GSP. The basic rule used with respect to all these programs relies on the CTH principle (discussed below). A related List A specifies additional requirements that must be satisfied, while List B specifies those operations and processes which are deemed sufficient to confer origin even if no CTH occurs. For products on both lists, the exporter may choose the test he wishes to apply, with some limitations. List C covers petroleum products. All of the protocols dealing with origin for these preferential programs contain enumerations of processes that will not confer origin even if a CTH occurs. The agreements generally contain value-added standards, which are covered by detailed criteria. Some of the programs (but not the GSP) permit cumulation of beneficiary country materials or of both beneficiary country and EC-origin materials (the latter referred to as bilateral cumulation); the calculations involved in determining whether the value content threshold has been satisfied are complex. In addition, appropriate certificates of origin must be supplied.

Summary.--It may be readily seen that the trading community faces serious difficulties in complying with such a wide variety of rules and that no single legal principle tends to be used in the majority of instances. This situation may result in increased costs and delays, higher prices to consumers, and other problems. Thus, a reduction in the number of rules and the differences in standards and recordkeeping requirements would tend to facilitate trade.

Purpose of Rules

It is extremely important for a government to be able to ascertain accurately the origin of goods being imported into and removed from its territory. First, origin determinations are needed to permit the granting of customs duty or other trade preferences to particular trading partners so that other nations' goods do not benefit therefrom. Second, they enable both the public and the private sectors to know about trade and production in individual categories of goods in the various countries and to examine trends in the location and extent of such production. Third, such data are necessary for the calculation of bilateral and multilateral balances of trade and of payments, critical to the assessment of trade and economic policies. Fourth, such decisions must be made where it has been decided that quantitative

restraints are required for product classes in order that articles may accurately be counted. Finally, country-of-origin criteria may be needed for the implementation of health, safety, or other standards; goods can be required to be marked with their origin to permit the government and the public to know their source.

From the viewpoint of the private sector, origin rules are necessary to the trading community as a means of predicting how each shipment of goods will be treated by customs officials in different importing countries for duty, quota, or other purposes. This is especially important in planning business operations or in making long-term contracts, where sudden changes or discretionary decisions could preclude the entry of goods into a country at the expense of the manufacturer or exporter. In addition, many multinational commercial or manufacturing undertakings are structured to benefit from advantageous duty or quota circumstances; these activities depend on the consistent administration of origin rules. Thus, origin rules may simultaneously serve as a government's means of regulating trade in all or particular products and of encouraging or facilitating such trade.

Advantages of a Standard Rule

In some respects, given the extent of world trade, it is surprising that there is no accepted international standard for determining, even for statistical purposes, the country of origin of goods manufactured or processed in more than one country. On the other hand, the significance of country of origin as a trade-related problem is undoubtedly unique to the last 30 years, as the practice of multiple country manufacturing has grown along with preferential agreements and country-specific trade restrictions.

As is further discussed below, each of the alternative rules has shortcomings, at least in terms of the criteria for a standard rule of origin discussed in the next section of this report. Presumably in recognition of these limitations, the United States and other countries have resorted to using different standards in combination for individual programs; this policy attempts to assure that trade restrictions or preferences to goods will be limited to those meriting special treatment. A standardized rule or code of origin would present major advantages--namely, to avoid the proliferation of

such multiple standards, to overcome the limitations of existing rules, to provide for simpler administrative requirements, and to reduce the opportunity for trade deflection (where shipping or production patterns are arranged to mask the real country of origin or to claim the benefits of preferential programs).

Standardization would also provide an agreed frame of reference for determining origin. Whereas most countries currently use either a value, a change of tariff heading, or an ST standard, differences in their application or interpretation prevent uniformity and predictability of result. A unified standard of origin could provide a single and fundamentally reliable discipline for deciding origin, first for statistical purposes and later for both existing (to the extent considered appropriate) and future tariff programs. That situation would contrast with the present multiple rules, developed using techniques neither originally created nor wholly suitable for the purpose. A new origin code could conceivably be used internationally as the basis for administering all trade agreements and customs laws but still permit the creation of special provisions needed to implement particular measures.

An international code of origin, once in place and widely implemented, would present a number of advantages. First, a single code would simplify customs considerations in business planning. In particular, origin determinations in complex multinational business operations would be easier to make, thus avoiding inadvertent misstatements of origin (and subsequent penalties) on customs documentation . Foreign trade data published on a country basis would also be at least better understood, if not improved in accuracy and usefulness, thereby simplifying the analysis of multilateral trade situations. Certainly the negotiation and monitoring of trade agreements and restrictions would also be facilitated.

Criteria for a Standard Rule

All of the objectives one might suggest for a uniform origin rule are dependent, to a large extent, on the perspective from which the question of a new origin rule is considered. That is, the goals chosen by a customs technician drafting such a new rule (or reviewing existing alternatives) may differ

from those of an importer or manufacturer. The former may look broadly at the rule's administrability and its effects on customs operations. The latter may be interested only in assuring that his particular goods would receive the same treatment under a new rule as under the present regime, or in changing specific origin treatment he views as disadvantageous. It is difficult to review any proposed alternative rule in the abstract (i.e., without ascertaining how it would apply to individual products) and to consider its long-term benefits or disadvantages.

With this problem in mind, however, four critical elements are likely to be desired of any standard rule of origin, in terms of its usefulness as a decision tool. They are relatively straightforward and thus require only a brief discussion. The Commission's preliminary report in this investigation included a fifth criterion, that of consistency with trade policy needs. After considering the needs of the Government and comments received by the Commission, this has been eliminated herein as an element to be used to evaluate origin rules. The inclusion of such a criterion could be interpreted to mean that any rule drafted with such a standard in mind condones the existence of discretion in the administration of origin rules and promotes the perception that the outcome of individual origin determinations should in some cases be subject to manipulation.

Uniformity

The standard rule should be capable of uniform application; that is, it should be interpreted in the same fashion by all customs administrations using the system. It should be unnecessary for customs officials at the ports of entry to give exceptions for individual shipments or products.

