Rules of origin in EU trade agreements

SUMMARY

The European Commission is currently in the process of simplifying and harmonising the rules of origin for EU trade agreements, with the aim of enhancing the effectiveness of the latter. Indeed, there is a general perception that the complexity of the rules and their lack of harmonisation across EU trade agreements, together with burdensome certification procedures, may be deterring some business managers from making use of the preferential trade tariffs allowed by the agreements.

Rules of origin govern the conditions under which an imported good is recognised as ‘originating’ in a preference-given country and eligible for preferential trade tariffs. Provisions on rules of origin cover two major areas. First, the conditions for conferring origin are designed on a product-by-product basis, following principles typically based on processing operations and/or share of input. An essential part of this process also consists of determining to what extent origin rules may ‘cumulate’ materials and operations, not only in the parties to trade agreements, but also in third countries (under specific conditions). A second aspect is the certification procedure for origin, including product consignment conditions.

The EU’s reform process touches on all of these areas. It started with the reform of the generalised scheme of preferences in 2011, a unilateral trade arrangement designed by the EU for developing countries that inspired the EU’s subsequent trade agreement negotiations. In some cases, the EU also promotes a more advanced cumulation system, particularly within the pan-Euro-Mediterranean system, to promote economic integration with neighbouring trading partners. Finally, the EU supports the use of flexible consignment rules that take into account increasingly globalised inventory management. It also encourages the use of self-certification by exporters as opposed to exporting authorities.

Rules of origin are complex and rely on negotiations with partner countries, and their harmonisation poses a genuine challenge for the EU. In its latest trade policy review published in February 2021, the Commission announced that policy actions on rules of origin are still needed. The modernisation of the rules of origin is supported by the European Parliament, which has argued that they determine the ‘true extent of trade liberalisation’.

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Background

**Rules of origin (RoO)** set criteria to define the conditions for conferring 'preferential origin', thereby permitting the application of lower preferential trade tariffs.\(^1\) RoO aim to ensure that products named in partners’ free trade agreements (FTA) as eligible for lower tariffs, undergo minimal processing in those countries and are not merely re-routed or shipped. The variation in RoO and their impact on trade means that they can be subject to intense negotiations when concluding FTAs. The complexity of RoO has been identified by studies as a factor contributing to low preference utilisation rates (PUR), with a higher PUR indicating higher FTA effectiveness.\(^2\) The European Commission is in the process of simplifying and harmonising its RoO. Major changes were first introduced in 2011 in the generalised scheme of preferences (GSP), with the objective of subsequently incorporating them into EU FTAs.

The Commission launched a review and discussion with stakeholders already back in 2003, through a green paper in the context of the Doha development round; the latter was expected to reduce customs duties, thereby making FTAs less attractive. It was considered necessary to modernise and harmonise RoO to make them more efficient and easily utilisable.\(^3\)

In its latest trade policy review published on 18 February 2021, the Commission announced that policy actions on RoO were still needed in the following areas:

- further harmonisation of preferential RoO in EU FTAs, taking into account EU stakeholders’ interests;
- development of new online tools to support EU businesses, in particular small and medium-sized enterprises (SMEs) and improve the Commission’s ‘rules of origin self-assessment’ (ROSA) online tool designed to help companies determine product origin;
- harmonisation of RoO applicable to trade arrangements with partners in Africa, with the aim of enhancing synergies.

Box 1 – Preferential and non-preferential rules of origin

**Preferential RoO** in trade agreements are distinct from **non-preferential RoO**. Non-preferential RoO are used both for goods that do not benefit from preferential origin and for commercial policy measures such as anti-dumping and countervailing duties. Each country determines its own non-preferential origin for goods, whereby the non-preferential origin of a good could be different from its preferential origin. The World Trade Organisation (WTO) has attempted to harmonise non-preferential RoO by means of the ‘harmonised rules of origin’ programme aimed at creating coherent rules and becoming part of the WTO agreement on rules of origin. **Preferential RoO** are part of bilateral and plurilateral FTAs, and unilateral trade arrangements typically aim to support development. EU non-preferential RoO are defined in the provisions on non-preferential RoO in the Union Customs Code Delegated Regulation (EU) No 2015/2446 and annex. The European Commission adopted the latest delegated regulation amending these provisions on 30 July 2021, following stakeholder consultations.

