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Rules of Origin

Background

What are Rules of Origin? Rules of origin (ROO) are laws, regulations, and procedures used for ascertaining the "nationality" of imported products. ROO are important for many reasons, including determining the admissibility of imported goods, assessing duty rates, country of origin marking, applying tariff quotas, enforcing U.S. trade laws, establishing eligibility for preferential programs and free-trade agreements (FTAs), and collecting trade statistics.

Determining origin is relatively straightforward if all of a product's raw materials and parts are manufactured and assembled in one country. However, in today's global economy, parts of manufactured goods to be assembled into products such as automobiles, computers, or clothing, often come from many countries. This can make determining origin a complex process.

Non-preferential ROO apply to imports from all countries with which the importing country has normal trade relations (NTR), and are consistent with World Trade Organization (WTO) obligations. For the United States, NTR applies to all WTO members, except those that have an FTA with the United States or receive another kind of U.S. preferential trade treatment. Non-preferential ROO are used to assess tariffs, enforce trade laws (e.g., antidumping and countervailing duties), collect statistics, and for other purposes.

For non-preferential ROO, there is no specific U.S. law or legislative methodology that specifically defines the term "country of origin." Instead, U.S. Customs and Border Protection (CBP) administers non-preferential rules based on a body of CBP regulations, prior agency interpretations, and court decisions. When the country of origin is in doubt, an importer may apply to CBP for an advance customs ruling.

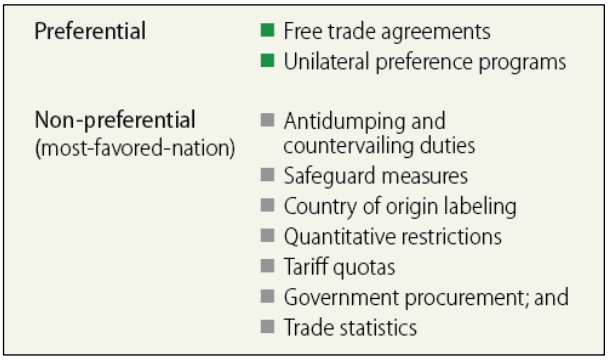
Preferential ROO apply to FTAs such as the United States-Mexico-Canada Agreement (USMCA) and certain non-reciprocal trade preferences, like the African Growth and Opportunity Act (AGOA) and the Generalized System of Preferences (GSP). Preferential ROO are important because they ensure only eligible trading partners receive the tariff benefits of the special program or FTA. Some preferential ROO may also be crafted to limit the impact of these programs on import-sensitive industries. They are unique to each special trade program or FTA.

Preferential ROO in FTAs are negotiated by the parties to the agreement and approved by Congress as part of the FTA implementing legislation. For special U.S. trade programs like AGOA and GSP, they are drafted and approved by Congress.

Enforcement. CBP interprets, administers, and enforces rules of origin, as well as country of origin labeling, tariff classification, customs valuation, and many other laws relating to U.S. imports.

International Commitments. The 1994 WTO Agreement on Rules of Origin requires WTO members not to use ROO to disrupt trade, to apply ROO in a consistent, transparent, non-discriminatory, and reasonable manner, and to notify other members about any rule changes. The WTO agreement also set up an ongoing program to harmonize non-preferential rules, with negotiations conducted by a WTO Rules of Origin committee and a technical committee under the World Customs Organization (WCO). The WCO also facilitates trade by providing assistance to customs administrations worldwide on interpreting ROO and other technical issues.

Figure 1. Rules of Origin Uses



Source: World Customs Organization. Graphic by CRS.

Rules of Origin in FTAs

ROO in FTAs generally stipulate how much manufacturing must come from within the FTA region in order to receive trade benefits (e.g., duty-free treatment). Although FTAs are individually negotiated, there are many common elements across agreements.

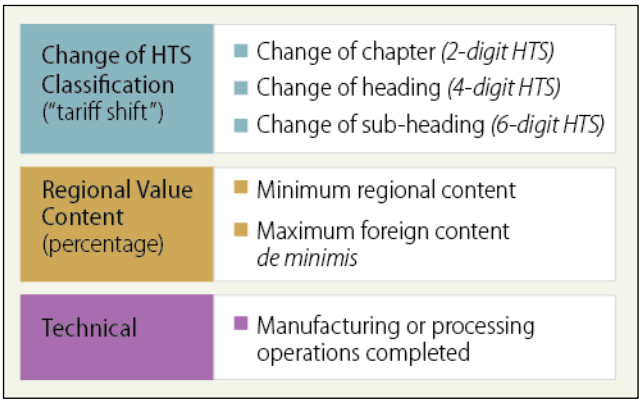
Originating Goods. In order to receive the benefits of an FTA, imported products must "originate" in one of the partner countries by satisfying one of three conditions. They must be: (1) grown, harvested, or fished in the FTA region; (2) produced in the FTA region using only materials made in the FTA region; or (3) produced in the FTA region with non-FTA country components while meeting additional product-specific ROO requirements.