Simplicity

The rule should be as clear and as comprehensible as possible, with a minimum of ambiguous language and of terms requiring subjective interpretation. Objective standards--factual and mechanical rather than subjective--should be favored, both to permit easier use and to discourage litigation. Such criteria will help reduce costs, avoid burdensome recordkeeping, and lessen delays in obtaining release of goods.

Predictability

A standard rule should produce predictable results, so that firms may independently undertake intelligent business planning and forecast how particular shipments will be treated by Customs at the time of entry. Regular need for recourse to Customs officials or the judicial process should be minimized. Consistency of rulings should be ensured to the greatest extent possible from one shipment to the next for more accurate duty assessment, statistical reporting, and trade analysis purposes.

Administrability

The standard rule should be drafted so as to be effectively verifiable and capable of smooth, uncomplicated operation, with the least possible burdens on all parties concerned. Customs officials must be able to apply the rule with available personnel to the entire volume of entries without undue delays and with a high degree of accuracy. The trading community should be able to comply with the rule; it cannot require excessive or unavailable information, or impose unfair costs. The amount of time potentially required for training, and for rulings to be issued or reissued under the new rule, should be contained.

Alternative Rules of Origin

The purpose of this section of the report is to examine the major alternatives which may serve as a basis for determining origin. Having been factually described in our earlier report, with the exception of the process-oriented approach suggested in the preliminary report in this investigation, the rules will be looked at here from a more general and analytical perspective. Some significant positive and negative features of each alternative rule identified by the Commission, including the proposed process-oriented rule outlined in the preliminary report, are set forth in this section.

Substantial transformation

ST is a legal concept employed in determining the country of origin of goods that are not entirely produced in one country but that undergo some modification, combination, or assembly in that country. If materials or components from more than one source are subjected to manufacturing, processing, or assembly operations in country A and the resulting article is imported into country B, customs officials in the latter may decide that

country A is the country of origin of the article even if few or no materials from country A were contributed to the product. This decision turns on several factors, at least in the United States: whether a "new and different article of commerce" was created, whether the ultimate article has a name, character, or use distinct from that of its components, whether the materials were significantly changed in country A (rather than merely packaged or assembled), whether the determination is being made for purposes of marking or some other particular customs program, and other criteria. Each of these factors is complex in application and requires interpretation based on the circumstances of the individual shipment concerned. Specifically, the finding of ST is done on a case-by-case basis. The number and variability of these rulings have posed problems for the Customs Service and for private-sector parties who cannot always predict in advance how shipments will be treated.

Some positive aspects of using ST as the basis for origin rulings are apparent. First, it has been alleged that the standard is widely used, is therefore familiar to the trading community and to Customs, and has a body of precedent attached; to that extent, it has proven possible for Customs to administer the rule. Second, the fact that commercially significant manufacturing or processing must occur in the exporting country helps assure that the country concerned has an "economic stake" in productive operations. Moreover, because many relatively simple processing or manufacturing operations have been held sufficient to constitute ST for certain products, developing countries may be aided in the creation or attraction of export industries. In addition, the degree of documentation and regulation under this standard is generally less burdensome than is the case under other standards, except in a few cases where elaborate cost data are needed to establish that significant processing occurred. Last, the standard is flexible enough to permit some discretion for those products where it is deemed desirable to identify a particular country of origin.

However, there are several important difficulties in using ST as the sole or major origin criterion. Foremost among these problems is the subjective nature of the standard, given the less than definite nature of such terms as "substantial" and "new article." The elements of the rule are easy to state, at least for experienced persons, but are not susceptible of broadly applicable definition or easy application. The fact that case-by-case interpretations are at times not predictable prior to importation poses obstacles for

importers, as well as for firms attempting to plan multinational operations, to locate in particular countries or to gain knowledge about foreign competitors. Even those expressing their support of the ST standard to Commission staff admit that recourse to attorneys, Customs, and even the ruling/judicial review process is often necessary; many of these supporters have spent considerable time and money obtaining rulings from Customs.

With so many shipments involved, especially of new products, the need for regular interpretation creates administrative difficulties for Customs officials. There is apparently a wide discretion in decisionmaking, which may be affected by considerations not directly related to any country's contribution to the goods concerned (such as the interest of particular firms or government agencies in certain products). It also necessitates obtaining formal Customs Service rulings and may promote litigation, particularly with respect to articles comprising components from or undergoing operations in more than one country and articles subject to intermediate processing operations. In addition, the susceptibility of the ST rule to various interpretations raises serious concern as to whether mutuality or reciprocity between countries using the standard can be achieved and maintained.

Apparently owing to concern that ST alone would not operate with a high degree of reliability to limit the preferential treatment under GSP and other programs to goods only of beneficiary countries, a number of trade programs impose other criteria in addition to ST in their rules of origin. These added elements have largely been in the form of direct-shipment requirements and value-content provisions, including foreign-content limitations. In the area of textiles and apparel, the element of "substantial manufacturing" (discussed below) is also now being utilized.

Substantial transformation plus processing

As noted in the Commission's earlier report cited above, the U.S. Customs Service now employs a variant rule for imports of textiles and apparel. This rule (referred to herein as ST+), combining ST with a requirement that substantial manufacturing or processing operations occur in the country claiming origin, made considerable changes in the way such articles are counted for quota purposes. The Customs regulations cite particular operations that will

generally be regarded as "substantial" for purposes of conferring origin on the country concerned, and provide guidelines for determining if ST to a new article of commerce has occurred. To that extent, the new regulations provide greater specificity than the relevant provisions previously used in relation to the marking of goods. 19 CFR sec. 134.1(b).

This factor is among the advantages of ST+ as an origin rule. Satisfaction of the standard may also require a greater economic contribution in the country of processing than ST alone, since more complex manufacturing operations can be enumerated as being "substantial" for purposes of the rule. Also, given some Customs Service experience in using this rule, it has a degree of familiarity and will be interpreted in a body of rulings--both helpful to importers in promoting consistent results. Further, since the rule provides somewhat more administrative guidance to Customs officers, it may be more easily administered.