How preferential origin is conferred

RoO\(^4\) for preferential trade are defined by FTA provisions and cover general rules and product-specific conditions, the cumulation of processing operations and inputs originating from third partner countries, certification procedures and shipping restrictions.

Product-specific rules of origin

RoO provisions establish ‘product-specific rules of origin’ (PSRO) by providing an exhaustive list of products – typically using the harmonised system (HS) nomenclature\(^5\) – and each product’s associated rule to qualify as ‘originating’.
To qualify as originating, products must either be 'wholly obtained' or 'sufficiently worked or processed' in a country that is party to the system. 'Origin' in that country is then conferred on the whole product, so that if a (lower) 'preferential trade tariff' is applicable to the good originating in a preference-given country, the preferential tariff would apply on the total value of the product and not on fractions of it.

'Wholly obtained' conditions are most often applied to primary industries, typically extracted minerals, plants and vegetables (grown or harvested), live or slaughtered animals (born and raised), or fish when caught in territorial waters.

Whenever a product is obtained by means of materials and processing in non-partner countries, the rules specify the conditions determining that the product is 'sufficiently' processed in the partner country to confer preferential origin, showing 'substantial transformation'.

'Sufficient production' is defined for each product and follows three classes of rules.

1. **Change in tariff classification** in the HS: a product is considered to be sufficiently worked or processed when it is classified in an HS classification (at 2-digit (chapter), 4-digit (heading) or 6-digit (sub-heading) levels) that is different from the classification of the non-originating materials.

2. **Manufacturing of specific processing operations**: provisions may include a list of operations and processes that qualify for origin-conferring.

3. **Ad valorem** percentage criteria: when the added value, or the input materials acquired, equal or exceed a specified percentage, the goods acquire origin in the country in which the manufacturing or processing was carried out. The FTA then specifies that a specific or all originating countries should have contributed to 'at least x% of the value-added'. The percentage is given for each product heading. Alternatively, in the model used by the EU, the *ad valorem* percentage expresses the maximum level of non-originating inputs that can be used in the production of a good for it to benefit from preferential duty rates.

Table 1 – Examples of rules from the EU-Canada FTA protocol on RoO

<table>
<thead>
<tr>
<th>Product heading in the HS</th>
<th>Conditions that confer preferential origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter 1: Live animals</td>
<td>All animals in Chapter 1 are wholly obtained.</td>
</tr>
<tr>
<td>Chapter 17: Sugars and sugar confectionary</td>
<td>A change from any other heading.</td>
</tr>
<tr>
<td>17.01 Cane or beet sugar and chemically pure sucrose, in solid form</td>
<td></td>
</tr>
<tr>
<td>87.03 Motor cars and other motor vehicles</td>
<td>Production in which the value of all non-originating materials used does not exceed 45% of the transaction value or 'ex-works price' of the product.</td>
</tr>
</tbody>
</table>

Data source: EU-Canada FTA protocol on rules of origin.7

The advantage of rules based on a change in tariff classification (CTC) or operation processing is that this enables origin to be conferred in a clear and straightforward manner that is easier to certify, while *ad valorem*-based rules may require burdensome accounting calculations subject to approval by authorities. In addition, both CTC and operation processing are independent of uncontrolled external factors, such as variations in foreign exchange rates and primary resource prices, making originating status more predictable for business managers. Nevertheless, CTC and operation processing rules restrict origin to a set of specific operations and may miss other operations that might be covered by more inclusive, *ad valorem*-based rules.8
Furthermore, several rules (from one or more classes of rules) may apply to a single product. These rules may be combined, and all may be required, thus making origin-conferring conditions more stringent. They may be used as alternatives by business managers, offering further flexibility to supply chains. In the EU RoO format, the latter, more flexible approach is commonly used.

