Convergence of rules of origin in preferential trade agreements: the case of the free trade agreement of the Americas *

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RESUMO

O objetivo deste trabalho é discutir regras de origem nos atuais acordos preferenciais em implementação nas Américas e o que precisa ser feito para conciliar os diferentes regimes em uma futura área de livre comércio no hemisfério, apresentando sugestões para sua convergência para regras de origem que sejam simples e transparentes, minimizando as restrições ao comércio no hemisfério.

Palavras-chave: regras de origem, acordos preferenciais de comércio, Organização Mundial do Comércio.

ABSTRACT

The objective of this paper is to discuss the role of rules of origin in the present preferential trade agreements in the Americas and what has to be done to reconcile the different regimes in a future free trade area in the Western Hemisphere and suggests guidelines for their convergence to simple and transparent rules that could minimize trade impediments in the Hemisphere.

Key words: rules of origin, preferencial trade agreements, World Trade Organization.

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I Introduction

The objective of this paper is to discuss the role of rules of origin in the present preferential trade agreements in the Americas and what has to be done to reconcile the different regimes in a future free trade area in the Western Hemisphere.

Rules of origin are essential in preferential trade agreements since they define the products which are eligible for duty-free treatment. Rules of origin that are complex, not transparent and costly to the private sector and to the government have to be avoided in order to maximize the gains associated with a free trade area. Special attention has to be given to minimizing the protectionist bias implicit in very restrictive rules of origin.

The first section of this paper presents an evaluation of trade performance and trade policies in the Americas as a background for the discussion on future trade liberalization. The analysis will concentrate on the last 10 years of trade growth within present sub-regional groups, followed by a description of the main characteristics of each group in terms of tariffs and non-tariff restrictions on trade, the types of preferential agreements within the hemisphere and the impact of recent macroeconomic instability on trade policies.

Secondly, I explore the role of rules of origin in a free trade area, detailing the main types, their advantages and shortcomings. The review of the literature will describe theoretical and empirical aspects of rules of origin with special attention to the protectionist bias implicit in restrictive rules of origin and its impact on trade, production and investment.

In the third section, I present a comparison between the different rules of origin, with special emphasis on the legal framework and procedures of the Latin American Integration Association (LAIA) and the North American Free Trade Agreement (NAFTA) rules, with the objective of identifying the problems and advantages of each. I then analyze the transitional rules of origin in the Mercosur (Mercado Comun del Sur, or Common Market of the South), before completion of the customs union. After this, I discuss the provisions of the main components of Mercosur and the private sector view of its operational and legal aspects. At this point, I present a discussion on the rules of origin of GATT/WTO, pointing out the present efforts to harmonize and clarify non-preferential rules of origin and how this will influence future discussions on preferential rules of origin at the hemispherical level.

Finally, the paper summarizes the main conclusions with respect to rules of origin in the Americas and suggests guidelines for their convergence toward simpler and more transparent rules that could minimize trade impediments in the Hemisphere.

II Trade performance and trade policies in the Americas

There has been a substantial increase in trade between the countries in the hemisphere since the mid-eighties. Unilateral trade liberalization implemented by several countries and the revival of trade agreements within the region have been responsible for this. Table 1 presents data on trade performance for the main sub-regional arrangements.[1] In nominal terms, total hemispherical trade with the world [exports (X) + imports (M)] reached almost US$ 1.9 trillion in 1994, against US$ 875 billion in 1984, more than doubling in one decade. If one allows for dollar devaluation during this period, the numbers are still impressive: between 1984 and 1994 total trade grew 44% , an annual rate of growth of 3.7%, well above the 2% annual growth of the American Hemisphere Gross Domestic Product (GDP) Within the hemisphere, rates of growth of intra-regional trade are slightly superior of those of total trade, reaching an annual rate of 4.1%,

The hemispherical market represents a large share of total trade of all sub-groups, ranging from 47.4% in NAFTA to 75% for CACM. NAFTA is the main market for most sub-regional groups, except for Mercosur, which has a trade share of only 23% with North America. It should be mentioned that of all the sub-groups, only NAFTA has a large share of intra-group trade, similar to the European Union. Hemispheric trade is heavily concentrated in North America: of the US$ 908 billion total trade in 1994, US$ 685 billion were from intra-NAFTA trade, or 75% of the total (see table 1).[2]

