

Progress Report on Preferential Rules of Origin (ROOs) Sector Analysis

1. MAG's Work on ROOs Sector Analysis in 2009

The APEC report on “Strengthening Regional Economic Integration” (REI Report), agreed by APEC Leaders in Sydney in 2007, outlined a wide range of actions that APEC should take to advance its work agenda on economic integration in the Asia-Pacific region. Among other things, the report underscored APEC’s commitment to high-quality and comprehensive RTAs/FTAs, but noted that the business community has expressed concerns about the unnecessary complexity of trade agreements as well as marked divergences among them. In this context, the report cited preferential rules of origin (ROOs) as a possible area of APEC future work on RTAs/FTAs, since differences between and complexities in these rules are often cited by business as an impediment to better utilization of preferential trade agreements. The REI report suggested, in close cooperation with the business community, exploration of the various preferential ROOs used in the APEC region, and how they might be rationalized.

Based on the above understanding, MAG agreed at MAG3 last year to conduct analytical work on preferential ROOs and to seek to examine common or model approaches to ROOs for specific sectors (2008/SOM3/MAG/007).

In February this year, SOM tasked CTI to work for “making Rules of Origin (ROOs) more business friendly” as one of the key priorities on accelerating trade and investment liberalization “at the border.” In this context, MAG was directed to initiate the work on “harmonization based on sectors.”

Based on the foregoing agreement and direction from Senior Officials, Australia, Japan, Chinese Taipei and the United States volunteered to lead analysis on particular sectors at MAG1 and MAG2 in 2009. The analyses undertaken by the volunteer economies are as follows:

Volunteer Economy	Selected Sector	Documents
Australia	Refrigerators	2009/SOM1/MAG/006
Australia	Musical Instruments	2009/SOM1/MAG/006
Japan	Steel	2009/SOM1/MAG/008 2009/SOM1/MAG/013rev1
Chinese Taipei	Bicycles	2009/CTI2/MAG/006
United States	Consumer Electronics	2009/SOM1/MAG/007 2009/SOM1/MAG/018

Furthermore, MAG invited Cisco System Inc. as industry representatives to the CTI-MAG Trade Policy Dialogue on Rules of Origin (ROO) held on 21 May 2009 to learn their views on different ROO approaches (2009/CTI2/CTI-MAG/TPD/008).

The following section encapsulates the sector analyses undertaken by MAG this year.

2. Key Findings from Sector Analyses Undertaken by MAG

i) Refrigerators (Australia)

Characteristics of the products in the selected sectors

HS heading 8418 covers refrigerators, freezers and other refrigerating or freezing equipment. It also includes heat pumps (but not for air-conditioning machines) and furniture designed to receive refrigerating or freezing equipment. The white goods industry is highly globalised. It consists of many producers and/or manufacturers with world-wide, regional or local brands. Additionally, many importers and distributors, such as department store chains, have created their own brands for specific markets.

Patterns and uniqueness found in preferential ROOs in the sector

The rules of origin of the 33 free-trade agreements surveyed show no consistent pattern. It is, however, possible, to discern two main categories, each of which contains broadly similar characteristics. The

first consist of agreements that follow more or less the NAFTA pattern. These agreements typically offer two choices:

- tariff shift only, with the change occurring either from a chapter or a heading; or
- tariff shift supplemented by a regional value content expressed as a build-down or build-up value, sometimes both.

The second major category consists of the economic partnership agreements between Japan and ASEAN economies. These agreements typically offer a choice between tariff shift only (either at the four-digit or the six-digit level) or a regional value content of 40 percent (transaction value). Two agreements rely entirely on the regional value content.

Factors that are assumed to affect the patterns and uniqueness of preferential ROOs in the Sector

The market for whitegoods (which includes refrigerators and freezers) tends to be fiercely competitive. It is characterised by a small number of multinational manufacturers with well-known brands, and a very large number of brands available in specific areas only. Many firms in this sector are manufacturers which import and export concurrently. Significant globalization has occurred in this sector over the last several decades. It is not possible to detect a convincing pattern in the rules of origin based on production, supply and demand.

Any other findings from sector analysis

The state of the economy and of the housing market is particularly important to the demand for white goods, since purchases may often be deferred. Consumers can opt for cheaper items than they may have wanted. Often it is a move to a new address that triggers the purchase of household goods, whether for the first time or as a replacement.

ii) Musical Instruments (Australia)

Characteristics of the products in the selected sectors

HS Chapter 92 (musical instruments; parts and accessories of such articles) lists musical instruments proper in headings 9201 to 9207. Some of these instruments, e.g. electric organs, electric pianos and electric guitars, contain electronic parts. Heading 9208 contains devices which, although they make a sound or a noise, are not generally considered musical instruments. Examples are musical boxes, fairground organs and whistles. Heading 9209 covers parts and accessories for all of the items included in this chapter.

