The manufacturers' organisation

BREXIT BRIEFING

RULES OF ORIGIN

WHAT ARE RULES OF ORIGIN?

Rules of Origin are the criteria used to determine the economic nationality of a product, as opposed to the geographic nationality of a product. They are important in international trade because import duties (i.e. tariffs) and restrictions – such as those the UK will face when leaving the EU – will be applied at differing levels depending on the nationality of the product. For example, EU tariffs on goods originating from China may be different from those on UK products.

Once the origin of a product is established, the correct rate of duty or tariff can be applied to it when it crosses a border. The origin can also be used to charge anti-dumping duties and put safeguard measures in place, for labelling and marking requirements, for government procurement purposes or for gathering trade statistics.

Determining the country of origin of a product is usually the final step in the customs clearance process, after the customs classification and the value of the goods are known.

WHY HAVE UK BUSINESSES NOT HAD TO WORRY ABOUT RULES OF ORIGIN BEFORE?

Currently, rules of origin do not apply in the EU Single Market, so only British companies exporting outside the EU have had to take them into account. Also EU trade (and thereby UK trade) with the rest of the world is currently governed by pre-agreed EU rules of origin set out within the EU's trade agreements with specific countries or regions.

After leaving the EU, both the EU and UK will have to agree a new set of rules covering the origin of the products traded between them, most likely within a future Free Trade Agreement (FTA). In the event that an FTA is not concluded, the UK would have to comply with origin rules the EU offers countries with which it doesn't have a trade agreement.

WHAT ARE THE CRITERIA FOR SETTING RULES OF ORIGIN?

There are two basic criteria commonly used in setting rules of origin. They are:

1. Whether a good is '*Wholly obtained*'

   – this is when a good naturally occurs in a country. This could be where live animals are reared; plants grown and harvested or natural minerals are extracted in a particular country.
   – The definition of *wholly obtained* also covers goods produced from scrap and waste derived from manufacturing or processing operations, or from consumption;

2. Whether a good has undergone a '*substantial transformation*' in a particular country

   – when a good is considered to have been "substantially transformed", having undergone specified manufacturing or processing.
   – There are a number of technical ways in which countries demonstrate this including when the manufacturing process:

     • results in the product changing tariff classification or
     • calculating the percentage change in value added

TYPES OF RULES OF ORIGIN

Rules of origin are commonly categorized into two types - *non-preferential* and *preferential* rules.

Non-preferential rules of origin are those which apply most generally. They are usually set in national policy and legislation where there are no preferential trade arrangements in place between two or more countries. Countries need to distinguish the non-preferential origin of a product on WTO terms to work out anti-dumping duties, countervailing measures, safeguard measures, origin labeling or the collection of trade statistics.

Preferential rules of origin are those which have been agreed between two or more parties in a bilateral or regional trade agreement or customs union or for non-reciprocal trade preferences (i.e. preferences in favour of developing countries).

Preferential rules of origin are generally more restrictive than non-preferential rules in order to avoid "trade deflection" (for example where a good might be trans-shipped through a preference-holding country so it gets preferential treatment).

Restrictive rules of origin could also act as non-tariff protectionist measure, if they set domestic production levels that are difficult to meet.

WHAT IS "CUMULATION"?

Ideally, inside a preferential trade agreement, countries can share production and jointly comply with the rules of origin provisions. This concept is known as accumulation or cumulation.

As basic rules of origin set out that only products which are either produced entirely in a particular country (wholly obtained) or substantially transformed may be considered as originating in that country, cumulation is a deviation from this core concept of origin.

It is common in the manufacture of a product to have inputs from more than one source from more than one country. Where two or more countries have the same rules of origin and free trade agreements in place between them, if the product of one country within the FTA is further processed in another country (also within that FTA) the

product can be considered as originating in the final country of production.

This widens the definition of originating products and provides flexibility to develop economic relations between countries within a free trade area.

TYPES OF "CUMULATION"

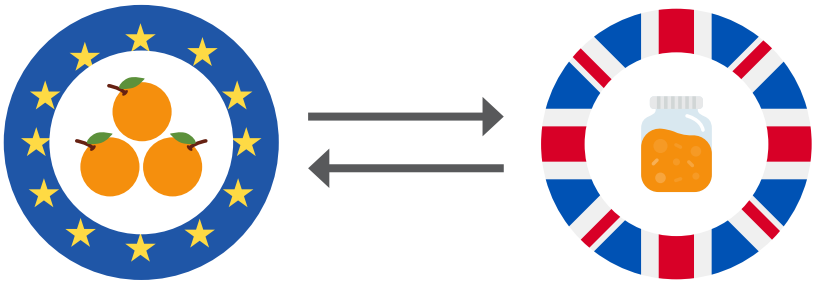
There are three main types of cumulation under preferential rules of origin:

1. bilateral cumulation;
2. diagonal cumulation; and
3. full cumulation

BILATERAL CUMULATION

Bilateral cumulation is the most basic form and is usually between two countries where a trade arrangement allows them to cumulate origin of goods. That is input originating in one country under a preferential agreement can also be considered as originating input in the other country.

