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Preferential and Non-Preferential Rules for Determining Product Origin and Their Significance in International Trade Law

Rules of origin constitute a fundamental pillar of international trade law, serving to classify goods based on their origin (or "economic nationality"). These rules are crucial role to the functioning of free trade agreements, which grant significant tariff and non-tariff preferences to countries participating in a preferential trade regime (preferential rules of origin). Rules of origin are also essential for the implementation of various trade mechanisms, such as anti-dumping measures, quantitative restrictions (quotas), trade embargoes, labeling requirements, and safeguard measures (non-preferential rules of origin).

This article examines the legal framework of preferential and non-preferential rules of origin within the World Trade Organization (WTO). It explores the pivotal role that the rules of origin play in shaping the free trade dynamics and their impact on the trade policies of countries, in which these rules can act as a mechanism for protectionism, potentially becoming a "hidden weapon" that limits free trade and competition. The article also analyzes the practical challenges associated with the implementation of rules of origin in global trading regimes.

Keywords: *Free Trade, World Trade Organization (WTO), Economic Nationality, Protectionism, Substantial Transformation, Tariff Classification, Preferential Treatment.*

1. Introduction

In the modern interconnected global economy, characterized by intricate and constantly evolving economic relations, the mechanisms of international trade law are vital for ensuring the effective implementation of free trade and fostering the stable development of a market economies. Within the broad network of global free trade, where goods can move seamlessly across national borders and become integrated into international markets, the concept of rules of origin holds significant importance in establishing both bilateral and multilateral economic relations between countries. These rules are fundamental in shaping trade policies that reflect the sovereign interests of states at the national level.

Rules of origin serve as an essential mechanism for determining the origin ("nationality") of a product within international trade relations. The relevant regulations allow the countries to distinguish clearly between the products produced on domestic markets and those imported from foreign markets, thereby allowing for the application of the appropriate legal regime at the national level. Rules of

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origin are of paramount importance in Free Trade Agreements (FTAs), which grant substantial tariff and non-tariff preferences in the field of trade to participating countries. By establishing precise criteria for determining the origin of products, rules of origin ensure that only those parties involved in the agreement benefit from the privileges and preferences arising from the specific trade agreements.

The Rules of origin play a significant role in advancing and deepening the economic integration of states while ensuring an effective balance between fostering fair competition and preventing protectionist trade policies that are inconsistent with the principles of free trade. Such protectionist measures, which may be employed by countries to promote domestic production, can create an unfair advantage to local producers in the domestic market over imported goods. By establishing a framework for fair competition in international trade relations, promoting economic integration at both the global and regional levels and safeguarding national interests, rules of origin contribute to the stability, prosperity and economic development of states engaged in free trade.

With the rapid development of global markets and the ongoing transformation of economic relations, the complexity of the rules of origin and the challenges associated with them continue to increase. In the modern era, the production process of products frequently extends beyond the borders of a single state, involving multiple countries. The components required to assemble the final product are often produced in different countries. Therefore, determining the origin of the final product can be a difficult task. Furthermore, as a result of globalization, traditional models of product supply in the trade sector have also undergone a fundamental transformation. Modern supply chains have developed into complex systems, and the efficiency of these systems relies heavily on the effective application of the rules of origin.

In the second half of the twentieth century, alongside the development of the legal framework governing global trade relations and the establishment of the World Trade Organization (WTO) through multiple agreements between the states, the study of the rules of origin of goods became increasingly complex. This complexity arose from the continual expansion of free trade agreements at both the bilateral and multilateral levels, as these trade agreements often involve differing criteria for determining whether a particular product qualifies for preferential trade treatment. As a result, modern international trade law has evolved into a multifaceted legal system, wherein various trade regimes operate simultaneously between states at both the bilateral and multilateral levels. Moreover, due to the fragmentated nature of current international trade law, there is a potential for conflicts between the obligations undertaken by states in bilateral and multilateral regional trade agreements (RTAs) and the global trade regime operating within the framework of the World Trade Organization, to which the vast majority of states, including Georgia, are member.