On the other hand, the rule's use of ST as one of the two determinative elements means that ST's subjectivity and other deficiencies have not been removed from the origin ruling process. This standard does not appear simpler and is often described by industry sources as failing to promote uniform decisions on origin. Moreover, the basis for the inclusion of processes in the enumeration is unknown; it is unclear if the list's development was based on actual and potential commercial practices, on subjective interpretations of their "significance,", or on an assessment of the degree of harm or benefit their inclusion might cause to specific products. Such concerns are likely to be of even greater importance if an ST+ rule were to be applied to broad product sectors. It would appear that the avoidance of arbitrary and subjective decisions is of the highest priority in such an undertaking.

Finally, the added requirement would pose a burden on foreign producers, particularly in developing countries previously able to comply with ST alone. This problem already exists in the textile and apparel area, as reported to Commission staff, and is said to present severe obstacles to the development or continuation of such production in the insular possessions. If the list is open to repeated change or if the standards become too hard to meet, companies are likely to move their operations to achieve greater economies.

Value-added tests

The value-added criterion has been implemented in the United States in the form of a "direct costs of processing" (DCP) rule--that is, a percentage figure which can be met by showing those allowable and verifiable costs involved in producing the imported article. For example, in the GSP program (as mentioned above), 35 percent of the appraised value of the imported article at the time of entry must be attributable to the sum of (a) the cost or value of materials produced in the beneficiary country plus (b) direct costs of processing operations performed therein. Where no local content was incorporated in the article, the entire 35 percent must derive from such direct costs, including labor. Illustrative examples of the allowable direct costs are set forth in Customs' regulations at 19 CFR sec. 10.178 along with certain nonallowable costs. Other elements of the GSP program and its rule of origin are treated in the regulations at 19 CFR secs. 10.171 through 10.177. Documentary evidence open to Customs verification must be submitted along with the entry papers for each GSP shipment.

On the surface, at least, this sort of standard appears to be simple, objective, and quantifiable. It also goes farther than ST or ST+ in promoting an economic stake in the exporting country by requiring a real investment of resources. It may lend itself to more uniform application, at least insofar as the non-ST portion of the rule is concerned. These facts may tend to make the rule more useful than ST or ST+ in the development and implementation of trade policy. Last, as noted above, it minimizes the chance that pass-through operations will receive a windfall in the form of U.S. preferential tariff treatment.

Various difficulties arise from the use of this standard. As is known from the GSP experience, the calculation of DCP may be complicated, especially as values, costs, and exchange rates change. It can be difficult to differentiate between articles sold from inventory and new production and to apportion costs among a firm's production. The definition or enumeration of appropriate DCP is likewise difficult, and litigation or protests may be necessary to resolve ambiguities and new issues. The criterion has been criticized by some as being designed to shape commercial operations rather than realistically reflect them, obscuring trade patterns and economic practicalities otherwise influencing business decisions. Given the number of cost elements involved,

it may be possible to adjust accounting totals and thereby appear to meet the requirements. Moreover, a single-value content threshold may not be useful with respect to all products.

On top of these problems, a DCP standard is, to say the least, difficult for customs officials to administer and for importers--who may know little about their suppliers' costs--to comply with and avoid the risk of fraud allegations. In this age of limited Customs resources, any meaningful program to verify foreign costs is virtually impossible to maintain. This standard may to an extent discriminate against those developing countries with limited local resources and low wage rates, where it may be hard to meet the requirement. Other countries, such as those not utilizing transaction value as the basis of appraisement of goods, might face added difficulties in producing acceptable supporting documents for their export shipments if such a rule were applied to them. Finally, the total DCP figure that may be required to deter pass-through or other trade deflection operations is likely to be different with respect to different groups of goods or countries and to vary over time.

Change of tariff heading

The change of tariff heading (CTH) principle, used for some purposes by the EC, holds that where sufficient processing or other operations are performed in a particular country to change the tariff classification of the materials or components from that which applied prior to processing, that country will be deemed the country of origin of the imported product. The European rule couples this criterion with a requirement that the processing be an allowable one or that other enumerated requirements be met, as discussed above. The standard requires the use of a common nomenclature of international application.

This standard has several advantageous characteristics. First, it is more mechanical in application than ST in that it relies on established principles of tariff classification. It also provides guidance, both to Customs officials and to the trading community, on what may be deemed a "different article," since the tariff nomenclature comprises descriptions of product categories. Similarly, the rule's focus on tariff provisions (that is, on whether a given article meets established criteria for classification

in particular tariff provisions) obviates the need to consider the significance of specific manufacturing operations or processes. Thus, the origin decision under such a rule is related to the basic tariff classification decision, making the origin ruling process simpler, considerably easier to administer, and more likely to result in uniform interpretation.

The CTH rule as a basis for finding origin could present several problems. First, since tariff nomenclature was not drafted with this use in mind, origin determinations as to individual products would not necessarily be logically dictated. The level of descriptive detail in and the scope of individual tariff provisions differs widely, so product sectors would most likely be affected in different and probably inconsistent ways. Thus, from some perspectives, CTH may operate mechanically but at the expense of substantive reasonableness. Second, it would require Customs to make more than one classification decision for imported articles--for the components and for the finished article. This would be difficult administratively because Customs would not be in the best position to verify the origin or classification of third country inputs, just as Customs has verification problems under the value-added standard. These factors may outweigh the greater ease of understanding made possible by this more mechanical standard.

Third, CTH does not function very effectively with regard to goods arising from assembly operations, especially from the perspective of encouraging the conferral of origin on the country making a significant economic contribution in the production process. Both the TSUS and the Harmonized System provide that, unless the context otherwise requires, article descriptions cover goods whether assembled or not assembled and whether finished or not finished. In addition, components may be imported from one or more sources for simple final assembly in the country of export, and the tariff classification of these components would most likely change upon such assembly. CTH would permit the exporting country to claim origin and may thereby allow the same kind of pass-through operations generally sought to be avoided by origin rules. Moreover, this result means that origin would not be attributed to the country providing the greatest share of inputs in the product--usually the principal country of manufacture of the components.

Fourth, the rule does not specify whether origin should be conferred where only a small portion of the components of a large assembly change classification. A rule setting a percentage minimum may be needed, presenting administrative problems in verifying input values (especially where multiple sources are involved).

Process

The Commission's preliminary report recognized problems associated with each alternative rule of origin currently in use and suggested that consideration be given to the development of a new standard based on processing requirements. This standard, which is more thoroughly discussed below, would confer origin on the last country where one of the enumerated processes for the particular product occurred.

