

Made in China or Made in Tlon¹?
The quest for a new origin concept measuring
international trade and respecting consumers' rights
by
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Abstract

In 1998 UNCTAD published a study on the Globalization and international trade issues related to origin¹ where it was advocated that the traditional concept of Rules of Origin had to be revisited in the light of the globalization dynamics. The study examined -in the context of international trade rules including the WTO Agreement on Rules of Origin (ARO-) the various application of Rules of Origin to different trade instruments ranging from antidumping to marks of origin. The study concluded that business life is faster than rule making and that the traditional concept of origin was vastly overtaken by the fragmentation of production.

Fourteen years later, the WTO agreement on rules of origin has still to be concluded. More recently the WTO launched the Made in the World initiative, introducing, inter alia, the idea of different methodologies for compiling trade statistics and examining some aspects of the concept of origin. This initiative was arguably launched to ease the tensions among WTO members, and especially USA and China, showing that according to a different use and application of the concept of origin China's trade surplus was not caused by Chinese products per se since the values added in China was minimal. More precisely, such surplus had to be reviewed and understood in terms of the minimal value addition contents of some Chinese products.

¹ See Globalization and the international trading system : issue related to origin ,UNCTAD March 1998

Evidence from trade in agricultural products and processed agricultural product in particular, has shown a reverse tendency where the concept of origin would tend to ensure the traceability of the origin, thus leading to the single farmer or producer -the exact contrary of globalization. Such traceability requirements go well beyond the traditional origin concept requesting the product to be grown and harvested in a specific region, respecting given production methods and traditional know how, Geographical indications² and organic accreditation are the ultimate example of this tendency.

The present study advocates for an inputs-output methodology based on the combined use of the Harmonized System, the worldwide used customs classification nomenclature, with trade statistics. . This methodology draws from and builds upon the Author's experience in negotiating rules of origin for more than two decades. The same methodology could be used to measure trade in intermediate products and would be an instrument for value chains analysis.

Introduction

Traditional trade policy instruments were designed to deal with a situation where production was seen as an activity which essentially took place within national frontiers, although, obviously, raw materials were imported and semi-finished products exported. These instruments were applied to influence or control the price or quantity of goods that entered a country. Liberalization under GATT was achieved primarily by progressively tightening the prohibition on quantitative measures and reduced tariffs through multilateral negotiations based on reciprocity.

Advances in information, communications and management technology make it possible for enterprises to globalize their production. They have adopted new "modes" of penetrating markets in addition to trade, foreign direct investment, international subcontracting, licensing of technology, mergers and acquisitions, international joint ventures and inter-firm agreements (strategic alliances). The composition of trade has shifted to high-tech products, mutual trade in like products and trade in services.

Governments have shifted their priorities, abandoning import substitution policies for those intended to increase their competitiveness in the global market. Such policies have involved supporting "their" firms' global operations, even when this leads to an increase in outward investment and transfer of employment to lower-cost countries. These are considered to be inevitable elements of national competitiveness, which is perceived as depending to a large extent on the overall global competitiveness of national firms.

At the same time, most countries are attempting to improve their physical, legal and administrative infrastructure as well as fiscal incentives to attract foreign investors. This tendency of delocalize firms and operations have been the persistent feature of the first phase of the globalization, while at

present another tendency if arising where firms may still move abroad certain production phases while retaining origin and national identities of their finished products.

Globalization and the fragmentation of production have modified the impact and effectiveness of traditional trade policy instruments, some of which have become relatively less important as means of influencing the volume and direction of trade and investment flows. On the other hand, other instruments may have become more significant in this respect.

In this context the traditional instruments of measuring trade flows and identify the origin of goods and services have become increasingly inadequate to depict the new industrial and economic realities.

Some older and more recent example like the *Barbie doll* and the recent *iPod* cases have shown that the traditional way of computing trade statistics linked to origin may not adequately reflect economic realities .In the case of the Barbie doll³ US imports statistics were showing that the Barbie dolls trade flows were recorded as China being the country of origin. It was found that China was charged an export value of \$ 2.00 in trade statistics, while the economic benefit deriving from it were just 35 cents. The Barbie doll case provided a first valuable example of the difficulties of origin determination and statistics and its suitability for trade statistics.