Some additional trade characteristics of the main sub-groups in the Hemisphere, based on the information presented in Table 2, can be mentioned :

firstly, the Andean Pact and Mercosur show the highest annual rate of growth of intra-group trade, 10,1% and 12,9%, respectively;

- secondly, with the exception of CACM, the annual rate growth of the internal trade of all sub-regional agreements is superior to the overall trade increase;

thirdly, excluding NAFTA from the hemispheric trade statistics, the annual rate of growth within the region falls from 4.1% to 2.8%

We may conclude that the region has become more trade interdependent in the last decade, and this has had a favorable effect on future trade integration initiatives in the hemisphere.

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1 CACM (Central American Common Market), Andean Pact, CARICOM (Caribbean Free Trade Association), LAIA (Latin American Integration Association), MERCOSUR (Southern Cone Common Market) and NAFTA (North American Free Trade Agreement).

2 A detailed analysis on trade block performance and consequences to further trade liberalization can be found in Braga (1994).

Table 1
Trade of the Regional Arrangements in America
millions of US $

	1994 (*)				1984				Trade	Share	1994	%
	(1) X+M World	(2) X+M W. Hem.	(3) X+M NAFTA	(4) X+M Reg. Agreem	X+M World	X+M W. Hem.	X+M NAFTA	X+M Reg. Agreem	(2)/(1)	(3)/(1)	(4)/(1)	(4)/(2)
CACM	13,158	9,853	6,811	1,669	9,120	6,351	3,835	1,448	74.9	51.8	12.7	16.9
Andean Pact	45,903	31,011	19,913	4,252	41,192	26,087	18,498	1,624	67.6	43.4	9.3	13.7
CARICOM	8,931	5,283	3,809	0,485	11,005	7,212	5,591	0,376	59.2	42.6	5.4	9.2
LAIA	233,538	142,289	103,704	35,100	140,510	75,654	56,216	16,528	60.9	44.4	15.0	24.7
LAIA (**)	147,545	71,744	36,731	32,537	105,801	52,384	34,944	15,315				
MERCOSUR	84,067	40,249	19,393	14,957	57,470	22,972	14,718	4,452	47.9	23.1	17.8	37.2
NAFTA	1095,659	518,885	456,506	456,506	759,989	340,795	283,086	283,086	47.4	41.7	41.7	88.0
W. Hem.	605,674				406,742							
W. Hem (***)	86,879				65,947							
Total	1265,263				875,915				47.9	39.8		

Source: Direction of Trade Statistics Yearbook (1988/1995).

(*) Nominal dollar values corrected by the change of the US real effective exchange rate (IMF) between 84-94.

(**) Excluding Mexico.

(***) Excluding NAFTA.

X=Total Exports; M=Total Imports.

Table 2
Trade of the America's Regional Agreements
Annual Rate of Growth between 1984-1994(1)

	X+M World	X+M W. Hem.	X+M NAFTA	X+M Reg. Agreem
CACM	3,73	4,49	5,91	1,43
Andean Pact	1,09	1,74	0,74	10,10
CARICOM	-2,07	-3,06	-3,77	2,58
LAIA	5,21	6,52	6,31	7,82
LAIA (2)	3,38	3,20	0,50	7,83
MERCOSUR	3,88	5,77	2,80	12,88
NAFTA	3,73	4,29	4,89	4,89
W. Hem.	4,06			
W. Hem (3)	2,79			
Total	3,75			

Source: Table 1.

(1) Nominal dollar values corrected by the change of the US real effective exchange rate (IMF) between 84-94.

(2) Excluding Mexico.

(3) Excluding NAFTA.

There have been two different trends in trade policy in the hemisphere since the mid-1980s: the first in the direction of unilateral trade liberalization, and the second leading to regional preferential trade agreements. Tariffs and non-tariff barriers have been reduced drastically in Latin American countries and there has been a general tendency to substitute administrative controls by the market-based mechanism (e.g. ad valorem duties), sharply increasing the transparency of the trade regimes and making them more similar to those found in North America. Even so, important differences persist in terms of tariff and non-tariff barriers between countries and sub-groups. This is a crucial issue to further trade liberalization in the hemisphere.

