

EU-Ukraine Free Trade Agreement Negotiations Stakeholder Briefing Note 2

Rules of Origin

"Rules of origin" are the criteria, laws, regulations and administrative procedures used to define where a product was made. Only those products that fully comply with the rules of origin defined in the free trade agreement (FTA) will qualify for duty free access. Bilateral cumulation allows for each party to the FTA to use originating products from each other. Diagonal cumulation operates between more than two countries provided they have FTAs containing identical origin rules and provision for cumulation between them. Diagonal cumulation operates between the European Community and the countries of the so-called "Pan-Euro-Mediterranean cumulation zone" allowing the manufacture of a product to have the origin of the country where the last working or processing operation took place, provided that it was more than a minimal operation.

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CURRENT SITUATION FOR UKRAINE

National

Ukraine's non-preferential rules of origin are governed by Section XII of the 2002 Customs Code, Articles 276 to 285. The Code establishes the main criteria for determining the country of origin for goods, while Resolution of the Cabinet of Ministers No. 1864 "On Approval of the Order of determination of Country of Origin of a Good, Crossing the Customs Border of Ukraine" of 12 December 2002 lays down detailed rules.

Other relevant legislative acts include Resolution of the Cabinet of Ministers No. 1861 of 12 December 2002, which approves the Procedure for the Verification of Certificates of the Ukrainian Origin of Goods, and Resolution of the Cabinet of Ministers No. 2030 of 27 December 2002, which approves the Schedule of Production and Technological Processes for Determining the Criterion of Sufficient Processing of Goods, and the Procedure for the Establishment and Application of the Criterion in Determining the Country of Origin of Goods¹.

Ukraine generally applies the concept of change in tariff heading at a 4-digit level to confer origin. The exception to this rule is a list of products for which sufficient processing criterion are determined by specific production and technological operations, including products in Chapters 25 and 27 of the Harmonised System (HS) of product classification and HS Headings 2818, 3301, 3403, 4001, 4017, 7103, 7111 and 8702-8704.

EU-Ukraine Agreements

The EU currently applies its General System of Preferences (GSP) to exports from Ukraine. Ukrainian products that meet the specific rules of origin detailed under the GSP can enter the EU at reduced rates of duty. While products wholly obtained in Ukraine are considered as originating there, products manufactured with inputs from other countries are considered so only if they have undergone sufficient working or processing. The requirements, which vary between products of different chapters of the HS tariff schedule and sometimes also between different headings within those chapters, refer to technical criteria, the added value or other economic criteria, or a change of tariff heading. The rules of origin also foresee that products have to be accompanied by a certificate of origin "Form A" or an invoice declaration, and that they have to be shipped directly to the EU.

The rules of origin applying to imports under the GSP allow, under certain conditions, for cumulation of origin. Where those conditions are met, inputs from other countries are considered as originating in the exporting country.

In order to foster economic co-operation between the EU and beneficiary countries, the rules of origin provide that all imports under the GSP are entitled to bilateral cumulation of origin (i.e. with the EU, which is also known as "donor country content").

A significant proportion of Ukrainian goods entering the EU market currently benefit from the GSP. GSP effective imports from Ukraine have increased significantly from 2000 and the GSP utilisation rate reached 72.5 per cent of the eligible products in 2006. With ! 1.73 billion of GSP preferential imports to the EU, Ukraine is ranking among the top twelve effective users of the

¹ WTO, WT/ACC/UKR/152

system. Preferential imports are diversified and include *inter alia* the following sectors: chemicals, plant oils, minerals, base metals, machinery and mechanical appliances².

WTO Commitments

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

As from the date of accession to the WTO, all Ukraine's preferential and non-preferential rules of origin comply with the WTO Agreement on Rules of Origin.

Other Agreements

International treaties and agreements concluded by Ukraine include preferential rules of origin for the CIS countries, adopted by the Council of Governments of the Commonwealth of Independent States (CIS) on 30th November 2000, and the rules of origin of the Free Trade Agreement between Ukraine and FYROM. The rules of origin of CIS countries are based on the wholly-obtained or minimal processing criterion as well as, for processed goods, the substantial transformation criterion involving change of tariff heading (at the four-digit HS level) and/or ad valorem percentage requirements. Imports from a CIS country covered by the wholly-obtained criterion include mineral resources, products of plant origin, animals and animal products, fish and fish products, products extracted from the sea bed, waste and scrap, high technology products made in open space or on board spaceships owned or rented from the CIS country; or products manufactured exclusively from the materials indicated above. Simple assembly operations; the preparation of goods for sale or transportation; preservation during storage or transport; mixing operations which do not result in an essentially different product; and the slaughter of cattle do not constitute sufficient transformation or processing. Imports from a CIS country are deemed to have undergone substantial transformation if the value added proportion exceeds 50 per cent³.

ECONOMIC IMPACT (COST-BENEFIT)

The ability to source inputs to production at the cheapest rates can be influenced by both rules of origin and the level of cumulation applied. More liberal rules of origin will allow for greater economic efficiency and hence lead to a greater opportunity to export.

A number of recent studies have looked at the impact of a potential EU-Ukraine FTA, however, none of these have analysed the role of rules of origin in detail.