Table 2 – Examples of combination of rules from the EU-Singapore FTA protocol on RoO

<table>
<thead>
<tr>
<th>Product heading</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2711 Petroleum gases and other gaseous hydrocarbons</td>
<td>Operations of refining and/or one or more specific process(es) or Other operations in which all the materials used are classified within a heading other than that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 50 % of the ex-works price of the product</td>
</tr>
<tr>
<td>9606 Buttons, press-fasteners, snap-fasteners and press-studs, button moulds and other parts of these articles; button blanks</td>
<td>Manufacture: – from materials of any heading, except that of the product, and – in which the value of all the materials used does not exceed 50 % of the ex-works price of the product</td>
</tr>
</tbody>
</table>

Data source: EU-Singapore FTA protocol on rules of origin and annex.

Finally, RoO provisions also provide a list of processes that are considered 'insufficient' to confer origin. Below are some examples of insufficient operations listed in the Trade and Cooperation Agreement between the EU and the United Kingdom (UK), Article 43:

A product shall not be considered as originating in a Party if the production of the product in a Party consists only of one or more of the following operations conducted on non-originating materials:

- **a)** preserving operations such as drying, freezing, keeping in brine and other similar operations where their sole purpose is to ensure that the products remain in good condition during transport and storage;
- **b)** breaking-up or assembly of packages;
- **c)** washing, cleaning; removal of dust, oxide, oil, paint or other coverings;
- **d)** ironing or pressing of textiles and textile articles;
- **e)** simple painting and polishing operations;
- **f)** husking and partial or total milling of rice; polishing and glazing of cereals and rice; bleaching of rice;

[...]

Cumulation

When a product is not sufficiently worked or processed in a party to the FTA according to the specific rules applicable to that product, FTAs may include cumulation provisions that allow materials originating in another country to be considered as originating materials for the purpose of fulfilling RoO requirements. There are three classes of cumulation:

1. **Bilateral cumulation** confers preferential origin taking into account the inputs originating in the other contracting party to the FTA;
2. **Diagonal cumulation** goes beyond bilateral cumulation and also takes into account the inputs originating in other preference-receiving countries;
Full cumulation goes beyond cumulation of originating materials as it allows account to be taken of working and process or value added in other preference-receiving countries. Full cumulation has the significant advantage that it does not require the goods to be conferred preferential origin before being shipped to another country; all operations carried out in the countries involved are taken into account.

By allowing for broader cumulation, the parties further facilitate the integration of the supply chain with those countries with which cumulation is permitted, and obtain preferential origin. Thus, by allowing more scattered operations, full cumulation potentially promotes economic integration among preference-receiving countries.

The list of RoO applicable in EU FTAs is published on the website of the Commission’s Directorate-General for Taxation and Customs Union (DG TAXUD) and on the Access2Markets portal of the Directorate-General for Trade (DG Trade). Nearly all of the EU’s FTAs provide for bilateral cumulation; many provide for diagonal cumulation. Only very few envisage full cumulation. Full cumulation is currently operated with the European Economic Area (EEA), the Maghreb, and with African-Caribbean-Pacific (ACP) countries. These agreements also apply diagonal cumulation to the partner countries of the pan-Euro-Mediterranean (PEM) zone (see also the section ‘Pan-Euro-Mediterranean cumulation system and convention’ below).

Administration of rules of origin: certification and consignment

The procedure for proving the origin of a product is defined in the RoO provisions of FTAs, and its complexity is another factor in the utilisation and effectiveness of FTAs (see Box 2). Typically, origin certificates are issued by the exporting country’s customs authority, or an invoice declaration is made by an approved exporter. In the most recent EU FTAs, the method for proving origin is more flexible, in that origin can be self-declared by the exporters themselves. Traditionally, the EU system relies on official certificates delivered by the exporting country’s authorities or by accredited organisations. Another method for proving origin consists of exporters’ self-certification of invoices of less than €6,000, or being an approved or registered exporter for higher values. Approved exporters meet certain conditions imposed by the customs authorities; registered exporters are registered in a database maintained by their country’s authorities and conditional on timely updates of changes. In the EU, the origin of a product is proven by the EUR.1 movement certificate (or EUR-MED in the pan-Euro-Mediterranean cumulation area) issued by the exporting country’s customs authority. Depending on trade agreements’ RoO provisions, origin may also be certified by an invoice declaration delivered by an approved exporter.

