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Support to Dialogue on the EU-Ukraine Free Trade Agreement

ISSUES PAPER 2: RULES OF ORIGIN



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CTA **ECONOMIC & EXPORT ANALYSTS LTD**

505 Pinner Road, Harrow HA2 6EH, United Kingdom

Tel: (+44) 870 199 5835 Fax: (+44) 870 383 5011

office@ctaeconomic.com

www.ctaeconomic.com

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Report Prepared by

Chris Cosgrove, Mark Hellyer, Serghei Nerpii & Yuri Muzika

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Executive Summary

The Ukraine EU FTA is likely to involve administrative cooperation, a two-step approach to cumulation and adoption of the “Pan-Euro-Mediterranean protocol of origin”.

The main benefits of this to Ukraine will be the ability of its exporters to source from cheaper suppliers outside of Ukraine and the EU and still qualify under the rules of origin, leading to more competitive exports to the EU.

The key issues, which stakeholders and negotiators need to address are:

By adopting Pan-Euro-Med rules of origin will Ukrainian industries be better or worse off?

How does the current system of issuing and verifying EUR.1 certificates need to be changed in order to meet the requirements of the Agreement?

Stakeholders in Ukraine should adopt a position on these key issues based on analysis of a number of factors which will determine how these potential changes will affect them.

Opportunities: The degree of benefit to Ukraine will depend upon exporters taking advantage of the following:

Greater access to EU and in due course other partner countries markets

Increased flexibility in sourcing raw materials

On the basis of the above analysis a list of further free trade agreements that should be entered into with other partner countries within the pan-euro-med zone should be determined and prioritised.

Laws: The legislative changes needed will depend on the difference between the current legislative framework and that needed to implement the requirements of the protocol.

The State Customs Service of Ukraine should be given the exclusive right to issue and verify EUR.1 certificates of origin

Institutions: Compliance with the Protocol on rules of origin will require an effective institutional framework.

Capacity of Customs to Issue and verify EUR.1 Certificates

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Context

“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.

Scope of negotiations

The FTA is likely to involve administrative cooperation, a two-step approach to cumulation (first bilateral and then, in a second step, diagonal cumulation) and adoption of the Europe-wide harmonised system of rules of origin (the “Pan-Euro-Mediterranean protocol of origin”).

Economic 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.

Key Issues

In light of the scope and implications of these negotiations, the key issues, which stakeholders and negotiators need to address, are:

By adopting Pan-Euro-Med rules of origin will certain industries and products face a relative advantage/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”?

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?

Existing Regime in the European Union

The European Union currently operates a multi-layered and complex system of preferential rules of origin with its various groups of partner countries. These include GSP (Generalised System of Preferences), LDC GSP, GSP+ and EPA rules. There are also separate, specific rules of origin that have been negotiated as part of individual free trade agreements, such as those with Chile and Mexico. With its partner countries in the Mediterranean and European countries with which it has negotiated free trade agreements, the EU applies a system commonly referred to as the 'Pan-Euro-Mediterranean cumulation' system of rules of origin. This is based upon the legal provisions of the Agreements between the European Union and its principal European and Mediterranean trading partners. Specifically it applies to trade between the EU and the following countries:

- Algeria
- Andorra
- Egypt
- Iceland
- Israel
- Jordan
- Lebanon
- Morocco
- Norway
- Palestinian Authority of the West Bank and Gaza Strip
- San Marino
- Switzerland (including Liechtenstein)
- Syria
- The Faroe Islands
- Tunisia
- Turkey

It is likely that other countries will be integrated into the system in due course.

Framework

The launch of the “Barcelona Process” in 1995 put in place a strategy aimed at the progressive establishment of free trade between the EU and its Mediterranean partners and amongst the partners themselves. The “Pan-European” cumulation system was subsequently introduced during 1997. Turkey was integrated into the system in 1999. From 1998, a series of Euro-Mediterranean association agreements were concluded between the EU and its Mediterranean partners granting reciprocal trade preferences. In 2003 the system was expanded to include EFTA countries. The ‘Pan-Euro-Mediterranean’ protocol on rules of origin was developed at a working group with all partner countries concerned and subsequently endorsed by the Euro-Med Trade Ministerial Meeting in Palermo on 7th July 2003¹.

Pan-Euro-Mediterranean cumulation can be applied between three countries of the zone as soon as Free Trade Agreements containing identical rules of origin between the countries concerned are in place, formally notified to the European Commission and a notice published in the Official Journal of the European Union.

The system can be applied between a limited group of countries who have completed FTAs amongst themselves, without the full network of FTAs having been completed (so called variable geometry).