This originating status is usually supported by a proof of origin certificate that accompanies the product during the import process.



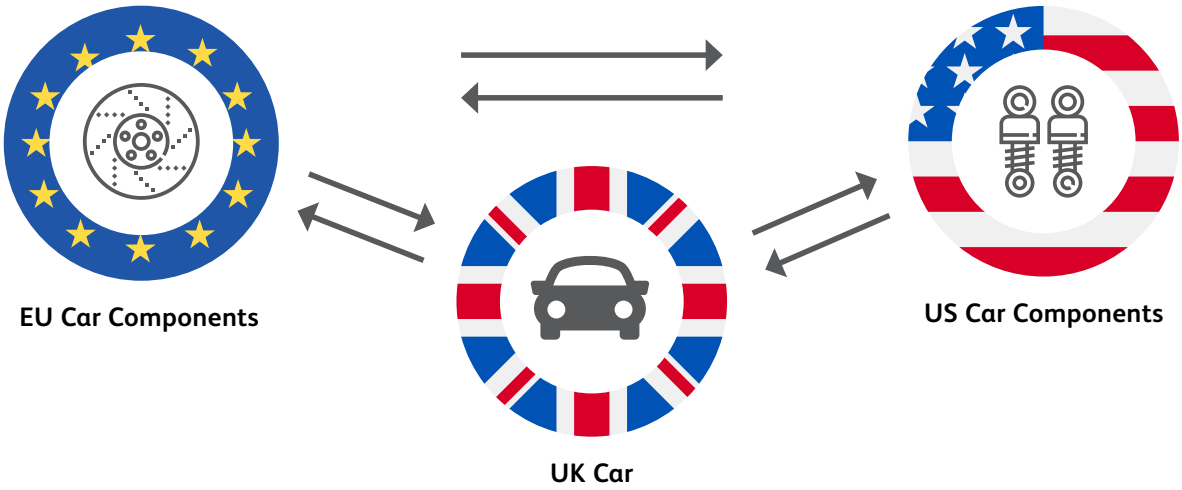
Spanish Oranges **UK Marmalade**

For example, if the EU and UK struck a free trade agreement with the same origin rules and Spanish oranges were turned into marmalade in the UK, the oranges could be considered as originating in the UK under a bilateral cumulation provision.

DIAGONAL CUMULATION

Diagonal cumulation applies generally to more than two countries that have FTAs with each other and where the same origin criteria are all met by each.

Where there is more than one country involved in the manufacture of a product, the final product will adopt the origin of the country in which the last processing took place (provided it was a 'substantial transformation').



If a car produced in the UK sourced component parts originating from the EU and the US, provided there were FTAs in place between the three countries, and the agreed origin criteria were met, under diagonal cumulation provisions, the car could be considered as being of UK origin.

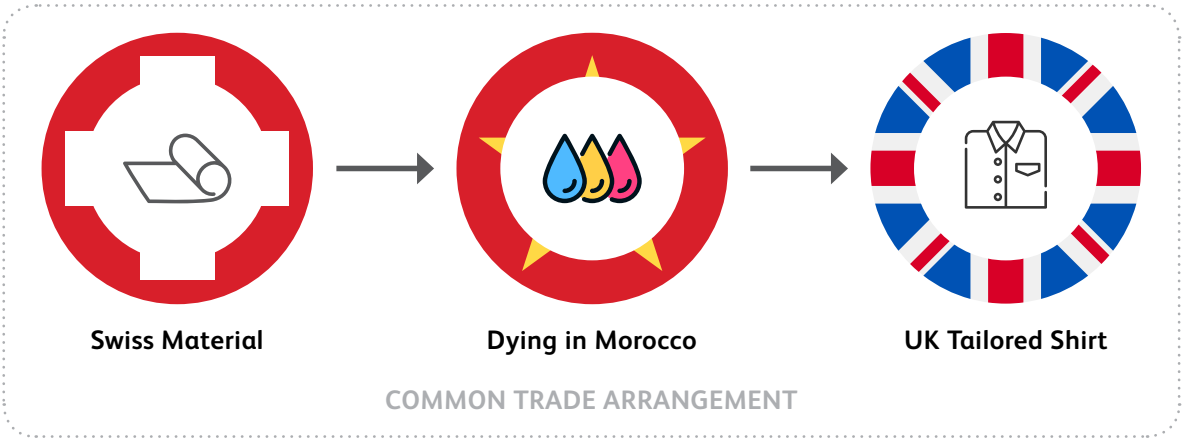
Currently one of the most extensive frameworks in which diagonal cumulation occurs is between the EU and members of the "Pan-Euro-Mediterranean cumulation zone[1]" (which includes EEA and EFTA members) and which the UK is currently a member of.

