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RULES OF ORIGIN IN ECONOMIC INTEGRATION AGREEMENTS SIGNED BY COUNTRIES BELONGING TO THE LATIN AMERICAN INTEGRATION ASSOCIATION

This article refers to rules of origin included in the main Economic Integration Agreements signed by members of the Latin American Integration Association (LAIA). Issues relating to trade facilitation and reduction of transaction costs of international trade in goods are also discussed.

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A. INTRODUCTION

Rules of origin are a set of requirements that must be met by a final good in terms of the inputs and intermediate goods used in its production in order to define the nationality of the product, in the case of an individual country, or its provenance from a geographic territory, in the case of a group of countries. In the case of an Economic Integration Agreement (EIA) that provides for certain tariff preferences, the main purpose of rules of origin is to allow trade between members to benefit from those tariff preferences in the importing market. A product always complies with the rule of origin when it has been wholly produced in a given territory. When this is not the case, three criteria are used to determine origin, namely, change of tariff classification, requirements relating to technical or processing operations and rules concerning the value added of a product.

The aforementioned substantive requirements for determining origin are distinct from the formal procedures associated with them, i.e., the certificate of origin and corresponding verification, both of which fall within the scope of trade facilitation. In this article, we discuss the three main families of rules of origin applied in EIAs signed by members of LAIA, either among themselves or with non-member trading partners. As described below, these families are the Latin American Integration Association (LAIA), the EIAs between members of LAIA and the European Union (EU) and the North American Free Trade Agreement (NAFTA).

B. THE LATIN AMERICAN INTEGRATION ASSOCIATION

The Latin American Integration Association (LAIA), created by the Montevideo Treaty of 1980, provides that at least two of its members may enter into an Economic Complementation Agreement (ECA). There are currently around 55 ECAs, each of which may have its own provisions, inter alia, regarding origin. In the beginning, there were significant differences between ECAs, including differences on the question of origin, so an effort was made to bring them more in line with each other. One of the initiatives aimed at unifying criteria in the ECAs was the first official LAIA rule of origin relating to trade in goods, established in 1987 (resolution 78).

The main problems that arose from the application of this rule had to do with the vagueness of the criteria for establishing the origin of merchandise that was not shipped directly from the exporting country to the importing country and to the fact that the rule did not accept the origin of a good when an invoice issued by a third country was attached to the certificate accompanying the merchandise, a practice that was fairly widespread throughout the world. Some partial improvements were made, and the entire rule was finally updated in 1999, by resolution 252. However, this rule still needs to be further refined. This is evident from the fact that some of the ECAs entered into by members of LAIA with each other depart considerably from the Association's own rule of origin. A good example is that of the current EIA between Chile and Mexico (ECA No. 41), although the previous bilateral EIA between the two countries (ECA No. 17) did follow the LAIA rule. That is why LAIA is one of the families discussed in this article.

The 1980 Montevideo Treaty also allows LAIA members to enter into EIAs with non-LAIA partners, subject to their complying with certain conditions relating to other LAIA members. Both Chile and Mexico have signed separate EIAs with the European Union (EU). These EIAs, which are very similar, belong to another family discussed in this article. Chile, for its part, will soon be signing an EIA with the United States; Mexico is a member of NAFTA and thus receives preferential treatment from the United States. The third family of rules of origin included in our comparison is that of NAFTA, whose model is followed in the current Chile-Mexico EIA.

C. SUBSTANTIVE ASPECTS OF THE THREE FAMILIES OF RULES OF ORIGIN

This section is divided into two parts. The first refers to the detail and clarity of the rules, while the second focuses on how the rules have worked under the circumstances prevailing in the international economy.

1. DETAIL AND CLARITY IN RULES OF ORIGIN

A common feature of the NAFTA and EU rules of origin is that in both cases, they were negotiated for specific products. There are advantages and disadvantages to this approach. One disadvantage is that the negotiation process is protracted, and the text produced is a very lengthy one. This can be a good thing, though, since the requirements for individual goods are very clear, leaving little room for interpretations that might create conflict. The LAIA criteria for determining the nationality of products are very broad, although there are some exceptions. The general criteria of LAIA are quite basic, making it easy for almost any merchandise to comply. This does not allow for fine distinctions to be made in establishing the nationality of a product. Such laxity leaves the rules open to different interpretations, so that sometimes they have to be brought before a specialized dispute-settlement tribunal.