The market for mainstream musical instruments is dominated by a relatively small group of makers. In the case of pianos they include Bösendorfer, Kawai, Steinway and Yamaha. A representative group of such makers of saxophones would be Jupiter, Keilwerth, Selmer, Yamaha and Yanagisawa. In addition, there is a vast number of smaller brands. Developing economies are important suppliers of musical instruments. Some instruments are produced through traditional handicraft processes.

Patterns and uniqueness found in preferential ROOs in the sector

The rules of origin of the 33 free-trade agreements surveyed show no consistent pattern. It is possible, however, to discern two main categories which each have broadly similar characteristics. The first category consists of agreements that follow more or less the NAFTA pattern. These agreements typically offer two main processes:

- tariff shift only, with the change occurring either from a chapter or a heading; or
- tariff shift supplemented by a regional value content expressed as a build-down or build-up value, sometimes both.

The second major category consists of the economic partnership agreements between Japan and ASEAN economies. These agreements typically offer a choice between tariff shift only (either at the four-digit or the six-digit level) or a regional value content of 40 percent (transaction value). Two agreements rely entirely on the regional value content.

Factors that are assumed to affect the patterns and uniqueness of preferential ROOs in the Sector

Most APEC economies produce or assemble musical instruments. Producers in developed economies

(or at any rate their brands) still dominate the high-end professional market for orchestral instruments. Many of the instruments for the remainder of the market are now made in developing economies. These instruments are often of high quality. It is clear that significant globalization has occurred in this sector over the last three decades or so. It is not possible to detect a convincing pattern in the rules of origin based on production, supply and demand.

Any other findings from sector analysis
None.

iii) Steel (Japan)

Characteristics of the products in the selected sectors

- ✓ HS72.10 describes 'Flat-rolled products of iron or non-alloy steel, of a width of 600mm or more, clad, plated or coated' including high-spec steel products.
- ✓ High-spec steel products (e.g. HS 7210.30 and HS 7210.49) are mainly used as materials for the production of automobiles (both two- and four-vehicles), electric/electronic appliances and machineries
(Examples)
 - Subheading 7210.30 (Electro-galvanized steel sheet and coil (EG)) → Plates of refrigerators and other white products
 - Subheading 7210.49 (Galvannealed steel sheet and coil (GA)) → Outer panel of automobiles

Patterns and uniqueness found in preferential ROOs in the sector

- ✓ Among 32 RTAs in the Asia/Pacific region, 26 basically employ Change in Tariff Heading (CTH: 4 digit basis) or Change in Tariff Sub-heading (CTSH: 6 digit basis).
- ✓ Other than CTH/CTSH style, 3 RTAs take RVC/VA criteria, 1 employs change in Chapters (CC: 2 digit basis) and 2 are unknown.
- ✓ While the commonalities (CTH/CTSH) can be found among RTAs in the Asia/Pacific region, difference exists even among those employ CTH/CTSH. The difference is defined as "exceptions" for using specific non-originating materials in satisfying CTH/CTSH: those materials excluded to use are required to be originating in the Parties (e.g. CTH except from heading 7208, 7209 and 7211).

Factors that are assumed to affect the patterns and uniqueness of preferential ROOs in the Sector

1. The finding of de facto commonalities that more than 80% of RTAs employ CTH/CTSH style seems to reflect the production processes of these products, which make it difficult to use RVC/VA criteria and CC rule. Steel makers purchase iron ores and other materials from various countries at a broad range of prices (volatility of iron ore prices). In the production process, iron ores are mixed at random along with the operation of blast furnace. This makes the calculation of RVC very difficult. Also CC rule prevents usage of ferroalloy (HS 7202: necessary for the production of any iron/steel products), so it is impossible to satisfy the rule.
2. The background of differences in "exceptions" on CTH/CTSH rules may be responding to interest/sensitivities of related industries (exporters, domestic steel producers, domestic steel users) which are slightly different from economy to economy.

iv) Bicycles and their parts (Chinese Taipei)

Characteristics of the products in the selected sectors

The bicycle is a 'multi-functional' product, and it provides a less-polluting, lightweight, energy-saving and traffic-friendly means of transportation and sports. Trade volume in bicycles has increased steadily in recent years, and we may expect great potential for further expansion in the future. APEC as a whole is the most important bicycle-producing region in the world. According to WTO statistics, the export value of bicycle products and components (HS 8712~HS 8714) for 16 APEC member

economies increased 18% from US\$10.81 billion in 2006 to US\$12.75 billion in 2007, while their export market share in the global bicycle trade increased to 89%.