Divergence in trade policies will be necessarily reflected in the complexity of rules of origin, since this will be the only way to reconcile different protectionist policies with a free trade area. To be more specific, there are important non-tariff barriers (NTB) in North America and tariff levels are high in some sensitive (or strategic) sectors. According to Garay and Estevadeordal (1995), the average nominal tariff in the Americas ranges from a minimum of 6.4% in the USA to a maximum of 17.9% in Honduras, with intermediate values of 13.4% for the common external tariff (CET) of the Andean Group and 11.1% for Mercosur. The maximum and modal tariff also differ significantly between countries, and the dispersion of tariff rates is high. Some Latin American exports are subject to important NTBs in the USA in the following sectors: textiles, iron and steel, machinery, transport equipment and clothing (IDB,1992). It should be mentioned that Latin American importation liberalization policies have not been always consistent due to macroeconomic policy problems. The opening up of these economies has taken place at the same time as attempts at monetary stabilization, and the overvaluation of the exchange rate has been a frequent problem. As a consequence, balance of payment problems associated with the Mexican crisis of 1994 have forced several countries to temporarily increase tariffs, even though these countries have long-term trade liberalization commitments at WTO and Mercusur level e.g., Brazil and Argentina.

It is within this environment that two types of sub-regional agreements are being implemented: customs unions and free trade agreements, which can pave the way (or not) to a free trade area in the Western Hemisphere with a small protectionist bias. This will the subject of the following sections of the paper.

III The role of rules of origin in a free trade area

With the spread of NTB after the mid-1970s and the increase of the number of FTAs during the 1980s, rules of origin gained importance and are nowadays essential in shaping the future

of the regional trade arrangements. From these developments two types of rules of origin emerged:[3]

- nonpreferential rules of origin, applied in the context of NTB, where rules of origin are designed to avoid transshipments associated with antidumping and countervailing duties and quotas;

- preferential rules of origin, used in FTAs, to determine which products are entitled to tariff preferences and to avoid trade deflection by non-members. This analysis will concentrate on these types of rules of origin, that is, rules designed to discriminate products originating from non-member countries.

In general, a product is considered as originating from a country member of a preferential trade agreement when it has undergone the last substantial transformation within its national boundaries. There are three different methodologies used to determine whether this took place, none of them completely satisfactory

1. Value added

There are two alternative ways to specify this criterion. According to the first, a product will have a preferential status if it embodies a minimum percentage of domestic value added; the second method is based on the maximum percentage of imported materials and parts allowed for preferential treatment. The value added method has a number of important shortcomings: firstly, it involves accounting and legal procedures that could be expensive for the private sector; secondly, it could lead to misallocation of production and investment if domestic content requirements are too high; thirdly, it tends to favor sectors with high production costs, and finally, it is highly sensitive to changes in exchange rates and to the accounting methods chosen, thereby introducing undesirable uncertainty into trade flows.

2. Specified process systems

According to this method, some critical stages of the production process must be performed in the region or the product must have specific characteristics different from the imported materials in order to confer origin. A drawback of this method is that It is very difficult to define which parts of the production process are the critical ones. Furthermore, technological

3 A detailed analysis of nonpreferential and preferential rules of origin can be found in Vermulst (1994).

innovation could make this kind of information obsolete. It is also unsatisfactory because it increases the discretionary power of the customs administration and is more vulnerable to protectionist demands. For these reasons, the specified-process system should be avoided, or used only in exceptional cases, where other forms of rules of origin are deemed insufficient.

