

April 20, 2016

TPP: Rules of Origin

Background

What is the Trans-Pacific Partnership (TPP)? The TPP is a proposed free trade agreement (FTA) among the United States and 11 Asia-Pacific countries that would reduce and eliminate tariff and non-tariff barriers on goods, services, and agriculture, and establish trade rules and disciplines that expand on commitments at the World Trade Organization (WTO) and address new “21st century” issues, such as digital trade and state-owned enterprises. It has both economic and foreign policy implications for the United States, and raises potential strategic issues regarding U.S. trade policy and broader U.S. engagement in the Asia-Pacific region.

What are Rules of Origin? Like all U.S. FTAs, the TPP includes rules of origin (ROO)—laws, regulations and procedures used to determine the country of origin of imported products so that goods from FTA trading partners can qualify for the benefits under the agreement, particularly with respect to tariffs. Parts of finished products often come from many countries in today’s global economy, which can make determining origin a complex process.

Preferential ROO, as in the proposed TPP, apply to FTAs like the proposed TPP, and other non-reciprocal trade preference programs, like the African Growth and Opportunity Act (AGOA) and the Generalized System of Preferences (GSP). They ensure that only eligible trading partners receive the tariff benefits from the program or FTA, and some may also be crafted to limit the impact of these programs on import-sensitive industry sectors. They are unique to each special trade program or FTA.

Non-preferential ROO apply on a most-favored-nation basis to imports from all countries with which the importing country has normal trade relations (i.e., for the United States, all WTO members except those that have an FTA with the United States or receive preferential trade treatment.) They are used to assess tariffs, enforce trade remedies (e.g., antidumping and countervailing duties), and for other purposes.

Who writes ROO? For non-preferential rules of origin, there is no specific U.S. law 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. In the proposed TPP, and in other FTAs, the agreement’s preferential rules of origin are negotiated by the trading partners and approved by Congress as part of the FTA implementing legislation. For special U.S. trade programs like AGOA, they are drafted and approved by Congress through legislation.

Who enforces ROO? CBP interprets, administers and enforces rules of origin, as well as country of origin

labeling, tariff classification, and many other laws relating to U.S. imports.

Are there international rules of origin commitments?

The 1994 WTO Agreement on Rules of Origin requires WTO members not to use rules of origin to disrupt trade, to apply them in a consistent, transparent, non-discriminatory, and reasonable manner, and to notify other members about any rule changes. The WTO agreement also set up a 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), which is still ongoing. 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

Preferential	<ul style="list-style-type: none"> Free trade agreements Unilateral preference programs
Non-preferential (most-favored-nation)	<ul style="list-style-type: none"> Antidumping and countervailing duties Safeguard measures Country of origin labeling Quantitative restrictions Tariff quotas Government procurement; and Trade statistics

Source: World Customs Organization. Graphic by CRS.

Rules of Origin in the TPP

All FTAs and trade preference programs have distinctive ROO, but there are many common elements across agreements.

Originating Goods. To be made in a TPP country, and receive lower tariffs, products must “originate” in a TPP country by satisfying one of three conditions. They must be: (1) grown, harvested, or fished in TPP countries; (2) produced in the TPP region using only TPP materials; or (3) produced in the TPP region with non-TPP country components while meeting additional product-specific ROO requirements.

Cumulation. Cumulation is a trade concept that means that countries that are part of an FTA or other preferential program may cumulate inputs of final products and still receive favorable tariff benefits. In the TPP, countries will be able to use unlimited inputs from other TPP partners, which could provide an incentive to further integrate production and value chains within the TPP region.

Types of Preferential Rules of Origin. As in other FTAs preferential product-specific rules in the TPP generally take one of three forms (see **Figure 2**). One ROO type requires that a product illustrate that it is “substantially transformed”

by showing a “tariff shift,” i.e., a change in its Harmonized Tariff Schedule (HTS) tariff classification. The level of change required varies from product to product.

Another type of rule requires that a minimum percentage of the product must be produced in the FTA region. These regional value content (RVC) rules cover many TPP products, including automobiles, appliances, footwear, and machine tools. Alternatively, for some TPP products, it is sufficient to show that the value of foreign content does not exceed 10% (*de minimis*). Another common type of ROO requires that some kind of manufacturing or processing operation (e.g., a chemical reaction) be completed in the region.