2. ADAPTING RULES OF ORIGIN TO THE NEW INTERNATIONAL ECONOMY

Since the LAIA rules of origin are open to interpretation, they are not predictable, and this creates uncertainty among operators involved in foreign transactions. Those countries that have entered into a large number of ECAs are more vulnerable than others to disagreements arising from the vagueness of the rules. Nevertheless, there are some advantages to having more general rules, since members of a given ECA are able to make exceptions. In contrast, the rules of origin established by NAFTA and the European Union are much more advanced than the LAIA rules, since they include more detailed conceptual definitions. They also cover a wide variety of new issues that are just coming to the fore in the international economy. All things considered, the NAFTA family seems to work better than the other two, since among other things, it includes provisions regarding the *de minimis* criterion, takes a very useful approach to the cumulation method, and deals with fungible goods and materials. Considering the importance of these issues, we shall discuss each one, using the the text of the current Chile-Mexico EIA as a point of reference.

(a) *De minimis*. Two criteria are used to allow for flexibility. The first provides that, with a few exceptions, a good is originating, even if it does not meet the change-of-tariff-classification requirement, provided that the value of all non-originating materials used in producing it is less than 8 per cent of the transaction value or, in certain cases, of the total value of the product. If the final product is subject to a value requirement and the non-originating value is no higher than one of the two 8-per-cent figures just mentioned, it may be imputed as originating. The second criterion has to do with goods that must meet the value requirement. In such cases, the merchandise does not have to meet the requirement if the value of non-originating materials is no higher than 8 per cent of the transaction value or, in certain cases, of the total cost.

(b) Cumulation. Cumulation only adds value when merchandise or materials from other partners in an EIA are used in the final phase of production of the final good. This is the case with the Chile-Mexico agreement, but this EIA has an advantage in that it allows for a good to be considered originating even if it does not meet the rules pertaining to materials used in the final phase of production. Thus, when a material used in production of the final good originates in a third trading partner, that part of the material may be broken down and considered originating, and the same is true of all non-originating materials used, down to the first stage in the production chain. This criterion also operates in the Mexico-EU EIA, but individual partners may only impute values prior to the final stage of production when they are local and do not originate somewhere else.

(c) Fungible goods and materials. The text of the Chile-Mexico EIA defines fungibles as goods that are interchangeable for commercial purposes when they have identical properties, i.e., it is not possible to differentiate between them by mere visual observation. This applies, for example, to products like coffee or certain liquid products, when they are stored in the same place without making any distinction as to their provenance, since a centralized system is more profitable (economies of sale). Thus, if a country exports such products, it must comply with the rule of origin in order to benefit from tariff preferences, but in a case like this, since the originating goods are stored together with similar products that do not meet the rules, the exporter may not sell under a preferential tariff regime any amount above that which is truly originating. This EIA includes provisions for such situations, for which reliable documentation is required. Since the latter is a purely formal element, it actually falls within the scope of section D below.

D. FORMAL ASPECTS OF THE THREE FAMILIES OF RULES OF ORIGIN

As noted earlier, sophisticated and efficient administrative systems are required in order to ensure the proper application of rules of origin that are drafted in full and specific terms. This section is

divided into two parts. The first refers to the issuance of certificates of origin. The second deals with customs procedures pertaining to oversight, control and verification of origin, as well as the legal implications of non-compliance.

1. ISSUANCE OF CERTIFICATES OF ORIGIN

(a) The LAIA family

In this case, certificates must be issued by a public authority, which means that any problems that might arise are a matter of public law. However, this authority may delegate the duty of filling out the certificate to a national private-sector producers' or exporters' association. In any event, the certificate of origin must be reviewed and signed by the public institution, which always bears final responsibility for the certificate. Thus, every ECA requires individual members to provide the names of the persons who are authorized to sign, and to keep that information up to date; this is not always done. Under LAIA, a separate certificate of origin is required for each commercial transaction.

(b) The NAFTA family

In this system, the method applied is self-certification, which means that the certificate of origin is issued directly by the exporter or the producer, with no participation on the part of a public authority. The certificate is valid for similar transactions over a period of one year. When questions arise concerning origin or possible fraud, the responsibility falls on the individuals concerned, not on the countries; hence, the problem is a matter of private law. The economic cost of non-compliance with origin requirements is borne by the importer, who is not legally liable unless it is demonstrated that he or she participated in a fraudulent action, in complicity with the exporter. If documents are altered or an offence is committed, the issuer of the certificate of origin, i.e., the exporter, is always held liable under the law. The absence of public-sector participation increases the potential for fraud, so importing countries participating in EIAs that apply this rule have to strengthen their oversight; this is especially true for countries with relatively less developed economies.

(c) The EU family

Although certificates of origin are filled out by exporters, they must be endorsed by a public agency. When the authority in the importing country discovers a problem of form, the importer is held liable. If there are questions with regard to content, the public agencies involved hold consultations on the matter. As a precaution against forgery, certificates of origin have to be issued on paper of a certain colour and quality, which are clearly spelled out.