The primary focus of this article is the legal aspects of the rules of origin, analyzed within the context of international trade law. In addressing the rules of origin, which serve as the principal mechanism for determining the origin of products and have a significant impact on customs tariffs and trade preferences, particular attention will be given to the legal framework established by the World Trade Organization (WTO). The article will further explore the concept of rules of origin and provide a detailed analysis of their classification, as well as the the criteria used to determine the origin of a product under the WTO Agreement on Rules of Origin. Additionally, this article will examine the current challenges associated with rules of origin in the context of global trade and explore theire

practical significance in international trade law. The article will also analyze the standards pertaining to the rules of origin within the framework of WTO law, along with the legal criteria and assessment tests relevant to the determination of product origin under both international and national law, particularly in relation to the principle of substantial transformation, which allows for the evaluation of the impact of rules of origin on business entities and trade policies.

2. The Concept and Fundamental Essence of the Rules of Origin

The rules of origin play a pivotal role in contemporary international trade law. Through these rules, states establish the criteria for determining the origin of goods.[1] The presence of rules of origin is necessary for the implementation of differentiated trade policies by states. For instance, they allow for the imposition of higher tariffs on goods imported from developed countries as compared to those imported from the least developed countries, or enable states to apply reduced or zero tariffs on imports from partner countries participating in a preferential trading arrangement (PTA). Furthermore, the rules of origin are vital when trade remedies are required to protect against unfair trade practices.[2]

A universal concept of rules of origin has yet to be established in international trade law. However, it can be interpreted as a set of criteria that determine the origin of a product in the field of trade. It is worth noting that, within the context of rules of origin, the term "product origin" does not refer to the geographical location from which the product was imported. Instead, it signifies the "economic nationality" of a product,[3] which is determined by the process of the creation of the product and its components. When a particular product is entirely manufactured within a single country, determining its place of origin is relatively easy. However, due to the internationalization of the production process in the modern economic landscape, such instances have become increasingly rare.[4] As a result of the globalization of trade relations, determining the country of origin of a product has become significantly more difficult. In the current landscape, most exported products contain a large number of imported components and materials that are produced in various countries.[5] The extensive use of free trade agreements in recent decades, coupled with the increasing trend toward regionalization constitutes a significant challenge to modern international trade law. Consequently, it is important to examine the standards developed to determine who is eligible to benefit from the advantages of a particular trade agreement.[6]

Rules of origin, as criteria for determining the origin of a product, enable a state to implement a preferential trade policy based on an existing preferential trade regime, where applicable.[7] Rules of

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1 See Agreement on Rules of Origin (ARO), World Trade Organization, Article 1, para. 1.

2 *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.,* The World Trade Organization Law, Practice, and Policy, Third edition, 2017, 237.

3 Rules of Origin Handbook, The World Customs Organization (WCO), 6.

4 *Harilal K.N., Beena P.L.,* Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly, Vol. 40, No. 51 (2005), 5419.

5 *Augier P., Gasiorek M., Lai Tong C., Martin P., Prat A.,* The Impact of Rules of Origin on Trade Flows, Economic Policy, Jul., 2005, Vol. 20, No. 43, 573.

6 *Chase K. A,* Protecting Free Trade: The Political Economy of Rules of Origin, International Organization, Vol. 62, No. 3 (Summer, 2008), 507.

7 *Gourdon J., Gourdon K., De Melo J.,* A (More) Systematic Exploration of the Trade Effect of Product-Specific Rules of Origin, World Trade Review (2023), 22, 421.

origin of goods are essential, on the one hand, for distinguishing between domestic and foreign products and for applying the principle of national treatment to the latter. On the other hand, they are also crucial for differentiating between similar products (“like products’’) from various countries and applying a preferential regime to goods imported from a trading partner country. This is particularly important since not all imported goods automatically fall under the Most Favored Nation (MFN) Clause.[8]