3. Change in tariff classification

Under the change in tariff classification rule, a good produced in one country, but using imported intermediate materials will be considered as originating in that country if the production process is such that the final product is classified - in the Harmonized Tariff Classification System - differently from the imported materials. This test is normally performed at the four-digit level (heading) and has the great advantage of being simple and transparent even though it is not completely insulated from protectionist pressures. This is the basic principle used in the main sub-regional agreements in the hemisphere (NAFTA, MERCOSUR, LAIA, etc.), but in certain cases this rule is supplemented by value added and specified process requirements. While this is the method most authors recommend and was adopted as the basic principle for rules of origin during the Uruguay Round negotiations for non-preferential trade, it has important flaws. Firstly, the Harmonized System was created for tariff and statistical purposes and not to facilitate the conferring of origin. Secondly, this rule has been used in such a way that several products have to pass the origin test at several different levels of tariff classification at different stages of production (two-digit; four-digit, six-digit and eight digit). Thirdly, the cost to the private sector to prove origin could be high, to a point that a company could choose to pay the tariff instead of taking advantage of the preferential treatment.[4]

The previous discussion indicates that there is no form of rules of origin devised so far that can avoid the imposition of significant costs on producers, importers and exporters. This leads us to the discussion of a broader issue: types of preferential trade agreements in the hemisphere and the role of rules of origin.

At the moment there are two basic types of preferential agreements in the hemisphere: free trade areas (like CUSFTA, NAFTA, LAIA, G3, etc.) and common markets (CACM, CARICOM, ANDEAN PACT and MERCOSUR). None of the second group have yet reached the status of true common markets as the the factors of production cannot move freely between members of any of the groups and the common external tariffs have long lists of exceptions.

4 Mentioned in N. D. Palmeter (1995) for the case of the FTA between the European Union (EU) and the European Free Trade Area (EFTA).

They can therefore be more accurately characterized as partial customs unions (CU). An FTA, on the other hand, is an agreement where tariffs among members reach zero within a specified period of time, and each country maintains its previous tariff structure toward third countries. Customs unions, besides being free trade areas, also have a common external tariff (CET). Both are subject to trade creation and trade diversion effects. Trade creation occurs when the preferential agreement leads to the substitution in production between the members in the direction of the lower cost production site; trade diversion takes place when lower cost third country imports are displaced by members´ production, due to the preference. The same analysis could be applied for investment creation and diversion.

Trade creation and trade diversion are determined - in the case of a CU - by the degree of trade integration between countries prior to the agreement and the level of the CET. In the case of the FTA, these effects will be determined by the restrictiveness of rules of origin, since there will be no change in tariffs toward third countries.

Rules of origin are essential to avoid "trade deflection" in a FTA and to permit free trade only for goods and services of members and discriminate against the rest of the world. This can introduce important trade diversion effects into the agreement. As Krueger (1995, p. 13) wrote in the NAFTA context:

"... the rules of origin adopted to avoid trade deflection can provide incentives for producers in one partner country to purchase higher cost inputs from another country (despite the existence of lower-priced inputs from the rest of the world given their tariff structure), in order to satisfy rules of origin requirements and thus export the end product to the partner country duty-free. Thus a Mexican producer may find it profitable to import a part from a higher-cost U.S. source rather than from his former Japanese supplier in order to export to the U.S. without paying duty. This could happen whenever the tariff protection in the U.S. gave net effective protection to the Mexican producer provided that he met the rules of origin. It could also happen that a foreign producer found it profitable to invest in Mexico in order to satisfy rules of origins, even though a Mexican facility was higher-cost than landed costs from a third-country market. This is the sense in which external protection can increase as a result of a free trade arrangement."

Two additional points can be made with respect to rules of origin. Firstly, since there are several preferential trade agreement in the hemisphere, it will not be a easy task to reconcile them. Nor can it be taken for granted that the reconciliation process will result in simpler rules of origin for the future FTAA since there are still significant differences in tariffs and non-tariff trade barriers. Secondly, there are significant incentives to lobby for protection through rules of origin where there are divergent trade policies.

IV Rules of origin in the hemisphere

There are two types of rules of origin regimes in the region: the NAFTA-type regime, also adopted by the G3 (Mexico, Colombia and Venezuela FTA), and the free trade agreements of Mexico with Costa Rica and Bolivia; and the LAIA-type regime adopted by the remaining preferential trade agreement in the hemisphere.