Patterns and uniqueness found in preferential ROOs in the sector

In regards to the ROO for bicycle products (HS 8712), we find that most of the 29 FTAs in the Asia-Pacific region have adopted ‘change in tariff heading’ , supplemented by Regional Value Content (RVC) requirements.

- (1) For FTAs signed by NAFTA members with other economies, the typical rules are “a change from any other heading except from heading 8714 which are the parts and accessories” And the RVC threshold for FTAs signed by U.S.A. with Australia, Chile, Korea and Peru respectively, is at least 35% (build-up method) or at least 45% (build-down method). The threshold for NAFTA is 50% while 30% for U.S.-Singapore FTA. Regarding Canada-Peru FTA, 55% RVC applies while for Mexico-Japan FTA, 50% applies.
- (2) As for Transpac Agreement and the most FTAs signed by Japan with economies such as Chile, Singapore, Thailand, Malaysia, the Philippines, often use tariff shift, i.e. a change to heading 8712 from any other subheading or 40% RVC rule.
- (3) The FTAs signed by New Zealand with China, Thailand, use tariff shift only, while China-Chile FTA uses 50% RVC rule.
- (4) 5 out of 29 FTAs have no specific rules for bicycle products. They include FTAs signed by Singapore with Australia, New Zealand, and Australia-New Zealand FTAs.

Factors that are assumed to affect the patterns and uniqueness of preferential ROOs in the Sector

In addition to preventing possible free riders from non-parties, ROOs reflect the level of competitiveness of the relevant industries and governments’ industrial policies which sometimes are affected by the strong domestic industrial associations with lobby power. In general, the stricter rules provide stronger protection for the domestic industries, including suppliers of key materials/components. So, it will help boost the intra-trade between partners. The more globalized the production process and supply chain has become, the less strict the rules should be, due to that businesses may have had their supply chain spread beyond FTA partners, based on the consideration of comparative advantages of locations.

Any other findings from sector analysis

We can see some clear pattern and similarity in the rules of origin of intra-regional FTAs. To further facilitate the bicycle trade and enhance the overall competitiveness of the sector, it may be quite a useful exercise for mid or long term, to try to harmonize or rationalize the rules of origin among APEC FTAs in the future. In general, the more flexible and simpler rules of origin would help facilitate the regional economic integration.

v) Consumer Electronics and Information/Communication Technology Products (the United States)

Characteristics of the products in the selected sectors

Thirty-six six-digit Harmonized System subheadings in the consumer electronics and ICT sector were studied. The product categories covered computers, computer monitors, transformers, static converters, electric storage batteries, cell phones, microphones, loudspeakers, headphones and earphones, amplifiers, set top boxes, transmission apparatus, television cameras, digital camera recorders, radar, radio apparatus, cathode ray tubes, projectors, TV reception apparatus, LCD or LED indicator panels, and various parts. About half of the products in this sector are covered by the Information Technology Agreement.

Patterns and uniqueness found in preferential ROOs in the sector

With respect to rules of origin for the 36 subheadings in the 32 FTARTAs studied, we find that economies used tariff shift only, regional value content (RVC) only, tariff shift supplemented by RVC, a general rule, or a combination of approaches. Our findings on both a product basis and as a percentage of the total FTA/RTAs are summarized in the table below. Note that the percentage of

approaches when examined on a product basis exceeds 100% because some economies permit more than one approach for a single product.

ROOs Approach	Percentage of 36 products	Percentage of 32 FTA/RTAs
Tariff Shift only	70.8%	57.7%
RVC only	30.5%	24.2%
Tariff shift + RVC	16.4%	13.5%
General Rule	5.5%	4.6%
TOTAL	123.2%	100%

From this table, it is apparent that tariff shift only is the predominant approach used by economies for rules of origin in the consumer electronics sector, followed by regional value content only.

The NAFTA pattern of tariff shift only or tariff shift supplemented by RVC is observed for seven agreements. Another eight agreements permit tariff shift only or RVC only for a majority of the 36 products. Three agreements rely entirely or almost entirely on RVC only.

