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IMPLICATIONS OF CERTAIN MAJOR PROPOSALS FOR HARMONISED RULES OF ORIGIN FOR ACCESS UNDER THE AGREEMENT ON TEXTILES AND CLOTHING: AN ANALYSIS OF POSSIBLE EFFECTS

Proposal by India

The following communication, dated 19 April 1999, has been received from the Permanent Mission of India.

I enclose herewith a paper by India titled "Implications of Certain Major Proposals for Harmonized Rules of Origin for Access under the Agreement on Textiles and Clothing: An analysis of Possible Effects" for consideration of the Committee on Rules of Origin during its discussions on "Implications of the Implementation of the Harmonized Rules of Origin on Other WTO Agreements", including at its meetings scheduled for 22-23 April 1999.

In April 1998, India proposed (G/RO/W/28) that the WTO Secretariat prepares an analysis bringing out the implications of major proposals for harmonizing the rules of origin for free flow of trade and the rights and obligations of Members under various WTO agreements. The proposal was made in the interest of promoting better understanding of the implications and of facilitating the development of transparent and neutral rules of origin in accordance with the purpose and objective of the Agreement on Rules of Origin. It was also felt that such an analysis was necessary to avoid unnecessary obstacles to trade in the future.

In response to questions by some delegations, India clarified that its purpose was merely to seek clarity with regard to the implications of major harmonization proposals and that it did not intend to seek interpretations of the provisions of any WTO agreements (G/RO/W/30).

It was hoped that the analysis proposed by India would facilitate the work of the Committee on Rules of Origin. Unfortunately, India's request could not find favour with certain Members. Under the circumstances India has had to undertake extensive consultations with experts in the workings of various WTO agreements, especially the Agreement on Textiles and Clothing (the "ATC"), to develop an understanding of the implications of certain proposals for the uninhibited flow of trade. Our consultations and analysis focussed particularly on the effects of the major proposals for the utilization of access under the ATC as well as for Members' rights and obligations thereunder.

India's analysis has confirmed its apprehension that harmonizing the origin rules on the basis of certain proposals is liable to create far-reaching adverse implications for the rights of Members under the ATC. It will also have negative consequences for the normal flow of trade in the sector.

The following analysis is being presented in the hope of facilitating the understanding of the implications of such proposals and of building consensus for transparent and neutral rules that can be applied in an impartial, predictable and consistent manner.

India remains committed to the objectives of the Agreement on Rules of Origin. It believes that harmonized rules are necessary for providing certainty in the conduct of international trade. It also believes that the harmonized rules should apply equally for all trade policy purposes so as to provide for predictability for trade and the businesses concerned. Finally, it is convinced that the rules of origin should be harmonized on the basis of an impartial and consistent set of principles.

International trade in textiles and clothing has long been managed in the major developed countries through an institutionalized system of quantitative restrictions. The sector has also seen a number of anti-dumping actions especially in recent years. Similarly, problems have also been experienced with respect to the marking of textile and clothing products.

The ATC was designed to phase out the quantitative restrictions over a transitional period. It prescribes the rights and obligations of importing and exporting Members, including with respect to the administration of quotas by the exporting countries, the possibility of new restrictions under the Agreement's transitional safeguard mechanism, and prevention of circumvention of the Agreement.

It is essential that the harmonized rules do not create obstacles in the utilization of quota access by the exporting countries under the ATC or otherwise compromise the exporting countries' interests. Likewise it is necessary that these rules do not create any problems with respect to other aspects of the ATC mentioned above.

Unfortunately, as the following analysis will show, this will not be the case if the rules are harmonized on the basis of certain major proposals.

Textile and clothing products are normally grouped under four different headings: yarns, fabrics, made-up articles, and clothing. With respect to each one of these product groups, proposals have been made by a number of countries. Within the short span of a few pages, it is not possible to analyze each and every proposal. It is, therefore, essential to group them under two broad headings. One set of proposals that recognizes most processing operations such as dyeing, printing, finishing, designing, cutting, sewing, embroidering, assembling and other making-up as origin conferring. The other set that recognizes only some of these processing operations as origin conferring but not the others.

The above distinction holds true of each of the four segments of the textile sector. Thus, for example, certain proposals do not recognize some operations that go into the making of some garment items (like assembling of knit-to-shape components into finished ready-to-wear garment products) as

origin conferring. Similarly, some proposals do not recognize the conversion of fabrics to such varied set of articles as tents, embroidered products, table/bed linen, home furnishing items, etc., as origin conferring. Finally, a number of proposals seek to ignore processing of fabrics and yarns by dyeing, printing and finishing as origin conferring.

Each one of the above processing operations involves sufficient working to secure new and distinct articles. In an ever increasing system of global manufacturing, industrial and business operation are often designed and developed to optimize the advantages by manufacturing various articles in different locations. It is true of textiles and clothing as for any other sectors of trade.

If some processing operations are not recognized as origin conferring, they are bound to have adverse effects for the exporting countries concerned with respect to virtually all the articles of the ATC. Such adverse implications are highlighted hereunder.