Figure 2. Types of Preferential ROO

Change of HTS Classification (“tariff shift”)	<ul style="list-style-type: none"> Change of chapter (2-digit HTS) Change of heading (4-digit HTS) Change of sub-heading (6-digit HTS)
Regional Value Content (percentage)	<ul style="list-style-type: none"> Minimum regional content Maximum foreign content <i>de minimis</i>
Technical	<ul style="list-style-type: none"> Manufacturing or processing operations completed

Source: World Customs Organization. Graphic by CRS.

Notes: HTS=Harmonized Tariff Schedule.

TPP ROO for Key Sectors

ROO are often an area of focus in import-sensitive industries. In TPP, the textiles and apparel sector may be particularly sensitive due to Vietnam’s participation, the second largest supplier of apparel to the U.S. market after China. In 2015, Vietnamese apparel made up 12% of all U.S. apparel imports. Motor vehicle ROO are also sensitive because TPP partners include the United States and Japan, the second- and third-largest auto manufacturing nations in the world. Japan’s historically low level of imported vehicles has led to allegations for more than 30 years that it uses non-tariff barriers to restrict sales of non-Japanese vehicles. Other auto producing countries in TPP include Canada, Mexico, Malaysia, and Vietnam, and each of them had specific concerns in TPP negotiations about their domestic auto industries.

Textiles and Apparel

A major factor shaping the U.S. ROO for textile and apparel in TPP were U.S. manufacturers who expressed concern that Vietnamese-made apparel could displace garments manufactured with U.S. fabric in the Western hemisphere—the most important export market for U.S. yarns and fabrics. While the U.S. textile industry supports the rules of origin in the proposed TPP, the U.S. apparel industry generally finds them more restrictive.

Currently, Vietnam’s apparel sector sources the overwhelming majority of its yarns and fabrics regionally, from non-TPP members such as China, Taiwan, and South Korea, and currently purchases a relatively small amount of yarns and fabrics (about \$100 million in 2015) from the United States.

Provisions. In most cases, the proposed TPP rules for textiles and apparel are “yarn-forward,” which requires the use of U.S. or other TPP country yarns and fabrics in the manufacture of textile and apparel products to qualify for preferential access under TPP.

Exceptions. Exceptions to the general yarn-forward ROO in TPP include an “Earned Import Allowance Program” (EIAP) applicable to imports of certain men’s cotton trousers. This U.S. commitment is intended to provide an incentive for Vietnam to purchase U.S. fabric. Another exception is a “short supply list” of 187 fabrics deemed commercially unavailable that may come from outside the TPP area. All but 8 of the short supply products will remain on the list permanently. TPP commitments for textiles and apparel also provide a temporary emergency safeguard provision if import surges cause “serious damage or actual threat thereof.”

Motor Vehicles and Parts

TPP origin rules for cars, trucks, and auto parts seek to prevent parts and vehicle manufacturers in non-TPP countries—such as China, Thailand or Germany—from taking advantage of TPP tariff reductions, especially the eventual phase-out of the 2.5% U.S. tariff on cars and the 25% tariff on trucks. The ROO also seek to preserve the highly integrated North American vehicle parts manufacturing and automobile assembly market, a priority for Canada and Mexico in the negotiations.

Provisions. TPP ROO for automobiles and auto parts generally use a regional value content (RVC) approach, with automakers choosing between a net cost calculation method (requiring 45% TPP content) or a build-down method (requiring 55%). TPP RVC for auto parts range from 35% to 45%, depending on the type of calculation method used and the product category. By comparison, under NAFTA, 62.5% of vehicle content and 60% of auto parts (net cost) content must originate in the United States, Canada or Mexico. Even though the TPP RVC requirement seems lower than in NAFTA, the calculation methods are different, so that the regional value content levels may not be strictly comparable. Vehicle and parts manufacturers producing and exporting within North America would be able to choose whether to use NAFTA or TPP rules.

Elimination of Non-Tariff Barriers. In addition to motor vehicle ROO and tariff reductions, Malaysia and Vietnam have agreed to provide more access to their motor vehicle and parts markets to U.S. and other TPP partners, and Japan has agreed in bilateral side agreements with the United States that seek to address specific non-tariff barriers that may hinder sales of U.S. vehicles in that market.

For more information, see CRS Report RL34524, *International Trade: Rules of Origin*, by Vivian C. Jones

Vivian C. Jones, Specialist in International Trade and Finance

Bill Canis, Specialist in Industrial Organization and Business

Michaela D. Platzer, Specialist in Industrial Organization and Business

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.