Background.--The major attribute of existing standards of origin is their tendency to confer origin on the last country of sufficient manufacture or processing prior to importation. This occurs where a significant contribution is deemed to be made therein, reflected by either a change in tariff classification, a transformation of the product or material into a new and different article of commerce, or the addition of significant value. On the other hand, if the appropriate standard is not satisfied, origin is conferred on the last country of manufacture that did satisfy the standard.

For obvious reasons, it is usually not desirable to recognize more than one country of origin for each product. Conferring origin on the country that made the last significant contribution to the goods, as opposed to the country that made the most significant contribution, is not unreasonable, since the last country of manufacture may have the most direct economic interest in the article. In addition, such a practice avoids the unusually onerous burden of determining origin by major contributor. Thus, it would appear origin should be afforded to the last country of manufacture, provided that the operations performed in that country are sufficiently significant. The rule of origin should accomplish this result in a clear, predictable, and consistent manner and with a minimum of subjective interpretation.

In a process-based code, processes considered sufficiently significant to confer origin would be enumerated for each product sector (in some cases for individual products). The determination as to whether a particular operation

would in fact constitute an enumerated process is already a familiar one for customs officials, since it is also frequently involved in the tariff classification of an article--that is, in deciding what physical (or use, depending on the tariff description) attributes make it fit in a specific tariff provision.

Descriptive approach.--In evaluating how to draft a standard that fairly satisfies the criteria of predictability, uniformity, simplicity, and administrability, consideration should be given to the development of a codified system in which origin is determined by reference to specific industrial processes. By focusing directly on particular processes performed on or used to obtain the imported article, this approach would provide the opportunity for verification, through either plant inspections or other demonstrable evidence of the processing operations. If customs officials were satisfied that a process enumerated in the code as conferring origin did in fact occur, origin would automatically be conferred without regard to the value contribution made or other extraneous standards. Whether a given process should be deemed to confer origin would be taken into account only during consideration as to its possible inclusion in the enumeration. The approach would also permit advance knowledge even at the earliest stages of production planning of the potential origin treatment of goods not to be made wholly in one country without the need for constant recourse to customs officials or the courts.

This systematic approach to the question would differ from the substantial transformation test in that it would not be subject to wide differences in interpretation and would not require determinations of whether "new and different articles" were created. The ST standard is one which is easy to state but difficult to apply consistently. In addition, under a process-based code there would be no need for reliance on less direct standards, such as the value-added test, with their accompanying limitations.

The difficult task of developing the enumeration could be approached first by segregating all products into related sectors defined in terms of the tariff nomenclature. Within each sector, individual processes that would confer origin would be enumerated. As a hypothetical example, for product X covered by sector Y, the pertinent portion of the enumeration might read as follows: "Sector Y--sorting, crushing, milling, agglomeration, grinding, magnetic separation, sifting, or washing." In such a case, anyone interested in product X could ascertain that accomplishing any named operation would confer origin on the country concerned. Where appropriate (particularly with textiles,

machinery, electronics, and instrumentation), the system would, of course, specify assembly operations that would satisfy the rule. Finally, explanatory material elaborating on the enumerated processes could afford examples of processes deemed not sufficient to confer origin or further describe processes included in the enumeration.

In considering the development of appropriate processing standards for conferring origin, a draft list of those processes that have been held to create new articles under current practice or cause changes in products' tariff classification would be reviewed to determine their sufficiency. Resort would also made to relevant explanatory materials. Once the listing is available, it should result in fewer interpretative problems and speedier application than present vague standards. It would also be simpler for someone not well versed in customs practice to apply the code than to ascertain or predict origin determinations under current rules.

Thus, the process approach would attempt to address the question of origin in a concrete, sector-specific manner. Over the course of time, the system would be subject to updating and would undoubtedly develop its own unique discipline. It is not the purpose of this report to suggest in definitive form how responsibility for the developmental work could be carried out or the appropriate forum for conducting any international negotiations on such a code. It has been suggested, in response to the preliminary report in this investigation, that decisions as to which processes should be included in the enumeration would be based on protectionist or otherwise political views not related to commercial reality. However, an appropriate mechanism could be created, perhaps the Committee for Statistical Annotation of Tariff Schedules (the so-called "484(e) Committee") or a similar body, to handle these functions. Given an appropriate standard, it does not appear likely that partisan economic motivations would necessarily be more compelling in this area than in the area of tariff nomenclature development.

Skepticism has been expressed about a process-based code because different shipments of a given product made through different processes might be treated differently and because a given process would not always result in the conferral of origin in all product sectors. However, present standards and the alternative standards all demonstrate these deficiencies, in as much as the ST decision is subjective and the tariff nomenclature varies in both detail and

specificity from sector to sector. Many tariff provisions are worded or interpreted so as to be applied based upon how the product concerned was made. In other areas, particularly chemicals, almost every process will result in a CTH; it does not seem reasonable to confer origin on that basis since many such processes probably are not sufficiently significant. If the stated goal of an origin rule is to confer origin on the country making a commercially significant contribution, the CTH approach cannot necessarily guarantee that result. It can say only that origin will be conferred on the country whose contribution was just enough to change the article's classification--which will not always be a commercially significant level for all tariff category changes.

Thus, instead of stating that a new article must be created or assuming that a CTH would necessarily denote that a commercially important change had occurred in an article, the process-based code would attempt to put in writing what accomplishes those outcomes. It would do so without recourse to outside factors such as exchange rates and, it is hoped, without a need for an "exceptions list."

While it appears that a process-based code would be an improvement over existing standards, the comments received during the course of this investigation indicate that a change of this magnitude would be met with considerable opposition. However, the code could be developed to be used for statistical purposes or possibly for determining MFN treatment under the General Agreement on Tariffs and Trade. It might also be applied to specific programs to supplement current origin rules. A process-based code would provide a useful benchmark for deciding origin status.

Views of Interested Parties

In order to help ascertain the effects of origin rules and of changes therein on U.S. industries and importers, the Commission sought written comments from any interested parties and published a preliminary report for their review. In addition, the Commission conducted a public hearing on January 23, 1987 on both this investigation and on investigation No. 332-243, concerning an origin rule for the proposed U.S.-Canada free-trade area.