Restrictions on shipping conditions aim to make sure that the certification obtained by the exporting country is valid at the time the good enters the importing country’s territory and that no operations were processed. To this end, the direct transport rule was typically applied in older FTAs, whereby a good had to be shipped directly. The new, more business conducive EU FTA model contains a non-alteration rule that allows for products constituting ‘one single consignment’ to be transported through other territories, provided that the products are neither altered nor released.
for free circulation in the country of transit. Products should not be subject to operations other than unloading and reloading, or any operation designed to keep them in good condition; evidence is to be supplied to the customs authority. The non-alteration rule facilitates trade and reduces related costs, not least because it allows the utilisation of distribution logistics centres in third countries.¹⁰

Box 3 – Rules of origin self-assessment tool

Lack of information is often cited by businesses as an obstacle to utilising FTAs. For this reason, the Commission has developed an interactive rules of origin self-assessment (ROSA) tool that guides operators through the RoO applicable to their product with simple explanations and examples, allowing them to self-assess whether their product complies with these rules and can qualify for preferential treatment in various FTAs. To facilitate the process for companies, ROSA contains clear instructions on the documentation required as proof of origin to obtain tariff preferences.

How the EU has modernised the rules of origin

Generalised scheme of preferences

In 2011, Commission Regulation (EU) No 1063/2010 amending Regulation (EEC) No 2454/93 reformed the RoO of the generalised scheme of preferences (GSP), a unilateral preferential tariff scheme¹¹ implemented by the EU in favour of least developed countries. Among other things, the new RoO reduced the number of PSRO exceptions significantly, with PSRO being set at HS 2-digit (chapter) rather than 4-digit (heading) levels. PSRO also increased the number of rules allowing non-originating inputs.

As for industrial products, the thresholds for non-originating materials were set to 50% (ex-works price) instead of 25-40%. More headings provided for alternative criteria, typically combinations of CTC and ad valorem rules. This is chiefly the case in industrial sectors, relating for instance to machinery, paper, aircraft and optical instruments.

Pan-Euro-Mediterranean cumulation system and convention

The PEM cumulation system is a system of diagonal cumulation of origin. It was established in 1997 and (today) includes the EU, the European Free Trade Area (EFTA) countries, Turkey (industrial products), the western Balkans, the Faroe Islands, and the participants in the Barcelona Process.¹² It is based on a network of FTAs with identical RoO protocols. In a notice document, the Commission provided an overview of the cross-country cumulation scheme as of 26 March 2020, hinting at its complexity.

The Commission’s initiative to frame a single convention as an instrument to promote regional integration was endorsed by the Euro-Mediterranean trade ministers at their meeting in Lisbon on 21 October 2007. The review of the regional convention on pan-Euro-Mediterranean preferential RoO (PEM convention) signed in 2011 marked a key step towards harmonising and simplifying RoO. At the ninth joint committee meeting on the revision of the PEM convention of 27 November 2019, the Commission tabled new RoO allowing for cumulation, based on the preliminary harmonisation of the PSRO. As the review of the PEM convention remained uncertain, the Commission proposed new rules to the Council on 24 August 2020, to be agreed with interested partners.

A key component of the new rules introduced by the PEM convention is that the processing operations and/or ‘value-added’ necessary for a good to be conferred origin will be subject to the ‘full cumulation’ rule. The rules applicable to specific products will also be made more flexible and easier to meet, as the thresholds for using non-originating materials or components have been raised. Those origin protocols are being replaced by a reference to the PEM convention. A single convention will facilitate the ongoing revision aimed at modernising and simplifying the PEM RoO.
As of 1 September 2021, the new rules initially apply between the EU and Albania, the Faroe Islands, Georgia, Iceland, Jordan, Palestine, Norway and Switzerland. The adoption of the amendments to the bilateral origin protocols on RoO with a number of other partners is ongoing and at different stages of progress.