Protocols between the EU and all countries involved are virtually identical and consist of the following:

STRUCTURE OF THE ORIGIN PROTOCOLS

Each Protocol is divided up into eight sections called "Titles". Titles cover all aspects of the origin system put in place by the Protocol. The eight titles in the relevant Protocols are the following:

- Title I General provisions
- Title II Definition of the concept of "originating products"
- Title III Territorial requirements
- Title IV Drawback or exemption
- Title V Proof or origin
- Title VI Arrangements for administrative co-operation
- Title VII Ceuta and Melilla
- Title VIII Final provisions

Within these eight groups is the legal basis for the origin system currently in force in the so called pan-Euro-Mediterranean cumulation zone. Each Title contains a number of Articles, each of which covers a specific aspect of the Protocol.

¹ Pan euro med “a User’s Handbook”, European Commission

Annexes to the protocols provide a full list of working or processing required to be carried out on non-originating materials in order that the product manufactured can obtain originating status detailed at a 4-digit HS level, specimens of movement certificate EUR.1 and application for a movement certificate EUR.1 and text of the invoice declaration.

Proof of Origin

To qualify for preferential access to the EU a consignment of goods must be accompanied by agreed “proofs of origin”. These prove that the goods they accompany have fulfilled the origin requirements set out in the protocols. There are four kinds of proof of origin allowed for within the protocols:

- A movement certificate EUR.1
- A movement certificate EUR-MED
- An “invoice declaration”
- An “invoice declaration EUR-MED”

Movement certificates EUR.1 and EUR-MED are issued by customs authorities of the exporting country on application after having received detailed applications made in writing by the exporter as detailed in the protocols.

To simplify procedures for manufacturers who regularly export their products to partner countries within the zone there is provision for “approved exporters” to issue invoice declarations rather than applying for EUR.1 certificates for each consignment.

Small consignments with a value of less than Euro 6,000 only require an invoice declaration.

Approved exporters

The protocols allow for countries to establish a list of “approved exporters”, who have met with certain criteria and conditions set out by the national customs authorities and are granted certain rights with regard to the proof of origin that they present. The national customs authorities must carry out regular inspections on approved exporters to ensure continued compliance. A national numbering system must be established for the designation of approved exporters and notified to the European Commission. The Commission in turn will convey that information to all other partner countries.

Existing Regime in Ukraine

Rules of Origin Applied to Ukraine by the EU

Ukraine currently benefits from the EU's General System of Preferences (GSP) for exports to the EU. Certain 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, 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 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 system. Preferential imports are diversified and include *inter alia* the following sectors: chemicals, plant oils, minerals, base metals, machinery and mechanical appliances².

Rules of Origin Applied by Ukraine on EU Imports

Ukraine's non-preferential rules of origin are governed by Section XII of the 2002 Customs Code, Articles 276 to 285. The Code established 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

² European Commission, Delegation to Ukraine

of a Good, Crossing the Customs Border of Ukraine" of 12 December 2002 laid down detailed rules. Other relevant legislative acts include Resolution of the Cabinet of Ministers No. 1861 of 12 December 2002, which approved 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 approved 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 Goods.

The implementation of the provisions of Article 2(h) and Annex II, paragraph 3(d) of the WTO Agreement on Rules of Origin (i.e., the right of an importer, exporter or any person with a justifiable cause to seek an origin determination prior to shipment, delivered within 150 days and valid for three years, providing the facts and conditions underlying the assessment remain comparable) have been ensured, through the adoption of Cabinet of Ministers Resolution No. 1443 "On Supplementing the Procedure for Identifying the Country of Origin of a Product Which is Moved Across the Customs Border of Ukraine" of 28 October 2004. Law No. 3269-IV "On Introducing Changes to Some Legislative Acts of Ukraine" of 22 December 2005 introduced changes to Section XII of the Customs Code. These changes stipulated the use of the change of tariff heading criterion in accordance with the nomenclature, the ad valorem criterion (Article 2(a) of the Agreement on Rules of Origin), and the latest processing operation (cumulative principle). The amendments also delineated preferential from non-preferential rules of origin. In addition, these amendments regulated the country of origin determination of packaging that must be declared separately from the goods, and the country of origin determination of components, parts and tools intended to be used with machines, devices, units or vehicles (Article 9 and 7 of Section 1 of the Special Annex to the Kyoto Convention).

Institutional framework

The Ukrainian Chamber of Commerce and Industry (UCCI) is currently authorised to issue mandatory certificates of origin for Ukrainian exporters. The legal basis for this is set out in the Law of Ukraine No.671/97-BP of 02.12.1997 "On the Chambers of Commerce and Industry in Ukraine" and Cabinet of Ministers of Ukraine Decree No.255 of 25.02.2003 "On authorising UCCI to issue certificates of origin". The State Customs Service of Ukraine has the legal right to audit and verify the issue of individual certificates of origin.