Testimony of witnesses

Five witnesses testified on origin rules now in effect, problems in their application, and possible changes in their formulation. 1/ All of the witnesses emphasized the necessity of having a rule that is predictable and consistent in its results and that reflects commercial reality. The latter criterion was generally described as the requirement stating that, before origin can be conferred, commercially significant operations actually be performed in the country involved. In other words, the rule must prevent trade deflection and ensure that the transshipment of goods or minor processing will not permit claims that a change of origin has occurred. Moreover, the witnesses all stated that they would oppose a change in origin rules that would have an adverse impact on their firms or members.

The witnesses accepted many of the criteria for a standard origin rule expressed in the preliminary report, but some expressed concern over the suggestion in the Commission's preliminary report that the origin rule must conform with trade policy needs. The witnesses recognized that the rule must permit the implementation of special trade policy initiatives such as the GSP, but they seemed to fear that the proposed criterion would mean that a standard rule should be capable of being molded for political--or possibly protectionist--purposes.

Mr. Don Everingham.--One witness, Mr. Don Everingham, 2/ asserted that the 35-percent value-content figure (national materials plus direct costs of processing) in the GSP program is too low, permitting what amount to transshipment operations and providing no benefit to the low-wage developing country economies. For at least the products of his industry, he would prefer a 100-percent local-contribution requirement; he suggested that a 65-percent value threshold should be utilized with respect to the U.S.-Canada free-trade area. Mr. Everingham stated that he favored an international origin rule that would enhance export opportunities. He also said he felt that ST needed to be better defined and that the types of processing operations done by his

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1/ See calendar of public hearing in appendix A.

2/ Vice President for Operations, Basic Vegetable Products, Inc., Division of Basic American Foods Co., on behalf of American Dehydrated Onion and Garlic Association (ADOGA).

association's members should not be deemed to accomplish substantial transformation of the commodities involved. In his accompanying written brief, he noted the existence of differing tariff provisions based on value and the fact that a CTH-based standard would therefore have different effects on various industries, thus pointing to the need for a sectoral approach. In ADOGA's posthearing brief, it reiterated these points and expressed its opinion that the rule proposed by the Joint Industry Group would fail with respect to agricultural products. ADOGA stated again that it is a "uniquely situated industry" with special problems, as are many others.

Mr. David Elliott.--A second witness, Mr. David Elliott, testified on behalf of the Joint Industry Group and its Rules of Origin Committee. He noted that there is a need to address the real problems in the area of origin rules and expressed the view that the present Customs Service approach (the addition of a substantial processing criterion) should be ended. Thus, in his view, a return to the pre-Uniroyal origin ST standards would be beneficial; under the old approach, origin was conferred on the last country in which products were substantially transformed into new or different articles having a distinct name, character, or use. He stated that emergency action should be undertaken now to alter U.S. rules and that the needed international rule should be considered later.

To ascertain whether goods underwent meaningful change in the commercial sense, the Group advocated a rule based on ST without the substantial processing element. Under the proposal, a CTH at the six-digit Harmonized System level would be presumptive evidence of ST unless the particular product were included in a negotiated "exceptions list"; the facts concerning the article's production would be considered if a CTH did not occur. The rule would thus assume, in the majority of cases where CTH would apply, that the mere fact of the classification shift would reflect a commercially significant change in the goods had occurred. Mr. Elliott stated that, in the Group's opinion, such a rule would be simple, administrable, predictable, and consistent in its results and would serve the purposes of determining applicable duties, quotas, and marking requirements. Under this proposal, standards of preference (such as those of the GSP program) would not be altered and would continue to be applied once the origin of each shipment is determined.

Mr. Elliott saw serious difficulties in any effort to create, operate, and maintain the origin code suggested in the preliminary report. He indicated his opposition to any concept involving consideration of the substantiality of processing of any goods and to a rule that could produce different results for two shipments of one product made by different processes. Finally, he supported the use of the Group's proposal in the origin rule for the U.S.-Canada FTA along with the preference rules (with a few modifications) now used for purposes of the GSP, including the 35-percent value-content figure.

Mr. Charles Bremer.--Mr. Charles Bremer testified on behalf of the American Textile Manufacturers' Institute, Inc. (ATMI), and supported the origin rules currently in use in the area of textile and apparel imports. He expressed the view that stringent origin standards should be applied, particularly under a possible free-trade area with Canada, and that the CTH and value-added criteria should not be used. Instead, he stated that he preferred a "multi-layer ST" approach with consideration of discrete processing steps and an evaluation of the types of operations and amount of costs and investment attributable to each country.

Mr. Salvatore Caramagno.--Mr. Salvatore Caramagno, testifying on behalf of the National Hand Tool Corporation, stated that a single origin standard cannot serve all trade policy objectives. He said that ST has been a good and useful test and that other approaches would not be useful. With regard to a possible negotiated exceptions list (in the Joint Industry Group's proposal), he saw possible obstacles being created by countries having no commercial interest in the product concerned. He agreed that a return to the pre-Uniroyal standard was needed and said that ST should not be used to accomplish policy goals, such as the administration of quantitative restraints on textile and apparel imports. Mr. Caramagno favored the international use of ST as the basic standard for determining origin and said that disputes or differences in interpretation could be handled at an international forum such as the Customs Cooperation Council.

Mr. Martin Lewin.--The last witness, Mr. Martin Lewin, testified on behalf of the American Association of Exporters and Importers-Textile and Apparel Group (TAG) of the American Association of Exporters & Importers.

TAG favors greater uniformity in the origin area and agreed with the criteria for a standard rule proposed in the preliminary report. While critical of the current textile and apparel rules, TAG favors the pre-Uniroyal ST approach for determining origin. Mr. Lewin expressed the view that the assembly of garments should always be deemed a substantial manufacturing operation and thus to constitute ST.

Written submissions

Several other parties submitted written comments pursuant to the Commission's request therefor.