Rules of origin in trade agreements

In its staff working document of 16 April 2019, the Commission specified that the GSP RoO reform would serve as a basis for negotiations on new FTAs, with adjustments reflecting, inter alia, new sectoral developments. However, RoO in FTAs remain the outcome of negotiations and therefore may not entirely replicate the GSP's RoO.

Since the GSP reform in 2011, the RoO promoted by the EU have been simplified and modernised. EU FTAs’ RoO are more flexible and allow for more non-originating input to reflect the progressive integration of EU industry with global value chains, while ensuring that significant processing is conducted within a party. For example, in the case of industrial products, the thresholds for non-originating materials have been set to 50 % (ex-works price), compared with 25-40 % in old-generation agreements. Alternative criteria are included for large numbers of products, typically combinations of CTC and ad valorem rules. This is the case in industrial sectors – such as machinery, paper, aircraft, and optical instruments – and is intended to facilitate compliance with RoO.

Moreover, because of the growth in preferential trade, the EU has favoured self-certification over time, in accordance with the European Court of Auditors’ recommendations (observation 104). Under all circumstances, verification of origin may be initiated by the importing party and relies on administrative cooperation. Starting with the EU-Canada FTA, the importing country's authorities take the final decision. Origin certification was simplified in that it can be established by the exporters' statements of origin; electronic issuance and presentation of proofs of origin are also accepted.

As to consignment, more recent agreements – such as those with Canada and Japan – apply the non-alteration rule, and the Commission is replacing the direct transport rule in earlier FTAs with the non-alteration rule, as it did in the EU-South Korea FTA (protocol Article 13).

With the ongoing objective of harmonising EU trade and customs, the Commission launched the customs union action plan on 28 September 2020, in which it set out measures to make the EU customs union more efficient. A major component of the action plan is the establishment of a single window environment for customs to make declarations easier for businesses, with enhanced information-sharing for customs authorities.

The Commission has also engaged in the harmonisation of RoO in EU FTAs with member states of the African Continental Free Trade Area (AfCFTA). Moreover, the EU has funded a programme on harmonising the classification of goods based on World Customs Organization (WCO) standards to enhance African trade, implemented by the WCO, that aims to build customs administrations' capacity to draw up, implement and manage their national classification systems. These national systems must comply with the HS convention, with international, regional, continental and global standards, and with commitments and best practice.

European Parliament position

In its resolution of 5 July 2016 on a new forward-looking and innovative future strategy for trade and investment, Parliament reiterated that RoO determine the 'true extent of trade liberalisation' and deserve policy-makers’ attention (recital M). It supported the Commission's initiative to modernise RoO, as the business environment is increasingly reliant on global production chains. Parliament called for 'flexible' RoO, including undemanding requirements relating to added value and CTC (point 34). Parliament also emphasised that non-tariff barriers, including RoO, needed to be addressed so as to cut trading costs for SMEs by means of RoO simplification (point 69). Finally,
in Parliament’s view, customs procedures need to be harmonised and further facilitate trade, and the Commission and the EU Member States should set up a unified EU customs service (point 83).

In its resolution of 7 October 2020 on the implementation of the common commercial policy (annual report 2018), Parliament reiterated its concern over the low preference utilisation rate on EU exports reported by some of the EU’s FTA partners, which it interpreted as evidence of the limited benefits of the strategy of trade bilateralism for smaller economic operators. It called on the Commission to come forward with ‘new innovative tools and practical solutions, highlighting the importance of flexible, streamlined and uncomplicated rules of origin in this regard’ (point 44). Parliament also asked the Commission to facilitate the use and understanding of RoO for SMEs. According to Parliament, the latter play a ‘vital role’ in international trade, while being affected disproportionately by administrative costs and bureaucracy (point 76).