Most recently the iPod example referred to an increase of the US-China trade gap trough imports of iPod parts manufactured in China and priced at \$ 287 while in fact just \$12 of value was added to China⁴.

For these products and more particularly the agro-processed products the consumer⁵ may question the criteria and international trade rules regulating the *made in* labels affixed to these products as wells trade mark.

Although from the example of the Barbie doll to the one of iPod there is more than one decade, little if anything has been done in the international trade system to properly address these emerging issues. The WTO agreement of rules origin provided more than a decade long harmonization work program of non- preferential rules was finalized they will also apply to trade statistics.

The number of lessons learned and technicalities have already shown that, notwithstanding the establishment of harmonized customs origin criteria, the determination of which country and which

³ 2 See R. Tempest, Times (London), 22 September 1996.and Globalization and the international trading system : issue related to origin ,UNCTAD march 1998

⁴ See Corcoran, T. 2010.

⁵ On the interfaces between the concept of origin and the IPRs such as geographical indications ,trademarks and traditional knowledge see Thomas Cottier and Marion Panizzon in "Developing countries and the Doha round" edited by Ulrich Petersmann Robert Schuman Centre for advanced studies, EUI Florence 2005 ,on the implications of trademarks and health see V. Vadi Trade Mark Protection, Public Health and International Investment Law: Strains an Paradoxes in The European Journal of International Law Vol. 20 no. 3 © EJIL 2009;

nationals will derive the substantial economic benefits of the production of a specific product is an extremely complex issue..

Today questions and recent literature⁶ are focusing on identifying ways and means to correctly measure trade flows and their implications. Substantive questions have already arisen on how to measure value addition as opposed to gross value and how to measure import content of exports.

The methodology

The research is aimed at developing a new *input-output* approach that can be used to:

1. provide a new reading of trade statistics
2. detect value chains and value addition on the basis of the import content, and
3. measure the impact of a given rule of origin and drafting rules of origin thereof.

International input-output tables are commonly used for the analysis of global supply chains when assessing the import content of exported goods. However, there are a number of technical difficulties and constraints in using such tables to assess value added in import-export trade flows. The research will address such shortcomings advancing on a new methodology that could be used to fill the existing gaps in the traditional measuring and monitoring of trade flows and trends.

Drawing from the Author's experience on drafting and negotiating Rules of Origin, the proposed methodology is based on the Harmonized System (HS), the worldwide used Customs Nomenclature.

An earlier research⁷ conducted in the framework of ASEAN-China Free trade area has shown some initial results of the methodology that under the present research has been substantially enlarged.

Under the previous research some initial observations were made looking at the trade data of ASEAN- China trade flows at subheading level of the HS and matching them with trade data of imports of ASEAN. In particular it found was that sub-heading 847330 of the Harmonized System classifying parts and accessories of computers was one the most imported and most exported item in 2002 among ASEAN countries and China.

The trade flows of this subheading captured the fact that there are significant assembly operations of parts or sub-components of computers between China and ASEAN. The analysis of these trade flows also revealed an intra-industry trade where China imports part of computers from ASEAN countries to assemble subcomponents classified in same the heading and exported to ASEAN.

Suppose that this intra-industry trend is confirmed following discussions with domestic industry and that a rule of origin is drafted in the following manner: (A) A change to heading 8473 from any other heading. This rule would practically mean that all assembly operations performed in China to

⁶ See WTO staff working paper ERSD 2010-12 of June 2010

⁷ See: The ASEAN-China free trade area: Negotiating beyond eternity with little trade liberalization? Journal of World Trade Vol 39 no 3 June 2005.

manufacture sub-components from parts imported from ASEAN will not be considered as originating in China since the finished product is classified in the same heading.