1. NAFTA-Type rules of origin

The NAFTA-type rules of origin are the most complex in the hemisphere. The basic criteria to confer origin in this preferential trade agreement is a change in tariff classification, but in several cases this criteria is supplemented by value added and specified process requirements. In the case of NAFTA itself, in sensitive sectors like textiles, clothing, and automobiles, the value added test is used, and, in electronics and autos, the specified process test is also used. As was mentioned earlier, complex rules of origin impose additional costs on firms and customs administrations, inhibit preferential trade and could introduce trade diversion effects. Even though there are no good estimates of the costs involved in these procedures, several analysts have indicated that they are probably high. The great advantage of this regime is that it is well suited to avoid "trade deflection"

In a recent paper, Garay and Estevadeordal (1995, p. 30) conducted an extensive analysis of NAFTA-type rules of origin. Their main conclusions are:

a. "*there are multiple combinations of rules of origin, as a result of not only the diversity and specificity of the basic criteria for classifying origin, but also the existence of alternative ways of determining origin. There are cases under NAFTA, in which a product may be qualified as regional by three different rules. The set of alternative rules of origin that apply to given item is defined here as a "family*";"

b. "*The regional content criterion is also quite important, as it is reflected in families of rules of origin governing 42% of tariff items in the case of NAFTA (and 38% of tariff items for the other two agreements G3 and MxCR). In most cases, the regional content criterion is not included in each and every one of the rules of origin in each family, meaning that there exists at least one rule of origin per family for which no regional content requirement applies. Nevertheless, the proliferation of regional content requirements is resulting in more and more complex rules of origin regimes, owing to the practical difficulties of certifying and verifying the requirements. Further problems are associated with the extreme sensitivity, in practice, of the quantification of regional content to ongoing (and not always predictable) changes in variables exogenous to the production process itself, such as movements in the exchange rates and/or in prices of raw materials.*"

2. LAIA -Type of rules of origin and the Mercosur

Compared with the NAFTA rules of origin, the LAIA rules are much simpler and almost without selectivity across the tariff classification. These criteria. have been adopted with some modifications by the Andean Group, the Central American Common Market, MERCOSUR and in the bilateral agreements between Chile and Colombia, Mexico and Venezuela. The LAIA-type regime was established by Resolution 78 of 1987, as an outcome of the Montevideo Treaty signed in 1980.

Under this system, a product will have a preferential treatment status (zero tariff) if:

1. the products are manufactured exclusively with regional material and parts; (Chapter I, Item a)

2. they are mineral, agricultural and animal products originating in the region (Chapter I, Item b and Attachment 1)

3. the products present different tariff headings, in terms of the harmonized LAIA nomenclature, from the third country imputs used (Chapter 1, Item c);

4. the product has a CIF value of imput from third countries that account for no more than 50% of the FOB export price of that product.(Chapter I, Item d);

5. some of the products satisfy specific requirements defined in Attachment 2.

The basic criterion is the change in tariff heading or a requirement of 50% regional value added. These criteria are applied across the board on the tariff schedule, except for the products defined in Attachment 2. It is simple, transparent and cheap, but has the great flaw of being so generic that it is difficult to enforce preferential treatment. Here we have the main trade-off between the different rules: the more restrictive they are, the more effective they are as discriminatory barriers. But at the same time, the more restrictive they are, the greater the compliance costs and possible trade and investment diversion. On the other hand, generic and simpler rules of origin are vulnerable to trade deflection schemes.

Rules of origin in MERCOSUR[5]

Given the difficulty to implement the CET for all the goods categories at the outset of the agreement, the country members of the customs union permitted substantial exceptions to the CET in a transition period that could last up to 10 years. A significant number of final products and inputs would converge linearly toward the common external tariff. In the Brazilian case there are exceptions to the CET for 1,429 tariff items, and for Argentina, Paraguay and Uruguay there are respectively 1,621, 1,917 and 2,350 tariff item exceptions. Rules of preferential origin were established for the transition period, following the general procedures of the LAIA regime (items 1 to 5 of page 14), but with important changes that made them more restrictive. These rules will be applied until all the exceptions are phased out and Mercosur is an actual customs union.