In its non-legislative resolution of 12 February 2020 on the draft Council decision on the conclusion of the FTA between the EU and Vietnam, Parliament welcomed the fact that the RoO included in the FTA follow the EU approach, and that their main features are ‘identical to those laid down in the EU’s GSP as well as in its trade agreement with Singapore’. Parliament also called on the Commission to monitor RoO implementation and to ‘step up action against any kind of manipulation and abuse, such as repackaging products coming from third countries’ (point 10). It noted that Vietnam would no longer be able to use cumulation from other trading partners that are GSP beneficiaries in the region to be able to comply with the RoO, and stressed that RoO in FTAs should not ‘unnecessarily break existing value chains’, especially with countries that currently benefit from the GSP, GSP+ or the Everything but Arms (EBA) schemes (point 11).

Furthermore, in its resolution of 7 February 2020 on the proposed mandate for negotiations with the UK, Parliament warned against cumulation being used by producers as a ‘free-riding’ tool.

MAIN REFERENCES


**Rules of origin in EU trade agreements**

**ENDNOTES**


2. The preference utilisation rate (PUR) compares the value of goods that use preferential tariffs with the value of goods eligible for preferential tariffs.

3. See for instance, a 2004 study by the International Monetary Fund (IMF) on the impact of 'preference erosion'. Preference erosion refers to the lower competitive advantage that an FTA partner enjoys when the other partner takes adverse decisions, such as lowering the tariffs applied to all imports regardless of origin (most-favoured-nation (MFN) tariffs) without lowering FTA tariffs proportionately.

4. Given the complexity of RoO provisions, this section merely aims to provide an introduction to the topic and is not intended to be exhaustive. For additional information, see the dedicated Commission website and S. Inama, *Rules of Origin in International Trade*, 2009.

5. The HS nomenclature is a product-classification system governed by the Convention on the Harmonized Commodity Description and Coding System developed under the auspices of the World Customs Organization; the EU and its Member States are contracting parties to the convention. The EU’s combined nomenclature incorporates the HS and comprises additional subdivisions.

6. ‘Ex-works price’ is a commonly used international trade term. It denotes the price paid for a product when it leaves the factory (i.e. ex-works), and thus excludes not only shipping costs, but also any internal taxes that are repaid when the product is exported.

7. See also an April 2020 EPRS briefing on the potential RoO during the EU-UK negotiations.


9. The EEA includes the EU, Iceland, Liechtenstein and Norway.

10. The EU-South Korea FTA is an example of the problems posed by direct consignment. A study prepared for the Commission in 2017 highlighted that this provision affected EU companies that use logistical hubs – mostly Singapore – not only for storage, but also for repackaging and labelling (according to fluctuating demand) prior to distributing the products to various Asian countries. To benefit from the preferential tariffs, some EU companies opted to ship goods directly to South Korea, at additional costs relating to inventory management.

11. Unlike FTAs, the GSP is a unilateral trade agreement, i.e. a one-sided and non-reciprocal trade preference arrangement. Under the GSP, the EU grants preferential tariffs to imports originating in developing countries.

12. The 23 contracting parties to the PEM convention are: the EU, the EFTA members (Switzerland, Norway, Iceland and Liechtenstein), the Faroe Islands, the participants in the Barcelona Process, Turkey, the participants in the EU’s stabilisation and association process, and the Republic of Moldova, Ukraine and Georgia.

13. This designation follows the Commission’s and shall not be construed as recognition of a State of Palestine and is without prejudice to the individual positions of the Member States on this issue.

14. The regulation on the establishment of a customs single window has been referred to Parliament’s Committee on Internal Market and Consumer Protection (IMCO). See also the European Parliament’s Legislative Train Schedule on the customs union action plan.

15. The African Union (AU) is a continental body. Its member states are the 55 countries that make up the African continent. It was officially launched in 2002 as a successor to the Organisation of African Unity (OAU, 1963-1999).

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