Certainly cumulation could play its role if the parts imported from ASEAN are of ASEAN origin. If this is not the case alternative drafting could be considered by for instance utilizing a percentage criterion based on clear percentages and rules to calculate such as:

- no required change in tariff classification to heading 8473, provided there is a regional value content of not less than:
- 35 percent based on the build-up method, or
- 45 percent based on the build-down method.

Then correct methodologies to calculate the ad valorem percentages under the build-up or build-down methods will have to be identified.

Another example identified under the Author's former research was related to HS sub heading 841430 classifying compressors that were the fifth most exported products to ASEAN by China. Matching this finding with China's imports from the World, it was observed that HS 8414 90 -parts of compressor- ranked as the 36th most imported product from USA and Japan. This observation showed that some parts of the compressors exported to ASEAN contain parts imported from outside the ASEAN-China Region. Thus, a rules of origin such as:

"A change to subheading 841430 from any other subheading, except from subheading 8414.90" may entail that the compressors exported to ASEAN utilizing parts imported from Japan and USA will not comply with rules of origin requirements.

These initial examples, although limited to assess the impacts of the analysis on drafting rules of origin, showed the potential of the methodology used.

The HS is a multipurpose tool in measuring international trade as it is used to classify the goods, levy customs duties and to compile trade statistics,. In addition, while originally conceived as a customs nomenclature, the HS has been widely used to draft product specific, highly sophisticated rules of origin starting from the NAFTA experience. It has also been adopted as the preferred method to draft product specific rules of origin in the context of the *Harmonization Work Program* carried out under the WTO's ARO.

The underlying nature of the HS is based on industrial processes, starting from agricultural products classified in HS Chapters (1-24) to industrial products (25-97) and ranging from the simplest manufacturing to the most sophisticated process.

The change of tariff classification of one product to another HS chapter , heading of the HS or subheading is caused by an industrial process -i.e. by moving from Chapter 1 "Live animals" to Chapter 3 "Meat", the process of slaughtering has taken place and from Chapter 2 to Chapter 16 the meat has been processed into canned beef.

The six digits level of detail of the HS subheading permits to focus at on specific products and their components .As a further example is canned tuna of Heading 16.04 can be manufactured from

fresh tuna of Heading 03 or brine tuna of Heading, from the tin of heading and the olive oil of HS heading.

In the area of machinery and electronics the assembly of parts of machinery and electronics article into a finished product is easily measured when parts are classified in a different heading or subheading of the finished products. However, as the HS has been designed for customs classifications purposes and, at times, parts are classified in the same heading of the finished products. In so doing the structure of the harmonized system will be adjusted daring from the lessons learned in drafting rules of origin in the Harmonization Work of non- preferential rules of origin conducted in WTO.

The overall purpose is this exercise is twofold: 1.to identify the various change of tariff classification possible for a given heading or subheading and the respective processes and 2. better understand how the HS could be used as tool to examine production chains. In particular the following analysis has been carried out:

1. Examine a HS heading text and determine from what other HS headings or HS subheadings a change of tariff classification is possible and describe what kind of working or processing operations are causing this change of tariff classifications
2. Examine the heading text and determine if a change within a heading though not a change of tariff classification nevertheless effected a substantial transformation. In that case, the appropriate rule would recognize the change as origin conferring. For example, a change from a parts heading of chapter 84 to a finished or unfinished product of the same heading as the part would be origin conferring.
3. provide a description of the processes involved under 1 and 2 above and contrasts it with WCO/WTO Origin Committees texts and determine those areas where members of the committees have not agreed and merely to express the issues for resolution by the negotiators.

By adopting this methodology the Author has deconstructed the majority of tradable products into their specific components identified at heading level of the HS in an excel spreadsheet that will be matched by exports and import of China in the last three years ah HS four and six- digit level.

The result of this exercise will be analyzed to:

- a) Mapping out at detailed level the input/output of China trade
- b) Calculate the import content of the Chinese exports to provide another reading of Chinese trade statistics
- c) Calculate value additions estimates and value chains at detailed product level
- d) Implications for rules of origin, marks of origin and trade statistics
- e) Draw research conclusions and policy recommendations.