Rules of origin are applied only to products that are on the list of exceptions, basically:

a. to avoid trade deflection for products that are in the process of convergence toward the common external tariff;

b. to avoid "artificial competition" derived from the fact that even though the final product is subject to CET, the tariffs of materials and parts are in the process of convergence;

c. when there are different restrictive trade policies (quotas, antidumping and compensatory duties);

d. in exceptional cases, decided by the MERCOSUR Trade Commission.

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5 Rules of Origin are defined by the " Additional Protocol No. 8 to the Agreement of Economic Complementation No. 18 signed by Argentina, Brasil, Paraguay and Uruguay on 12/30/94.` For a detailed analysis of the MERCOSUR rules of origin see Kume (1995).

MERCOSUR rules of origin are more restrictive that the LAIA rules since minimum regiona value added was increased to 60%, against 50% of the LAIA regime, and specified proces systems were introduced for chemical, iron and steel, informatics goods and telecommunication sectors. There are heavy penalties for false certificates and the export activities of companies coul be suspended for 18 months, There are also penalties for the associations that issue the certificate (industry or trade federations) and they could be suspended for 12 months. If this happens twice companies and associations will be banned permanently from receiving preferential treatment ir the regional market. The bureaucratic procedure to issue the certificates of origin i straightforward, and they are valid for 6 months for products that are exported frequently as lon as the production process and the materials used do not change. Interviews conducted with firm indicated that rules of origin do not represent important impediments to trade expansion, an the only concern detected was with respect of the "quality" of the certificates of origin, indicatin that the enforcement of rules are rather loose in the case of the MERCOSUR.

Rules of origin within GATT/WTO

According to Varona (1994, p. 355) "*The General Agreement of Tariffs and Trad includes no specific regulation on origin matters. The Contracting Parties are, so far, fre to determine their own rules of origin. However, the question of origin is relevant i relation to various issues regulated by GATT, and the text of the agreement refers to the problem at several points.*"

The first attempt of harmonization of rules of origin in the ambit of GATT started from initiatives of another international institution, the Customs Cooperation Council (CCC), that led to the signature of the Kyoto Convention in 1973. Attachment D.1 of this agreement refers to preferential and non preferential rules of origin and was ratified by twenty-three countries. The great contribution of this convention was to clarify the different approaches for the determination of origin, as well as the recommendation on patterns and custom practices. The established rules had not helped to harmonize the existing rules as the countries maintained grea freedom in the application of the rules of origin.

In the Uruguay Round, the contracting parties committed themselves to harmonize and clarify non-preferential rules of origin and to ensure that such rules do not themselves create unnecessary barriers to trade. This objective is to be reached through a three-year work program carried out by the WTO Committee on Rules of Origin, with the support of the World Customs Organization (formerly the CCC), and this task will be completed by July 1998. The work program is not addressing rules of origin in preferential trade arrangements, even though the Agreement requires members to apply both preferential and non-preferential rules of origin

in a non-discriminatory, uniform, and consistent manner. Until the completion of the harmonization of rules of origin, members would be expected to ensure that their rules are applied in a consistent, impartial and reasonable manner, and that they are based on positive standards, i.e. they should point out what does confer origin rather than what does not.

According to the WTO Implementation Report (1997) and the Seventh Report of the Technical Committee on Rules of Origin (1997), the first phase of the work program, which dealt with the definition of goods wholly produced or obtained in one country, and the definition of minimal processes that do not change the origin of goods, was successfully completed. The second and third phases, currently being addressed by the work group, will harmonize rules of origin based on changes in tariff classification which are based on substantial transformation, and rules for goods when substantial transformation does not result in a change of tariff heading. Even though this harmonization effort is not applied directly to preferential trade agreements, some general principles will be common to both regimes, and will influence future agreements on preferential rules of origin. It should be pointed out that there are some general guidelines for preferential rules of origin defined in Attachment II of the Agreement of Rules of Origin reached in the Uruguay Round. According to this document (GATT 1994):

"The Members agree to ensure that:

a) when they issue administrative determination of general application, the requirements to be fulfilled are clearly defined. In particular·

- *in cases where the criterion of change of tariff classification is applied, such a preferential rule of origin, and any exceptions to the rule, must clearly specify the sub-headings or headings within the tariff nomenclature that are addressed by the rule;*