[1]Members include the EU, Switzerland, Norway, Iceland and Liechtenstein, the Faroe Islands, Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestine, Syria, Tunisia and Turkey, Albania, Bosnia and Herzegovina, the former Yugoslavia Republic of Macedonia, Montenegro, Serbia and Kosovo and the Republic of Moldova

FULL CUMULATION

Full cumulation involves a greater degree of economic integration. Unlike bilateral or diagonal cumulation, it is not just originating goods that can be considered as input for cumulation purposes in another country. All processing stages within the zone can be considered as conferring origin, regardless of whether the transformation is substantial enough to change the product origin or not.

It only requires that origin requirements are satisfied within the preferential trade zone as a whole allowing the origin criteria to be distributed across any number of countries within a zone. In effect it facilitates more complex supply chains.



For example, if fabric was sourced from Switzerland and then dyed in Morocco and finally sewn into a shirt in the UK, all three processes taken together could contribute to origin rules under a common trade agreement (with a full cumulation provision). This would allow the final product to be considered as a UK-origin product (which each individual process may not have resulted in on its own).

Full cumulation rules exist between the EU and EEA countries. The origin legislation within free trade arrangements such as NAFTA, ASEAN and the TPP are all also on full cumulation bases, but they each allow for varying degrees of flexibility in their application.

HOW UK BUSINESSES CURRENTLY COMPLY WITH RULES OF ORIGIN

Currently, UK businesses that export must comply with rules of origin under any (EU) free trade agreements. This means they have to comply with a range of measures to prove that their goods are of UK origin.

While each targeted export country may have differing rules of origin requirements, some of the steps involved may include:

- conferring with HMRC as to the origin requirements of that market
- conferring with overseas customs authorities
- preparing documentation to prove or certify origin prior to export (goods must be certified before leaving the UK). Separate certification can extend to imports and exports – depending on whether or not the preferences extend to both. The onus remains firmly on the exporter to ensure that all of the paperwork is correctly complied with and supplied.

For exports that move repeatedly across EU borders, exporters can currently apply for a Binding Origin Information (BOI) document to confirm the origin of the goods. This is valid for a 3-year period. The BOI facilitates the easy movement of goods across local customs borders while in transit, by preventing goods being held up at every customs point and repeatedly having to prove origin.

THE WTO AGREEMENT ON RULES OF ORIGIN

During the set-up of the WTO, the need for a clear and binding multilateral discipline in the field of rules of origin was clear, which led to the official Agreement on Rules of Origin.

The objective in the WTO was to ensure that non-preferential rules of origin were harmonized (the same agreed rules would be applied by all countries regardless of their purpose) and should facilitate trade, rather than creating unnecessary obstacles to trade.

The Rules of Origin Agreement calls on WTO members to ensure their rules of origin are transparent. It asks that they do not have restricting, distorting or disruptive effects on international trade and that they are administered in a consistent, uniform, impartial and reasonable manner. They must also be based on a positive standard (in other words, they should state what does confer origin rather than what does not).

As negotiations on harmonised non-preferential rules of origin are still not agreed in the WTO about 40 WTO members currently apply their national rules of origin.

NEXT STEPS

It will be important for UK manufacturers to understand the complexity of rules of origin and how they are likely to affect supply chains. This will be particularly important for those companies with supply chains that weave across numerous borders between the UK and EU. For these industries, the need to comply with new origin documentation and processes will result in costs and delays to the export and delivery process. We are now looking to work with members to identify the impact of various models of rules of origin and assess priority rules for each sector.

The manufacturers' organisation

EEF is dedicated to the future of manufacturing. Everything we do, from business support to championing manufacturing and engineering, is designed to help our industry thrive, innovate and compete locally and globally.

In an increasingly uncertain business environment, where the UK is now on a path to leave the European Union, we recognise that manufacturers face significant challenges and opportunities. We will work with you throughout this period of uncertainty to ensure that you are on top of any legislative changes and their implications for your business.

Furthermore, as the collective voice of UK manufacturing, we will work tirelessly to ensure that our members' voices are heard during the forthcoming negotiations and will give unique insight into the way changing legislation will affect their business.

Our policy, employment law, health, safety and sustainability and productivity experts are on-hand to steer you through Brexit with rational, practical advice to help your business succeed.

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