National Knitwear and Sportswear Association.--First, the National Knitwear and Sportswear Association expressed its support for effective and enforceable rules of origin as an essential element in the administration of the textile and apparel import control program. In particular, it noted its involvement in the development of the current origin regulations relating to textiles and apparel due to the association's special interest in the customs treatment of sweaters. The statement discussed in some detail recent incidents of quota circumvention and asserted that present Customs regulations were eliminating such problems.

The association expressed its view that the number and complexity of origin rules is not necessarily undesirable and that the goal of such rules is to achieve specific policy objectives. Also, it stated that while international harmonization is desirable in the abstract, it might not alleviate many problems for importers or exporters. According to the statement, further consideration would be needed prior to and during the development of a new rule, and textiles and apparel should continue to be treated separately for origin purposes.

Acme Tool Company.--Counsel for the Acme Tool Company of Detroit, Michigan in its prehearing brief commented on the preliminary report issued in this investigation. Acme agreed that the last country where a significant manufacturing process occurred should generally be the country of origin of a product. It notes that the approach proposed in the preliminary report would require careful draftsmanship and should be implemented without the creation of a cumbersome system. In addition, Acme noted problems in the labeling of goods with their country of origin. It emphasized its belief that much

subjectivity in deciding if ST has occurred results from the fact that the Customs Service introduced the adjective "substantial" into the rule without basis in legislation. However, it emphasized that the concept of transformation (minus the "substantial") to a new article of commerce can avoid problems presented by the mechanical application of the CTH approach. Along with the unneeded adjective, Acme would discard value-added tests in favor of refining the basic rule; to that extent, this position seems to minimize any distinctions between rules of origin and standards of preference. Accordingly, the submission advocates an origin rule along the lines suggested by the Joint Industry Group.

Yuri Fashion Company, Ltd.--Counsel for Yuri Fashion Company, Ltd. (Yuri) submitted a statement focusing on issues relating to imported apparel, in particular knit sweaters. (It may be noted that Customs' current practices relating to textile and apparel articles from the insular possessions derive largely from the litigation involving Yuri.) Yuri cited Customs' 1985 regulations changing the country-of-origin requirements for textiles and apparel as creating ". . . a complex, unmanageable system for determining the proper country of origin of textiles, resulting in the designation of two countries as the country of origin for the same product, according to the distinct purposes served by the individual origin rules." Yuri advocated, in any uniform rule of origin that might be enacted by Congress, that special attention be paid to the rule's effects on the U.S. insular possessions, so that the intent of TSUS headnote 3(a) is not nullified. That headnote provides that articles (1) not containing more than 50 percent foreign materials by value and (2) subjected to some processing or manufacturing operation in the possession will receive duty-free entry into the United States. Yuri noted several references to the headnote in various congressional documents that indicated no substantial transformation requirement was intended to apply to the insular possessions. The statement emphasized the longstanding efforts to promote economic activity in the possessions and stated that the rule of origin being employed by Customs prevents such apparel articles from being entered, free of duty or otherwise, to the detriment of the possessions.

Marino Industries Corp.--In its submission, Marino Industries Corp. (a manufacturer of lightweight steel framing sections) expressed support for the

concept of a uniform origin rule, saying that consideration of origin rules is ". . . of unique importance to American industry." In any origin rule, according to the statement, there should be a value-added test as a basic element and an analysis of each country's economic contribution; the rule should relate to domestic Federal Trade Commission standards for U.S. distribution of goods. Marino stated that both ST and CTH permit ". . . unacceptably broad spectrums of results." It noted the great confusion pertaining to the present marking statute and the difficulties inherent in an origin rule that ostensibly tries to examine each country's contribution but does so without consideration of manufacturing assets and activities. Marino expressed support for the principle that, in the value-added determination, the costs which should be examined should be manufacturing costs, not general or administrative ones. Thus, it felt that a "costs of manufacture" standard would be the easiest to administer and to understand. The statement indicated support for a below-50 percent value requirement as the basis for an origin rule.

Intel Corporation.--Intel Corporation (a manufacturer of semiconductors, computers, and related subassemblies) pointed in its statement to the multinational nature of its operations and stated that products must be moved with a minimum of delay and expense. Among its problems, Intel listed the difficulties involved in marketing the same article to countries with differing origin rules and marking requirements. However, it noted that these factors are to some extent mitigated by the fact that many countries maintain no marking requirements--not including those wishing to employ such criteria as protectionist barriers.

Intel said that current U.S. origin rules are confusing and foster noncompliance; the rules are complicated by such other regulatory measures as "Buy American" provisions in many laws and Eximbank financing requirements. It also cited differences between export (Department of Commerce) and import (Customs) standards for origin decisions, at least in the high-technology area. Intel viewed the Customs Service's trend toward substantial manufacturing criteria as "ominous" and said that compliance may in many instances be impossible. This is particularly true where multiple countries are involved in the production of goods. According to Intel, standards of preference must be separated from origin rules, the Harmonized System tariff nomenclature should be used to assist in origin decisions, and disputes over its recommended

ST-based rule should be negotiated. Further, it said that value-added and substantial manufacturing tests should be avoided and that, for shipments containing goods with many different origins, importer certificates or the use of "multiple countries" as the country of origin should be used.

Bloomfield Manufacturing Co., Inc.--The Bloomfield Manufacturing Co., Inc. (a manufacturer of mechanical jacks), filed a statement supporting the use of a single origin rule and raised many of the same concerns cited by Intel. Like Intel, it favored a cost of manufacturing standard as the U.S. origin rule.

American Fiber, Textile, Apparel Coalition.--In its submission, the American Fiber, Textile, Apparel Coalition (AFTAC) expressed its concern as to origin rules and said the rules must fit with the U.S. textile and apparel restraint program. AFTAC stated that current origin rules created by Customs must be maintained in order to permit the functioning of the restraint program. Thus, it said that only ST should be used as a basis for U.S. origin rules and should be applied in a case-by-case manner.

American Iron and Steel Institute.--The American Iron and Steel Institute (AISI) agreed in theory that a standard origin rule would be more transparent and predictable. AISI believed that the present system could continue to be used if the process were made transparent--that is, if Customs were required to publish requests for comment and all decisions in the federal register. According to the statement, a CTH approach linked to the HS nomenclature would not be advisable because the negotiators did not develop the HS with this use in mind. The AISI cited particular problems with the CTH-HS approach with respect to steel products. It also noted that current steel restraints would need to be renegotiated if a new origin rule is adopted; it advocated considering special origin rules or treatment for steel products. However, the AISI generally accepted the present origin system as the best one available and said that its biggest problem is obtaining information on rulings from Customs.