- *in cases where the ad valorem percentage criterion is applied, the method for calculating this percentage shall also be indicated in the preferential rules of origin;*

in cases where the criterion of manufacturing or processing operation is prescribed, the operation that confers preferential origin shall be precisely specified;

b) their preferential rules of origin are based on a positive standard. Preferential rules of origin that state what does not confer preferential origin (negative standard) are permissible as part of a clarification of a positive standard or in individual cases where a positive determination of preferential origin is not necessary;

c) theirs laws, regulations, judicial and administrative rulings of general application relating to preferential rules of origin are published as if they were subject to, and in accordance with, the provisions of Article X:1 of the GATT 1994;

d) upon request of an exporter, importer or any person with a justifiable cause, assessments of the preferential origin they would accord to a good are issued as soon as possible but no later than 150 days after a request for such an assessment provided that all necessary elements have been submitted. Requests for such assessments shall be accepted an any later point in time. Such assessments shall remain valid for three years provide that the facts and conditions, including the preferential rules of origin, under which they have been made remain comparable.

e) when introducing changes to their preferential rules of origin or new preferential rules of origin, they shall not apply such changes retroactively as defined in, and without prejudice to, their laws and regulations;

f) any administrative action which they take in relation to the determination of preferential origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures, independent of authority issuing the determination, which can effect the modification or reversal of the determination;

g) all information that is by nature confidential or that is provided on a confidential basis for the purpose of the application of preferential rules of origin is treated as strictly confidential by the authorities concerned, which shall not disclose it without the specific permission of the person or government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings."

This "Common Declaration" imposes certain restrictions on preferential rules of origin and will influence future negotiations at the hemispherical level in terms of transparency, consistency, predictability and neutral status of those rules. The next section summarizes the principles that should govern the establishment of rules of origin in order to minimize unnecessary obstacles to trade.

V Conclusions

It has been emphasized in this paper that in addition to the increase in trade interdependence and an overall tendency to trade liberalization in the Western Hemisphere, there are certain areas where trade policy convergence is partial and the existence of tariff and non-tariff barriers is still important. It was also shown that the widespread existence of FTAs and CUs in the region (one can count 19 preferential trade agreements in the hemisphere) poses an additional challenge to trade policy harmonization. It is within this context that FTAA negotiations will take place, and special attention should be devoted to the establishment of rules of origin, since the negotiators will have the difficult task of differentiating regional trade from trade with the rest of the world without creating a strong protectionist bias and imposing costly procedures.

Even though there is no single criterion that can fulfill the needs of rules of origin, there are some basic recommendations - compatible with the WTO Common Declaration on preferential rules of origin - that should be followed in the future negotiations:

a. rules of origin should be clear, objective with requirements precisely specified;

b. they should concentrate on having general, transparent, simple and low cost criteria that apply to most situations, leaving more cumbersome methods for exceptional cases;

c. they should avoid the "overlapping" of criteria, as when a product is be subject to a double or triple test of origin;

d. "negative" rules of origin should be avoided, since they are used only in specific cases and are associated with very restrictive trade policies;

There is a general tendency among analysts to recommend the change in tariff classification as the basic methodology to confer origin, supplemented only in exceptional cases by a value added or specified process system tests. Even though the previous prescriptions could be useful to minimize trade distortions imposed by rules of origin, there is only one definite way to avoid the restrictive practices associated with rules of origin: to further pursue multilateral trade liberalization within the World Trade Organization framework. Divergence in trade policies within the region and with third countries will be necessarily reflected in the complexity of rules of origin as this will be the only way to reconcile different protectionist policies with a free trade area. Here we have the main trade-off between the different rules of origin: the more restrictive they are, the more effective the trade discrimination against third parties and the greater the effect on compliance costs and on possible trade and investment diversion are; on the other hand, generic and simpler rules of origin are vulnerable to trade

deflection schemes. It is a rather dismal conclusion but, if tariff and non-tariff barriers are important in world trade, rules of origin will reflect those restrictions and will have a detrimental effect on regional and world trade.

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