It is important to note that rules of origin, in isolation, do not produce any direct positive or negative effects, however, their existence is essential for the application of (other) trade mechanisms concerning specific products.[9] The rules of origin play a fundamental role in the implementation of trade regulations, which, on the one hand, necessitate the distinction between domestic and foreign goods, and, on the other hand, require differentiation between similar products (“like products’’) originating from different countries. Trade regulations, in which rules of origin constitute an important element, include measures such as quantitative restrictions (quotas) on imports, import prohibitions, trade embargoes, safeguard measures, countervailing duties and drawback of customs duties.[10] In addition, by assigning a specific origin to a product, it may be entirely exempt from customs duties (referred to as “duty-free treatment”) or be subject to a reduced duty due to the fact that it is imported from a developing country eligible for preferential treatment, or is imported from a state that is a partner of the importing country in a free trade area or a customs union.[11]

While the rules of origin serve as an important mechanism to facilitate the enforcement of trade mechanisms, their misuse can transform them into trade policy instruments that, in turn, hinder free trade in the market and promote protectionist trade policies.[12] Moreover, the inconsistent approaches adopted by the states in determining the origin of a product, along with the rules governing to the labeling of the origin of imported goods, may lead to significant discrepancies and could be considered an unlawful trade barrier.[13]

3. The Agreement on the Rules of Origin and its Core Principles

The determination of the origin of goods is of fundamental importance in international trade law. However, the establishment of clear criteria and the harmonization of rules of origin at the international level have not been properly implemented for years.

The General Agreement on Trade and Tariffs (GATT), which aimed to facilitate the reduction of barriers and tariffs in international trade, did not incorporate specific provisions governing the rules

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8 *Falvey R., Reed G.,* Economic Effects of Rules of Origin, Weltwirtschaftliches Archiv, Bd. 134, H. 2, 1998, 209.

9 *Satapathy C.,* Rules of Origin: A Necessary Evil?, Economic and Political Weekly, 1998, Vol. 33, No. 35 (1998), 2270.

10 *Falvey R., Reed G.,* Economic Effects of Rules of Origin, Weltwirtschaftliches Archiv, Bd. 134, H.2, 1998, 209.

11 *Satapathy C.,* Rules of Origin: A Necessary Evil?, Economic and Political Weekly, 1998, Vol. 33, No. 35, 1998, 2270.

12 *Harilal K. N., Beena P. L.,* Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly, Vol. 40, No. 51 (2005), 5419.

13 *Satapathy C.*, Rules of Origin: A Necessary Evil?, Economic and Political Weekly, 1998, Vol. 33, No. 35, 1998, 2270.

of origin, with the exception of Article 9 of GATT, which pertains to product marking requirements ("Marks of origin").[14] The General Agreement on Tariffs and Trade (GATT) establishes the foundational legal framework for the regulation of global trade and constitutes a cornerstone of international trade law. However, the GATT does not include specific provisions governing the criteria by which the country of origin of a product should be determined in international trade. Instead, each contracting state retains the authority to establish its own rules of origin and, depending on the objectives of a specific regulation,[15] states may apply alternative methods for determining the origin of a product, reflecting the heterogeneous practices of that country.[16]

Rules of origin are addressed only indirectly through the general provisions of the General Agreement, such as Article I (Most-Favoured-Nation principle, MFN), which obliges member states to extend, upon request, the same trade privileges and preferences unconditionally to "like products" imported from different countries, and Article V, which stipulates that states participating in free trade areas or customs unions are prohibited, under the principle of non-discrimination, from increasing trade restrictions against GATT member states that are not part of the respective free trade area or customs union.[17]

In addition, it is worth noting that while Article XXIV of the General Agreement permits member countries to conclude preferential trade agreements (PTAs) under certain conditions, it does not directly address rules of origin, however, it does allow member states to negotiate alternative rules and requirements for determining the origin of goods, including within the framework of concluded preferential trade agreements.[18] GATT permits members to establish their own rules for determining the origin and labeling of imported products, thereby safeguarding the interest of consumers by ensuring they are properly informed.[19] At the same time, it is prohibited to use trade names and geographical indications in a way that could create misleading representations about the origin of the goods.[20] Rules governing the marking of the origin of a product must not be discriminatory or unjustifiably prejudicial.[21] Origin marking requirements that impose different requirements on foreign products may violate the principle of equal treatment, in particular, the principle of national treatment.[22]

Although the General Agreement on Trade and Tariffs (GATT) does not yet contain specific regulations on the identification of the country of origin of a product, the existence of this agreement and the series of negotiation rounds carried out within its framework from 1947 to 1995 paved the way

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14 *Das R.U., Ratna R.S.,* Perspectives on Rules of Origin, 2011, Palgrave Macmillan, 11.