Examples:

Assume that the rule of origin for a knitted garment is harmonized on the basis of where the fabric was knitted rather than where the garment is made. Likewise assume that the rule for dyed and printed fabric is where the grey fabric was made rather than where it is processed by dyeing and printing. Also, assume that a made-up article (for example, a tent or bed/table linen) is conferred origin on the basis of where the component fabric was made rather than where the made-up article is obtained.

Also assume that the above products are under quota restrictions for some WTO Members.

Implications under the ATC:

(a) For Existing Quota Access:

If a country exports any of the above basic products (knit fabrics, grey fabrics, etc.) to a second country which, in turn, processes it into another article and exports it to a third country which applies quotas against these products, the third country will deem the product to have originated in the first rather than in the second country and therefore charge it to the first country's quota. This obviously is against the interests of the first country because its exports to the second country are adversely affected.

If in this example the second country is unable to export to the third country, the second country's interests are also adversely affected.

(b) For Administration of the Quotas:

The ATC provides that the exporting Members shall administer the quotas. In the above example, if imports from the second country are debited by the importing country against the quota for the first country, the administration by the first country of its quota access becomes unmanageable.

(c) New Restrictions under ATC Safeguard Mechanism:

Assume that the first country is not currently under quota and is exporting only to the second country, which exports to the third country. If the third country invokes a safeguard action under

Article 6 of the ATC, the imports from the first country could be placed under quota even though it may not have exported to the third country at all.

(d) Circumvention of Quotas:

Even when the second country is the actual exporter to the third country, the first country could be accused of circumventing the quotas without its knowledge or intent.

It can also happen that the second country may not be a WTO Member. In this case, curiously, the first country – a WTO Member – may be held responsible for exports from a non-WTO Member.

(e) Integration Process under the ATC:

Assume that in the above example, an imported product (say, a tent or quilt) the making of which is not considered to be origin conferring, has already been integrated into the GATT. In this case, the quota for the basic product (that is, the component fabric) could be debited thereby creating a situation where integrated products would effectively stand as not having been integrated.

Summing up

The above analyses reveal that if the origin rules are harmonized in such a way that they ignore some important processing operations they are likely to have adverse implications for the implementation of a number of ATC provisions. Conversely, the more the processes that are recognized as origin-conferring, the greater would be the certainty in the administration of restrictions applied to the products covered by the ATC as well as smooth implementation of the integration process under the Agreement.

Implications under the Agreement on Safeguards:

The above analyses would be equally valid for cases of WTO Members under a system of quotas allocated according to the provisions of the Agreement on Safeguards.

Implications for Anti-dumping Cases:

Assume that, in the above example, an anti-dumping action is initiated by the third country against a company exporting from the second country. In this case also the first country's interests may be adversely affected even when it may not have any direct involvement in dumping.

A footnote at the end of Article 1, paragraph 2 of the Agreement on Rules of Origin states that: "it is understood that this provision is without prejudice to those determinations made for purposes of defining "domestic industry" or "like products of domestic industry" or similar terms wherever they apply".

Could it mean that the Member applying a restriction might define domestic industry by a criterion that is different from the rule of origin applicable to the products in question? This could lead to a situation of domestic industry appearing to suffer greater damage than may be the case if domestic production were defined according to the harmonized rules of origin.

If for purposes of anti-dumping the terms "like product" may be defined differently than for the harmonized rule, then it would be contrary to the principle of applying the harmonized rule for all trade policy instruments.

Implications for Countervailing Duty Cases:

Article 11:8 of the Agreement on Subsidies and Countervailing Measures provides that "in cases where products are not imported directly from the country of origin but are exported to the importing Member from an intermediate country, the provisions of this Agreement shall be fully applicable and the transaction or transactions shall, for the purpose of this Agreement, be regarded as having taken place between the *country of origin* and importing Member".

In the example given above, the countervailing duty measure by the third country could be visited on the first country although the product may have been processed in the second country and exported to the third country.

Implications for Origin Marking Requirements:

In the above scenario, assume that the second country owns intellectual property rights with respect to particular designs incorporated in the processed product. However, since it is not treated the country of origin of the product exported to the third country, does it follow that the product exported by it would have to be marked as the product of the first country?

Concluding Remarks:

India's objective in this paper is not to criticize any particular proposals. It is motivated solely by a desire to promote the understanding of the issues involved, if the origin rules are harmonized on the basis of restrictive criteria of substantial transformation. Its overriding concern is to facilitate the development of trade on the basis of neutral and predictable rules.

India considers that a free and open process of analysis and discussion of the implications of the main proposals is necessary to assess their impact on access available under the ATC and rights and obligations of Members under various WTO agreements. India also urges that there should be general acceptance of the principle that origin rules be developed in such a way that they do not produce adverse effects. To that end, the Committee on Rules of Origin may consider establishing a specific mechanism to ensure that this principle is adhered to.