A study by CEPS⁴ (2006) remarks that "Formally, Ukraine benefits from the EU Generalised System of Preferences (GSP). Most agricultural and food industry products are in the 'sensitive' goods category, however, where the

² European Commission, Delegation to Ukraine

³ WTO, WT/ACC/UKR/152

⁴ CEPS, IFW & ICPS (2006): The Prospects of deep free trade between the European Union and Ukraine

margin of preference is small and procedures are complicated (particularly by rules of origin). Also, information about GSP advantages has not been efficiently delivered to Ukrainian producers and exporters; hence the level of GSP usage by Ukraine remains low”.

A study by ICPS⁵ states “Practice has shown that the rules of origin attached to a Free Trade Agreement by the European Union are not open to negotiation. Moreover, the kinds of rules proposed by the EU are generally developed using a somewhat untransparent mechanism to protect certain markets and not to facilitate trade: the greater protection certain sector needs, the stricter the rules of origin for the related goods are. As a rule, no analysis is performed to justify the expediency of including specific rules of origin of goods in a new free trade agreement”

EU APPROACH IN OTHER AGREEMENTS

Most of the EU’s free trade agreements follow a similar approach to the GSP concerning the methods used to calculate rules of origin, detailing specific lists by HS chapter and 4 digit heading of working or processing operations conferring or non-conferring originating status to manufactured products when they are carried out on non-originating materials.

Bilateral cumulation operates between the EU and a partner country where a free trade agreement or autonomous arrangement contains a provision allowing them to cumulate origin. This is the basic type of cumulation and is common to all origin arrangements. Only originating products or materials can benefit from it.

Diagonal cumulation operates between more than two countries provided they have free trade agreements containing identical origin rules and provision for cumulation between them. As with bilateral cumulation, only originating products or materials can benefit from diagonal cumulation. Although more than two countries can be involved in the manufacture of a product it will have the origin of the country where the last working or processing operation took place, provided that it was more than a minimal operation. Diagonal cumulation operates between the EU and the countries of the so-called "Pan-Euro-Mediterranean cumulation zone".

Pan-Euro-Mediterranean cumulation is currently used by:

The Member States of the EU, the Faeroe Islands, Iceland, Liechtenstein, Norway, Switzerland, Turkey, Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Tunisia and Palestinian Authority of the West Bank and Gaza Strip).

The EU has customs unions with Turkey, the Principality of Andorra and the Republic of San Marino. Products covered by the customs unions with Andorra and San Marino are treated in accordance with the provisions of the Origin Protocols to those agreements. All the relevant agreements contain Joint Declarations stating that products of HS Chapters 25 to 97 originating in Andorra and all products originating in the Republic of San Marino are to be considered as originating in the EU by the partner countries.

The EU operates cumulation with those countries with which a free trade agreement providing for such cumulation and containing Pan-Euro-Med origin rules is in place.

Under the Pan-Euro-Med rules, cumulation can be only applied if the countries of final manufacture and of final destination have concluded free trade agreements, containing identical rules of origin, with all the countries

⁵ ICPS (2007): Free Trade between Ukraine and the EU: An impact assessment

participating in the acquisition of originating status, i.e. with all the countries from which all the materials used originate. Materials originating in a country which has not concluded an agreement with the countries of final manufacture and of final destination shall be treated as non-originating⁶.

ISSUES FOR UKRAINE

What does this mean for stakeholders and negotiators in Ukraine:–

Implications: It would appear likely that a decision will be taken to adopt the Pan-Euro-Med protocol of origin:

- *By adopting Pan-Euro-Med rules of origin will certain industries and products face a relative advantage in comparison to existing GSP access to the EU market?*
- *By adopting Pan-Euro-Med rules of origin will certain industries and products face a relative disadvantage in comparison to existing GSP access to the EU market?*
- *What action does Ukraine need to take to ensure full benefit from "diagonal cumulation"?*

Next Steps: Stakeholders need to engage with government negotiators in a positive way to agree possible changes in rules for specific products:

- *Representatives of producers who believe that their access to EU markets will be negatively affected by the introduction of the Pan-Euro-Med system should articulate their position to Ukrainian negotiators, providing fully justified positions based on facts and figures;*
- *Ukrainian negotiators should determine the likely benefits of diagonal cumulation as opposed to purely bilateral cumulation.*

Implications: To take advantage of diagonal cumulation with other members of the Pan-Euro-Med system in addition to the EU, Ukraine will need to enter into free trade agreements with them containing identical rules of origin:

- *Would any industries benefit from access to cheaper raw materials by sourcing inputs from other members of the Pan-Euro-Med system rather than traditional suppliers?*

Next Steps: Stakeholders should analyse the potential benefit of diagonal cumulation, and present a justified and prioritised list of countries to negotiators:

⁶ European Commission, A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European countries and the countries participating to the Euro-Mediterranean Partnership

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- *Representatives of producers who believe that the introduction of the Pan-Euro-Med system would benefit their sector should articulate their position to Ukrainian negotiators, providing fully justified positions based on facts and figures;*
- *Ukrainian negotiators should plan to negotiate FTAs with identical rules of origin with prioritised countries as soon as is feasible.*