15 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of the World Trade Organization, Unit II: Globalism v. Regionalism, 2016, 7.

16 *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.*, The World Trade Organization Law, Practice, and Policy, Third edition, 2017, 238.

17 *Das R.U., Ratna R.S.,* Perspectives on Rules of Origin, 2011, Palgrave Macmillan, 11.

18 See General Agreement on Trade and Tariffs (GATT), 1994, Article XXIV.

19 *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.,* The World Trade Organization Law, Practice, and Policy, Third edition, 2017, 237.

20 General Agreement on Trade and Tariffs (GATT), 1994, Article IX, para. 6.

21 Ibid., Article IX, paras. 1 and 4.

22 Ibid, Article III, para. 4; see *Territory of Hawaii v. Harry MY Ho.*, No. 3078, 41 Haw. 565, 571 (1957).

for discussions on the rules of origin of goods in international trade law and became the foundation for efforts to harmonize rules of origin. These discussions ultimately led to the establishment of the Agreement on Rules of Origin, which, together with the General Agreement on Tariffs and Trade (GATT), became an integral part of the World Trade Organization (WTO) system and set out minimum criteria for member countries on how to determine the origin of products.[23]

The Agreement on Rules of Origin (ARO), established during the Uruguay Round of negotiations, outlines a work program for the harmonization of rules of origin in relation to the non-preferential trade policy mechanisms.[24] At the same time, the Agreement seeks to ensure that the rules of origin themselves do not create unnecessary barriers to international trade.[25] The Agreement on Rules of Origin should establish clear and predictable criteria for determining origin while simultaneously facilitating international trade flows in a manner that does not undermine the rights granted to member states under the General Agreement on Tariffs and Trade (GATT) of 1994.[26] The Agreement (ARO) requires member states to ensure the transparency of legislation, regulations and practices related to rules of origin, and to apply the rules of origin at the national level in a predictable, consistent, and neutral manner.[27] Additionally, the Agreement should ensure the establishment of a consultation mechanism for member states and provide the necessary procedures for the prompt, effective, and fair resolution of legal disputes arising from the Agreement.[28]

The Agreement on Rules of Origin establishes a work program for the harmonization of rules of origin, to be implemented in cooperation with the World Customs Organization (WCO).[29] Until the harmonization work program is completed, member states are required to ensure the transparency of their rules of origin.[30] Member countries are obliged to implement rules of origin in a consistent, uniform, impartial and reasonable manner, using clearly defined standards to determine the conditions a product must meet to be considered as originating from a particular country or region (the so-called positive standard).[31] Under the Agreement on Rules of Origin, member states have agreed not to use rules of origin to pursue trade policy objectives in a way that would hinder free trade.[32] Moreover, WTO members have committed to informing other member states and the World Trade Organization, in accordance with the appropriate procedures, about the existence of preferential rules of origin that apply to them under a specific preferential trade agreement (PTA), and providing them with information on relevant administrative and judicial decisions regarding the general application of these rules.[33]

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23 *Weiß W., Ohler C., Bungenberg M.,* Welthandelsrecht. 3. Auflage, 2022, Rn. 446, 177.
24 *Van den Bossche P., Zdouc W.*, The Law and Policy of the World Trade Organization, 2021, 502.
25 See Agreement on Rules of Origin (ARO), World Trade Organization, Preamble.
26 Rules of Origin Handbook, The World Customs Organization (WCO), 12.
27 See Agreement on Rules of Origin (ARO), World Trade Organization, Preamble.
28 Rules of Origin Handbook, The World Customs Organization (WCO), 12.
29 *Nell P.G.,* WTO Negotiations on the Harmonization of Rules of Origin, 33 J. World Trade (1999), 45.
30 See Agreement on Rules of Origin (ARO), World Trade Organization, Preamble.
31 Ibid, Article 2, paras. “e” and “f”.
32 Ibid, Article 2, para. “c”.
33 Ibid, Annex II, para. 4.