UCCI issues the following types of certificates of origin depending upon trade conditions:

- General-purpose certificate;
- Certificates of origin for textiles exported to EU countries;
- ECSC certificate for metal products exported to EU countries;
- Form A preference certificate under the General System of Preferences (EU countries, Japan, Turkey);
- EUR-1 preferential certificate for goods exported to the Republic of Macedonia;
- General-purpose certificate for goods exported to CIS countries
- CT-1 certificate for goods exported to CIS countries;
- U-1 certificate for the customs territory of Ukraine;
- Preferential certificate for goods exported to Mexico;

UCCI currently employs approximately 800 people in 27 offices throughout Ukraine who are involved in this process and issued more than 97,000 “FORM A” certificates of origin in 2007 (representing in the region of twenty percent of the total number of certificates issued). Exporters are charged a fixed fee of UAH 150 per certificate issued, generating an income to UCCI of roughly UAH 15 million per annum relating to the issuance of FORM A.

In cases where the Ukrainian Customs Authorities doubt the authenticity of the certificates of origin issued by UCCI, Cabinet of Ministers Regulation N1862 of 12.12.2002 with changes introduced by Regulation N92 of 18.01.2003, confers them the right to carry out investigations to verify the authenticity of certificates of origin and subsequently cancel them.

Discussion Points

In order to address the key issues, stakeholders and negotiators need to analyse the current differences between existing rules of origin and their operation in Ukraine and that of the proposed pan-European rules. Only when they have analysed this, will they be able to form an individual position for national debate on:

By adopting Pan-Euro-Med rules of origin will certain industries and products face a relative advantage/disadvantage in comparison to existing GSP access to the EU market?

What action does Ukraine need to take to ensure full benefit from both bilateral and diagonal cumulation?

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?

Opportunities

One of the major considerations in addressing the key issue of whether to adopt the proposed Pan-Euro-Med rules of origin will be the benefit that is derived. Stakeholders may support full adoption if the benefits to them are significant. To assess the benefits each stakeholder group should consider a range of benefits and costs.

Greater access to EU and in due course other partner countries markets

The major opportunity for Ukrainian firms will be the possibility to benefit from preferential access to the EU market and in due course to those partner countries operating the pan-euro med system.

Therefore, stakeholders should assess which industries and or individual products will face a relative advantage/disadvantage in comparison to existing access to the EU and other partner country markets

Increased flexibility in sourcing raw materials

In order to qualify for this preferential access Ukrainian exporters will not be limited to only utilising raw materials from the EU and Ukraine, but will also be able to use potentially cheaper raw materials from other partner countries (as long as Ukraine has negotiated a free trade agreement with them). This means that Ukrainian goods exported to the EU could potentially be cheaper and therefore more competitive, resulting in greater volumes of exports.

An analysis should therefore be made of which raw materials could be sourced from within the Pan-Euro-Med area to benefit from diagonal cumulation. This could be achieved by undertaking a statistical review of where raw materials are currently imported from and comparing them to possible new sources of supply in the Pan-Euro-Med zone.

From this, it would be possible to determine and prioritise a list of free trade agreements that should be entered into with other partner countries within the Pan-Euro-Med zone.

Laws

Another factor in determining how to implement the protocol on rules of origin will be the difference between the current legislative framework in Ukraine and that of the EU, as well as the likely ease of developing and adopting the necessary legislation. Prior to this, legislative changes will have to be made to ensure that:

The State Customs Service of Ukraine should be given the exclusive right to issue and verify EUR.1 certificates of origin

UCCI currently has the mandate to issue all certificates of origin in Ukraine. In order to comply with the proposed protocol, the issuance of EUR.1 forms has to be undertaken by the State Customs Service of Ukraine.

Institutions

Compliance with the Protocol on rules of origin will require an effective institutional framework. How much and how quickly Ukraine will be able to benefit from the protocol will depend on the institutional development required to ensure effective institutions. This in turn depends on necessary changes to the existing institutional framework and the further development of it that may be required to fully implement the protocol.

Capacity of Customs to Issue and verify EUR.1 Certificates

Currently in Ukraine, certificates of origin are all issued by the UCCI. In order to fully comply with the protocol, the function of issuing and verifying EUR.1 certificates will have to be transferred to the State Customs Service of Ukraine.

Therefore, there will be a need to review how this could be achieved by the State Customs Service. It could be necessary to establish a new unit to undertake these activities. Initial estimates by Customs are that this would entail the recruitment of 320 new staff at a cost of UAH 31.1 million per annum in salaries. These staff will need to be trained in issuing and verifying EUR.1 certificates. Additional infrastructure requirements are estimated at UAH 2.5 million and the costs of printing 100,000 EUR.1 forms per annum would be approximately UAH 117,000.

Establishment of an Approved Exporter Scheme

Plans will also need to be made to establish and implement a fully functioning approved exporter scheme in line with the requirements of the protocol.

A detailed feasibility study needs to be undertaken to ensure that adequate funding is available from the State budget for these activities and that all necessary staff, systems and equipment are in place prior to signature of the Agreement.

Impact on UCCI

UCCI will face an immediate reduction in revenue of approximately UAH 15 million per annum as a result of no longer being able to charge fees for issuance of GSP Form A. It will therefore need to ensure that it has adequate structure, resources and sources of income to continue to provide its full range of support services to Ukrainian businesses. This will include meeting the requirements for issuing the other certificates of origin that will continue to be within its remit.