Specific Rules of Origin. Each U.S. FTA has a chapter containing general ROO provisions, combined with an annex that lists ROO for individual products. These product-specific ROO generally take one of three forms (see **Figure 2**).

Change of Tariff Classification or "tariff-shift" rules require that a product be "substantially transformed" as illustrated by a change in its Harmonized Tariff Schedule

(HTS) tariff classification. The level of change required varies from product to product. One example of a tariff-shift rule is the so-called "yarn forward" rule for textiles and apparel. Yarn-forward means that all yarn and fabric used to make a textile or apparel product must be formed in the FTA region (see below).

Figure 2. Types of Preferential ROO



Source: World Customs Organization. Graphic by CRS.
Notes: HTS=Harmonized Tariff Schedule.

A **Regional Value Content (RVC)** rule requires that a minimum percentage of the product be produced in the FTA region. Value can be calculated in various ways, such as "building down" from the value of the finished product or "building up" from the value of the originating materials, as follows:

- **Build-up method** calculations add together the costs *originating in the FTA region*, including factory, parts, labor, insurance, packing, and transportation, duties, taxes, customs brokerage fees, and waste/spoilage of production material.
- **Build-down method** calculations subtract the *non-originating* costs (see individual costs above) from the adjusted value of the finished project.
- **Net cost method** calculations capture the direct manufacturing costs per unit, such as factory labor, materials, and direct overhead.

Technical rules require that some kind of manufacturing or processing operation be conducted in the FTA region for the product to originate. For example, chemical reactions, purification, deliberately controlled mixing and blending, or specifically defined changes in particle size confer origin of certain chemicals and related products.

Cumulation means that producers in FTA countries may manufacture goods from parts originating in more than one FTA country and the end product will still receive duty-free FTA status. For example, in USMCA, a product can be produced "in the territory of one or more of the Parties," as long as any of the parts not coming from the region (non-originating materials) undergo a tariff classification change. The end product must also meet any regional value content requirement, and any other applicable ROO requirements.

FTA ROO for Key Sectors

Since ROO are negotiated industry by industry, some critics assert that negotiators use them to shield import-sensitive industries or products from the effects of an FTA. Supporters contend that these measures are important for reducing FTA opposition from adversely affected industries, thus making its enactment more politically feasible. Two particularly sensitive sectors for the United States are the textile and automobile industries, which have dutiable rates from non-FTA partners as high as 32% for certain apparel products and 25% for light-duty trucks.

Textiles and Apparel

Most bilateral and regional FTAs negotiated by the United States over the past two decades, beginning with the North America Free Trade Agreement (NAFTA), have included the "yarn forward rule" for most textile and apparel products. This requires that in order to receive the tariff-free benefits of an FTA, although fibers may be produced in any country, all subsequent manufacture, including spinning into yarn; weaving or knitting; dyeing; printing; finishing; cutting and sewing; or other assembly into a finished garment or textile product must take place in one of the FTA partners. Depending on the product, some apparel must comply with a "fiber forward" rule (more restrictive) or a "fabric forward" rule (more liberal).

Motor Vehicles and Parts

As with textiles and apparel, ROO for cars, trucks, and auto parts in FTAs are designed to prevent vehicle and parts manufacturers in non-FTA countries from taking advantage of tariff reductions available to FTA partners. ROO for autos and parts in U.S. FTAs generally use a regional value content (RVC) approach. NAFTA had a RVC requirement for automotive products at 62.5%, which reflected the already integrated North American auto market at the time of negotiation. USMCA, which replaced NAFTA, increases the RVC requirement for automotive products to 75% and also includes a labor value content (LVC) requirement that was not in NAFTA. The LVC requirement stipulates that 40-45% of auto content be made by workers earning more than $16 per hour.

ROO Implementation in USMCA

CBP published USMCA implementing instructions on June 30, 2020 and provided all U.S. importers a 6-month transition period (until December 31, 2020) to fully comply with USMCA ROO requirements.

The largest differences between NAFTA and USMCA are in the automotive sector, including the increase in the RVC requirement, the LVC requirement, and additional RVC requirements for steel and aluminum. CBP will require additional certification to ensure these conditions are met, and up to 5 years of transition time is being provided to auto manufacturers to come into full compliance.

USMCA also marks the first time that a labor wage component (for auto workers only) is included in the ROO of a U.S. FTA. On July 1, 2020, the Labor Department's Wage and Hour Division published interim final rules in the *Federal Register* for implementation of these requirements, and opened a public comment period until August 31, 2020. No further information has been released as of this writing.

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