2. CUSTOMS OVERSIGHT IN REGARD TO ORIGIN

(a) The LAIA family. This system has limitations, given that if a certificate of origin does not meet the substantive requirements, the authorities of the importing country report this to the public agency of the exporting country, so that it can take such measures as it deems necessary to solve the problem. As far as the importing country is concerned, it is allowed to apply the necessary fiscal safeguards. This is the only verification procedure provided for in the LAIA family. No criteria are laid down for dealing with potential disputes or for due process. No time limits are established, and there is no indication as to what body should deal with the problem, since LAIA does not have a dispute-settlement tribunal. As a result, all the ECAs entered into in the context of LAIA have had to create their own specialized bodies in order to fill this gap.

(b) The NAFTA family. In this system, the importing authority may request the exporter to provide information on the origin of a good. Three non-exclusive procedures may be followed: written questionnaires may be sent directly to producers or exporters; verification visits may be made to an exporter or a producer, in order to examine the documentation showing compliance with the rules and inspect the facilities used in producing the merchandise and, if necessary, the locations where the materials are produced; and other procedures may be followed as agreed by the partners. The first of these is used most often, and the third has not yet been used.

The option of conducting verification visits has not been used very often. This would appear to be because the use of questionnaires has proven quite adequate, so visits have only been necessary in special cases. However, that is not necessarily true. It should be borne in mind that in order for direct verification to take place, the importer, through the competent customs authority, is required to notify in writing its intention of carrying out a visit. This notification must be sent to the exporter or producer and to the customs authority in the exporting country. Lastly, the customs authority must obtain the written consent of the exporter or producer. If this authorization is not received within a given time limit, which is set by the parties concerned, imports will not be subject to the tariff preferences established in the EIA. This directly affects the importer, who will have to pay non-preferential tariffs.

The verification visit is conducted by customs officials from the importing country. However, the exporter or producer is entitled to appoint two observers to be present during the visit, strictly as observers. If the customs authority of the importing country finds that there has been non-compliance with origin requirements, before that finding can be implemented, both the importer and the person who filled out and signed the certificate of origin must be notified. The process entails a considerable financial cost, which may explain why the system is not often used, given that the cost of using questionnaires is much lower. One might conclude that the few problems that have arisen regarding origin in the NAFTA family are caused by the weaknesses in its own oversight system, which does not make provision for the level of financing that might be required by the relatively less developed countries. This may be the case with the current Chile-Mexico EIA, which includes complex criteria that call for efficient oversight.

As far as the legal aspects are concerned, each trading partner applies the penal, civil or administrative sanctions provided for in its own domestic legislation or regulations. Should it be necessary, the parties can always resort to a specialized agency to settle the dispute. In that event, the parties may choose whether to use the institutions established under the EIA or those set up by the World Trade Organization (WTO).

(c) The EU family. In this case, the competent national authorities are responsible for issuing certificates of origin and for taking the measures necessary to verify compliance. They are empowered to require any kind of proof and to inspect exporters' books as well as to carry out any other kind of verification they may consider necessary for a proper investigation and to ensure due process. Verification itself is conducted at random or whenever the authorities of the importing countries have reasonable questions about the form of the certificate of origin.

When there is suspicion regarding the content of the certificate, the customs authorities of the importing country must return the relevant documentation to the authority of the exporting country, stating the reasons why an investigation is in order and attaching all necessary background information. All this documentation is sent along with a request for an a posteriori verification. The authorities of the exporting country then conduct the investigation as they see fit. During this process, although questions may be raised as to whether the authority of the importing country is a passive

party, it is empowered to temporarily suspend preferential tariffs for the products under investigation.

The authority of the exporting country must present a report to the importing country as soon as possible and within 10 months at the latest. If the reply is received in time and suspicions remain, the tariff benefits may be permanently suspended. The 10-month deadline seems too long from the standpoint of trade facilitation. If the authorities involved do not reach an agreement after the verification process has been completed, the case must be submitted to the ad hoc committee on customs cooperation and rules of origin of the EIA. This is a limitation resulting from the fact that customs procedures in this family of rules of origin fall within the scope of "administrative cooperation". Consequently, if the dispute continues after verification, it is not taken to a dispute-settlement tribunal. In order to avoid diplomatic disagreements or political friction between signatories of an EIA, the importer may, at its own Government's suggestion, cover economic costs that are not really its responsibility. Lastly, differences between importers and their national authorities are always settled in accordance with the domestic legislation of the country concerned.