The Agreement on Rules of Origin outlines four fundamental principles: non-discrimination, predictability, transparency and neutrality, which imply that: (1) rules of origin must be applied uniformly for all purposes of non-preferential treatment; (2) rules of origin must be objective, understandable and predictable; (3) rules of origin must not be used directly or indirectly as instruments to achieve trade policy objectives; and (4) rules of origin must not themselves have a restrictive or distortive effect on international trade.[34]

It is essential that the rules of origin established by states for goods do not impose overly strict requirements or conditions unrelated to production or manufacturing as prerequisites for determining the country of origin.[35] Furthermore, the rules of origin applied by the states to imports and exports should not be stricter than those used to determine whether a particular product is domestically produced, and it is also not permissible to apply an unequal approach to different member countries and producers participating in the Agreement.[36] The rules of origin of member states should be based on the so-called positive standard, although a negative definition – explaining cases in which a product does not originate from a particular country – may also be allowed as an exception, for example, in cases where the interpretation of a positive standard is necessary.[37]

Rules of origin should be applied uniformly for all purposes related to non-preferential treatment in a manner that ensures objectivity, clarity, and predictability in their application, while also avoiding the use of rules of origin as instruments for achieving trade objectives and preventing unjustified restrictions on international trade.[38] While these general requirements are upheld, the origin criteria defined by the states may vary and reflect their heterogeneous practices.[39]

Article 1 of the Agreement defines rules of origin as laws, regulations and administrative rulings of general application used to determine the country of origin of goods, excluding those related to the granting of tariff preferences. Therefore, the Agreement directly applies only to rules of origin used in mechanisms related to non-preferential trade policies, such as most-favoured nation treatment (MFN), anti-dumping and countervailing measures, safeguard measures, origin marking requirements, discriminatory quantitative restrictions or tariff quotas, as well as those rules applied to trade statistics and government procurement.[40]

While the provisions of the Agreement on Rules of Origin (ARO) directly apply only to non-preferential rules of origin,[41] Annex II of the same agreement provides multilateral principles for preferential rules of origin.[42] The Agreement on Rules of Origin excludes from the scope of harmonization the rules of origin that apply to preferential tariffs, however, Annex II of the same

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34 *Das R.U., Ratna R.S.,* Perspectives on Rules of Origin, 2011, Palgrave Macmillan, 13-14.

35 Agreement on Rules of Origin (ARO), World Trade Organization, Article 2, para. "c".

36 Ibid, Article 2, para. "d".

37 Ibid, Article 2, para. "f"; see also *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.,* The World Trade Organization Law, Practice, and Policy, Third edition, 2017, 238.

38 Ibid, Article 2, paras. "a", "b", "c".

39 *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.,* The World Trade Organization Law, Practice, and Policy, Third edition, 2017, 238.

40 Agreement on Rules of Origin (ARO), World Trade Organization, Article 1, para. 2.

41 Ibid.

42 *Van den Bossche P., Zdouc W.,* The Law and Policy of the World Trade Organization, 2021, 502, 504.

agreement establishes several principles that should apply to preferential regimes, in particular, it is specifies that, within the framework of preferential rules of origin, the requirements for granting origin must be clearly defined, and the rules of origin should be based on the so-called positive standard.[43] Legislation relating to preferential rules of origin must be published in accordance with Article X of the General Agreement on Tariffs and Trade (GATT), and such legislation may not be applied retroactively.[44] Annex II of the Agreement also provides for the right to appeal, through judicial, arbitration or administrative procedures, against any administrative action related to the determination of origin, and further guarantees the confidentiality of classified information, as well as the obligation to notify the World Trade Organization of any legislative changes related to preferential rules.[45] It is important to note that the aforementioned general principles do not constitute international standards, as in practice, all countries have the ability to negotiate and establish their own preferential rules of origin tailored to their specific needs, which means that preferential rules of origin often vary depending on the types of products and the terms of the trade agreement.[46]