Factors that are assumed to affect the patterns and uniqueness of preferential ROOs in the Sector

APEC economies are major producers of consumer electronics and information/communication technology products. These products range from basic to very high-tech, and like other electronic products, components are sourced globally. The industry is characterized by intense price competition and profit margins on many products are small. New consumer electronics and ICT products are always coming on the market, replacing older models, and frequently at lower cost or with additional functionality. Classification divergences – which can be exacerbated by ever-changing products – can affect rules of origin. The Harmonized System was not designed to differentiate between partially manufactured products and fully manufactured goods, particularly in high tech products. As a result, a component and the finished product into which it is incorporated may be within the same six-digit tariff subheading (e.g., printed circuit board and the finished product). Prices of consumer electronics, ICT goods, and component parts change frequently, as do suppliers in the global supply chain; therefore, tracing component values through the global supply chain is more difficult in this sector than on average.

It may be assumed that product-specific rules of origin in this sector – as in any other sector – reflect the particular competitive situation of the industries in the respective FTA/RTA partners. No specific ROOs patterns were observed for products covered by the Information Technology Agreement.

Any other findings from sector analysis

According to one company in this industry, more consumer electronics companies would take advantage of FTAs/RTAs if rules of origin were simple, clear and harmonized; compliance was easier to achieve; and compliance could be managed systematically.

3. Summary of MAG's Work on Sector Analysis

Summary of Key Findings

Up until MAG2, MAG examined the preferential ROOs to seek to examine common approaches to ROOs on the five sectors stated above. Key findings of this exercise are as follows:

First, the volunteer economies researched on approaches of the preferential ROOs in APEC region with regard to respective sectors.

- ✓ Refrigerator and Musical Instruments - ROO show no consistent pattern. It is, however, possible, to discern two main categories. The first consists of agreements that follow more less the NAFTA pattern, and the other category consists of the economic partnership agreements between Japan and ASEAN economies.
- ✓ Steel – Among thirty-two RTAs in the Asia-Pacific region, twenty-six basically employ Change in Tariff Heading (CTH: 4 digit basis) or Change in Tariff Sub-heading (CTSH: 6 digit basis)

- ✓ Bicycle products – Most of the twenty-nine FTAs in the Asia-Pacific region adopt CTH, supplemented by Regional Value Content (RVC) requirements.
- ✓ Consumer Electronics – Among a number of approaches, tariff shift only is the predominant approach (70.8% of thirty-six products) used by economies for ROOs in this sector, followed by regional value content only (30.5% of thirty-six products).

Then, the volunteer economies laid out their finding on the patterns and the presumed rationales (if any) of the preferential ROOs with regard to respective sectors.

- ✓ While for some sectors (e.g., musical instruments, refrigerators), it has been found that there is no consistent pattern in ROOs, for other sectors (e.g., steels), it has been found that de facto commonalities among various ROOs have emerged presumably as a reflection of the production processes of the products concerned;
- ✓ While for some sectors (i.e., bicycles), it has been found that that, in general, ROOs reflect the level of competitiveness of the relevant industries and governments' industrial policies, for consumer electronics sector, no specific difference in ROOs patterns was observed between products covered by the Information Technology Agreement (ITA) (i.e., the products already liberalized) and non-ITA products.

Work Plan for Sector Analysis

The original proposal on sector analysis (2008/SOM3/MAG/007), which was agreed by MAG3 last year, prescribes the timetable of this sectoral exercise as follows:

- i) MAG 3 2008 – MAG agrees to undertake work on preferential ROOs in specific sectors.
- ii) Sept 30, 2008 – Economies volunteer to lead analysis for a particular sector
- iii) MAG 1, 2009 – Lead economies present the inventory of approaches in APEC FTAs based on a common template.
- iv) MAG 2, 2009 – Industry presents on its views on approaches to ROOs for the selected sectors
- v) June 30, 2009 – Lead economies circulate analysis of various approaches to ROOs in their selected sector.
- vi) MAG 3, 2009 – Analysis of the various approaches to ROOs, along with the common approach, is agreed at MAG and forwarded to CTI for endorsement. MAG selects additional sectors for examination in 2010.

MAG has completed (i), (ii), (iii) and (iv) in accordance with the agreed timetable. MAG, however, has not come up with any strategy such as “common approach” on how to move this exercise forward after completion of analysis of the five sectors, except that MAG members are encouraged to volunteer in analyzing on additional sectors. At MAG 2 this year, therefore, members agreed that the current workplan could be modified reflecting where we are on this exercise at MAG. Therefore, the workplan will be revised based on the discussions at MAG3.