TAG.--The TAG expressed its opposition to the process-based approach suggested in the Commission's preliminary report in this study. The statement reflected the view that ST and substantial manufacturing should not be used in an origin rule and that the proposed approach would retain such elements and present other problems. The TAG said that a special rule of origin is not

necessary for textiles and textile products to prevent quota circumvention. Further, it said that there is no logical reason to differentiate between TSUS item 807.00 (American goods returned after assembly) operations and assembly operations relying on the looping of knit-to-shape components.

Grocery Manufacturers of America, Inc.--A statement filed by counsel for the Grocery Manufacturers of America, Inc. (GMA), indicated the association's support for a uniform origin rule based on ST. The GMA expressed its opposition to any rule change which would expand the labeling requirements under applicable regulations and voiced its concern as to the criteria now being employed by Customs (e.g., "substantial manufacturing"). It noted that additional labeling requirements and their related costs could have the undesirable effect of discouraging imports of foods or ingredients from small or less developed countries. The GMA stated that there is no basis to assume that consumers desire more country-of-origin information on grocery products. It described current Customs practices as "severely restricting" the regulatory meaning of ST and as ". . . significantly expanding the scope of the labeling requirements." The GMA cited these practices as failing to accord with the purpose of origin rules--namely, in its view, to provide information to consumers. While GMA opposed an origin rule based on processing, as suggested in the Commission's preliminary report in this investigation, it did so based on its understanding of the suggested approach and appeared to view it as still requiring "substantial manufacturing." The GMA indicated that a uniform rule (to the extent uniformity would serve the purposes of various programs) must be based on ST to be predictable and workable.

Association of Food Industries, Inc.--The Association of Food Industries, Inc., submitted comments favoring uniform origin criteria, saying that origin should be afforded to the last country where either a significant processing operation or significant added value due to processing occurs. It supported a prospective prohibition on labeling of multicountry goods with only one of the supplier countries. The Association cited examples to justify its statement that, "Using the concept of substantial transformation to determine whether or not country of origin markings are required on imported product [sic.] does not result in consistent application of the law." According to the submission, the inconsistencies and uncertainty created by current Customs practices ". . . create a chaotic marketing situation which serves no purpose."

EG&G, Inc.--EG&G, Inc., indicated its support for a uniform origin rule worldwide, in order to simplify marketing, manufacturing, and administration (including the application of "Buy American" requirements). It described existing U.S. rules as unclear and pointed to serious problems resulting from the application by various countries of different value-added figures in their origin rules.

Dewey, Ballantine, Bushby, Palmer & Wood.--The law firm of Dewey, Ballantine, Bushby, Palmer & Wood expressed support in principle for a uniform origin rule--one which would take into account the policy factors relating to anti-dumping and countervailing duty cases. The comment noted that ST, while generally useful, ". . . is not always appropriate as a basis for determining eligibility for preferential programs or for administering country-specific trade restrictions . . .". It pointed to the very different policy concerns surrounding each trade program as a major difficulty in developing such a rule. Moreover, the statement noted that some other agencies (such as the Department of Commerce) now apply other standards and refuse to follow Customs' determinations in many or all instances.

Bumble Bee Seafoods, Inc.--Counsel for Bumble Bee Seafoods, Inc. (BBS), indicated in its submission that the Commission should include in its origin recommendations a rule for ascertaining the origin of migratory fish. In BBS' view, the "initial country of origin of highly migratory species" should be based, as it now is, on the flag of the fishing vessel taking the fish. A separate comment from the Tuna Research Foundation, Inc., agreed with BBS.

National Food Processors Association.--The National Food Processors Association (NFPA) expressed its desire for an origin rule ". . . that will achieve certainty in its interpretation and application." The NFPA cited recent Customs rulings on the country of origin of fruit juices as saying the present rules are not compatible with the Standards Code of the General Agreement on Tariffs and Trade or with standards of the U.S. Food and Drug Administration. Moreover, it cited Customs' enforcement of its rules as "haphazard" and pointed to complete reversals of previous rulings based on the same standard, ST.

California Pistachio Commission.--Counsel for the California Pistachio Commission noted several changes and problems relating to the country-of-origin determinations on pistachios. Again, the submission seemed to indicate

enforcement difficulties and possible deceptions, at least in the food industry. It supported the use of ST as a basic element for an origin rule and the harmonization of origin rules, as long as the rulings on pistachios are reflected.

Other comments.--Other statements 1/ discussed in detail the origin and interpretation of the concept of substantial transformation. They tended to express the opinion that, apart from recent confusion stemming from Uniroyal and the textile regulations, ST should be retained as the basis for origin decisions. One submission expressed the view that it would be more useful to examine the effectiveness of origin rules than their potential standardization. This letter, from an official of the International Ladies' Garment Workers' Union, stated that the crucial factor is having rules that accomplish their intended purposes, rather than uniform only for the sake of uniformity. While expressing some concern as to the possible process-based approach briefly outlined in the preliminary report, the comment seemed to indicate that a different sort of origin rule would be incapable of achieving the same end results as the current system. However, in the view of others, this predicted failure of other types of rules could probably be avoided through careful draftsmanship and industry input.

1/ See, for example, preliminary comments and prehearing brief of counsel for the Florsheim Shoe Company Division of Interco, Inc.

APPENDIX A

COMMISSION NOTICE, LETTER

OF REQUEST, AND CALENDAR OF HEARING

UNITED STATES INTERNATIONAL TRADE COMMISSION
WASHINGTON, D.C.

Investigation No. 332-239

THE STANDARDIZATION OF RULES OF ORIGIN

AGENCY: United States International Trade Commission

ACTION: Institution of an investigation.

EFFECTIVE DATE: October 20, 1986

FOR FURTHER INFORMATION CONTACT: Janis L. Summers, Esq., Office of Tariff Affairs, U.S. International Trade Commission, Washington, DC 20436 (202) 523-0326

BACKGROUND AND SCOPE OF INVESTIGATION: The Commission hereby institutes investigation No. 332-239, under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)) following receipt of a request therefor from the Committee on Ways and Means, U.S. House of Representatives.