It is stipulated in Article 9, para. 2 of the Agreement on Rules of Origin (ARO) that the harmonization work program should be completed within three years, i.e. by July 1998.[47] Although significant progress has been made in implementing the work program, it has not been possible to complete it due to the complexity of the issues involved.[48] Due to the complexity of the relevant issues in this process, the original deadline specified in the Agreement has been extended several times, and negotiations are still ongoing without any formal timetable or deadline.[49]

It is noteworthy that once the harmonization work program is completed, all member states will use a single type of non-preferential rules of origin for all purposes.[50] Although the Work Programme for the Harmonization of Non-Preferential Rules of Origin has not yet resulted in any specific multilateral agreement on harmonized non-preferential rules, some progress has been made since December 2005 in harmonizing preferential rules of origin, in particular, with regard to preferential rules of origin applied by other states to imports from least-developed countries.[51]

4. Criteria and Assessment Tests of the Agreement on Rules of Origin

WTO member states frequently establish rules for determining the origin of imported goods that differ from those of other member states, and many of them, at the same time, employ a differentiated

43 Agreement on Rules of Origin (ARO), World Trade Organization, Annex II, paras. "3a", "3b" and "3c".
44 *Das R.U., Ratna R.S.,* Perspectives on Rules of Origin, 2011, Palgrave Macmillan, 14.
45 Comparative Study on Preferential Rules of Origin, WCO, Version 2017, 22.
46 Ibid.
47 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 6.
48 Ibid.
49 Rules of Origin Handbook, The World Customs Organization (WCO), 15.
50 *Van den Bossche P., Zdouc W.,* The Law and Policy of the World Trade Organization, 2021, 504.
51 Ibid, 504, 505; see also Decision on Measures in Favour of Least-Developed Countries, WTO, Uruguay Round Agreement, 1994, <https://www.wto.org/english/docs_e/legal_e/31-dlldc_e.htm> [10.01.2025].

approach depending on the specific purpose for which the rules of origin are to be applied.[52] However, the two main standards used to determine origin are: the "wholly obtained/produced goods" criterion and the "substantial transformation" principle.[53]

4.1. Criteria for Wholly Obtained (Produced) Goods

When a product is entirely obtained or produced in one country, it is relatively easy to determine its origin.[54] This category typically includes natural products and goods derived from them, as well as products manufactured in a single country without the inclusion of imported parts.[55] Goods that are wholly obtained in a particular country are considered to be "originating" in that country.[56]

According to Georgian legislation, the following are considered to be wholly obtained in a particular country: minerals extracted from the subsoil, territorial waters, or seabed of the country; products of plant origin that are grown or collected within the country; animals that are born and raised in the country; products obtained from animals living in the country; products obtained as a result of hunting and fishing in the country; and waste, scrap and used goods arising from industrial operations, which were collected in the country and can only be used as raw materials for further processing, among other.[57]

In order to grant the status of Georgian origin to a specific good for export to the European Union, it is necessary to meet the conditions outlined in the First Protocol to the Association Agreement, specifically, the good must be wholly produced in Georgia or, if the good is not wholly produced in Georgia, the materials used in its production must have undergone sufficient processing within the territory of Georgia.[58] Any product that is not wholly obtained in Georgia but meets the conditions set forth in Annex II to the First Protocol to the Association Agreement shall be considered sufficiently processed in Georgia.[59] In addition, the First Protocol to the Deep and Comprehensive Free Trade Area (DCFTA) Agreement with the European Union stipulates that,[60] which deals with the rules of origin and methods of administrative cooperation in this field, stipulates that, for the purposes of implementing the Agreement, the relevant provisions of the "Pan-Euro-Mediterranean Convention on preferential rules of origin (PEM)" shall apply.[61]

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52 Ibid, 501.

53 Rules of Origin Handbook, The World Customs Organization (WCO), 9.

54 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 184.

55 Ibid.

56 Resolution of the Government of Georgia of September 16, 2019 No. 453 "On Approval of the Criteria for Determining the Country of Origin of Goods, the Form of the Certificate of Origin, the Procedure for its Completion and Issuance" (2019), Article 6, para. 1.

57 Ibid, Article 6, para. 2.

58 See "Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part", Protocol I, Article 4. <https://matsne.gov.ge/ka/document/view/2496959?publication=0> [10.01.2025].