In his letter requesting the investigation, Committee Chairman Dan Rostenkowski noted that producers, exporters and importers have expressed concern regarding the rules of origin used to govern both tariff classification for customs purposes and the application of restrictive and preferential trade programs. Since Congress has never focused on the enactment of a uniform rule of origin for use in administering U.S. trade laws generally, it would be useful to consider the development of a standard rule for use in the United States and the possibility of establishing a uniform origin code for international use.

As requested by the Committee, this study will address the issues of (1) the need for harmonization and rationalization of rules of origin, (2) criteria which should underlie the development of a standard rule of origin suitable for domestic or international use, and (3) U.S. industry concerns regarding origin rules.

A copy of the request letter received from Ways and Means is available for public inspection in the Office of the Secretary. As requested by the Committee, the Commission will transmit its completed report to the committee not later than May 2, 1987.

DRAFT REPORT AVAILABLE: Copies of the public version of the draft report will be made available for review by the public on or before January 8, 1987. Requests should be directed to Ms. Janis L. Summers, at the number indicated above.

PUBLIC HEARING AND WRITTEN SUBMISSIONS: A public hearing will be held in room 331 of the U.S. International Trade Commission Building at 9:30 a.m. on January 23, 1987. The deadline for filing pre-hearing briefs and requests to testify is January 13, 1987. Interested persons not wishing to testify are invited to submit written statements concerning the investigation. All written statements, including post-hearing briefs, should be received by the close of business on February 12, 1987. Commercial or financial information which a submitter desires the Commission to treat as confidential must be submitted on separate sheets of paper, each clearly marked "Confidential Business Information" at the top. All submissions requesting confidential treatment must conform with the requirements of section 201.6 of the Commission's Rules of Practice and Procedure (19 CFC 201.6). All written submissions, except for confidential business information, will be made available for inspection by interested persons. All submissions should addressed to the Secretary at the Commission's office in Washington, D.C.

By order of the Commission.

Kenneth R. Mason
Secretary

Issued: October 20, 1986

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC 20515

September 2, 1986

The Honorable Susan Liebeler
Chairman
U.S. International Trade Commission
701 E Street, N.W.
Washington, D.C. 20436

Dear Madam Chairman:

The Committee on Ways and Means has received a number of expressions of concern from producers, exporters, and importers regarding the rules of origin used to govern the application of restrictive and preferential trade programs. The concerns reflect both an increase in trade of products produced and/or assembled from components originating in more than one country and an increase in the number of preferential trade programs administered on a non-most-favored-nation basis.

The Committee is aware of the previous study by the Commission ("The Impact of Rules of Origin on U.S. Imports and Exports," USITC Pub. 1695, May 1985), in which standards used for determining origin--both within the United States and among selected foreign countries--were outlined and discussed. You point out in that study that Congress has never focused on the enactment of a uniform rule of origin for use in administering U.S. trade laws generally. In that regard, it would be useful to consider the development of a standard rule or rules for use in the United States, and the possibility of establishing a uniform origin code for international use. On behalf of the Committee on Ways and Means, I am, therefore, requesting that the International Trade Commission conduct an investigation, under section 332(g) of the Tariff Act of 1930, for the purpose of developing relevant criteria for a standard U.S. and international rule of origin.

The Commission's report should address the following issues:

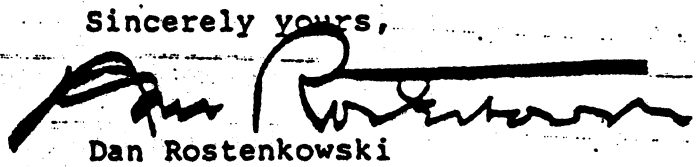
-- The need for harmonization and rationalization of rules of origin;

-- The criteria that should underlie the development of a standard rule of origin suitable for domestic or international adoption;

-- U.S. industry concerns regarding rules of origin.

In preparing its report, the Commission should seek the views of the private sector, foreign governments, and U.S. Government agencies. The Commission's report, along with public and agency comments, should be submitted no later than eight months from the date of this letter.

Sincerely yours,



Dan Rostenkowski
Chairman

DR/gjw

TENTATIVE CALENDAR OF PUBLIC HEARING

Those listed below are scheduled to appear as witnesses at the United States International Trade Commission's hearing:

Subjects : The Standardization of Rules or Origin

and

Origin Rules for Proposed U.S.-Canada Free Trade Area

Inv. Nos. : 332-239 and 332-243

Date and time: January 23, 1987 - 9:30 a.m.

Sessions will be held in connection with the investigation in the Hearing Room of the United States International Trade Commission, 701 E Street, N.W., in Washington.

WITNESS AND ORGANIZATION

National Knitwear & Sportswear Association
New York, N.Y.

Thomas E. Cahill, President

Seth M. Bodner, Executive Director

The Joint Industry Group
Washington, D.C.

David J. Elliott, Chairman of the Rules of Origin Committee

Basic Vegetable Products Inc., Division of the Basic American Foods Co., on behalf of the American Dehydrated Onion and Garlic Association

Don Everingham, Vice President of Operations

- more -

American Textile Manufacturers Institute, Inc.,
Washington, D.C.

Carlos Moore, Executive Vice President

Schramm & Associates, Inc.,
Washington, D.C.
on behalf of

The California Pistachio Commission

Robert Schramm, President

Ross & Hardies--Counsel
Washington, D.C.
on behalf of

The National Hand Tool Corporation, Dallas, Texas

Stephen M. Creskoff)
Salvatore E. Caramagno) --OF COUNSEL

Olsson and Frank, P.C.--Counsel
Washington, D.C.
on behalf of

The Association of Food Industries, Inc.

Richard L. Frank)
Arthur Y. Tsien)--OF COUNSEL

Mudge, Rose, Guthrie, Alexander & Ferdon--Counsel
Washington, D.C.
on behalf of

The Textile and Apparel Group of the American
Association of Exporters and Importers

Martin J. Lewin--OF COUNSEL