59 Ibid, Protocol I, Annex II, <https://matsne.gov.ge/ka/document/view/2496959?publication=0> [10.01.2025].

60 See Agreement on a Deep and Comprehensive Free Trade Area between Georgia and the European Union (DCFTA), First Protocol.

61 See Pan-Euro-Mediterranean Regional Convention on Preferential Origin, 26 March 2012.

It is essential to highlight that operations carried out solelyy to preserve goods in optimal condition for the purpose of their transportation and storage, or to facilitate their handling and transportation, or to package and present them for sale, are classified as so-called minimal operations that cannot be taken into account in determining whether the goods qualify as wholly obtained in a single country.[62]

Under Georgian legislation, the following operations are considered insignificant for the purposes of determining the origin of goods (i.e., a change of origin): operations that are necessary to ensure the transportation or storage of goods; operations that enhance the external appearance or commercial quality of goods, or prepare them for transportation, which include the division of a batch of goods, grouping of packages, sorting, marking, secondary packaging; simple assembly operations; and the mixing of goods from different origins, provided that the characteristics of the resultant product do not differ substantially from those of the products that are being mixed.[63]

4.2. Substantial Transformation

In cases where imported goods do not meet the criteria of wholly obtained goods due to the fact that their production process was carried out in more than one country, the country of origin shall be considered to be the country where the goods underwent a substantial transformation, which refers to a process of extraction and production determining the fundamental essence and nature of the goods (whether in terms of material or the product).[64] In the traditional sense of the principle of substantial transformation,[65] a good is considered to originate in the last country where it was assigned a distinctive name, nature or intended use as a result of the production process.[66]

A substantial transformation of goods requires more than a mere change in substance.[67] In the process of substantial transformation, the product must undergo a transformation into a new and different product that has a "distinctive name, character, and use".[68] For a product to be considered as originating from a specific country, it must be substantially transformed in that country, and in order to prevent a product from having multiple countries of origin due to the specifics of production, the product is regarded as originating solely from the country where it underwent its last substantial

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62 *Inama S.,* Rules of Origin in International Trade, 2022, 123.

63 Resolution of the Government of Georgia of September 16, 2019 No. 453 "On Approval of the Criteria for Determining the Country of Origin of Goods, the Form of the Certificate of Origin, the Procedure for its Completion and Issuance" (2019), Article 10, para. 1.

64 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 185.

65 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 10.

66 *Anheuser-Busch Ass'n v. United States,* 207 US 556, 562 (1908); *Hartranft v. Wiegman*, 121 US 609, 615 (1887).

67 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 10.

68 See *Anheuser-Busch Ass'n v. United States,* 207 US 556, 562 (1908); see also *United States v. Gibson-Thomsen Co.,* 27 CCPA 267 (1940).

transformation.[69] The substantial transformation of materials establishes a new origin for a product; therefore, goods comprising materials from a foreign country should be considered products of the country in which they were substantially transformed.[70]

Substantial Transformation can be implemented in three ways, namely, by changing the tariff classification, by increasing the added value, or by implementing a specific production process.[71] These methods for determining the origin of goods may be used either individually or in combination with each other.[72] While the principle of substantial transformation is widely recognized, there are varying approaches to its practical application, namely, some countries primarily rely on the criterion of change in tariff classification, others resort to the criterion of added value, and some adopt the criterion of specific processing (manufacturing).[73]

Accordingly, three basic questions must be addressed in determining the origin of goods,[74] namely: (1) whether the tariff classification of the goods has been changed as a result of the manufacturing operations (this rule is predominantly applied in the European Union);[75] (2) whether the production process has led to a substantial transformation in the name, nature, or use of the product;[76] (3) whether the value of the product has increased by a specified percentage in the preferential country in terms of the labor and materials employed in the production process.[77] The criteria for these three tests may be consolidated into a single rule, and in some instances, different tests may also be applied based for different purposes.[78]

4.2.1. Change in Tariff Classification

The first method for determining the substantial transformation of goods is the Change in Tariff Classification Method. According to this method, goods are considered to originate in a particular country if the tariff classification of the product changes as a result of production or manufacturing carried out in that country.[79] For the purposes origin determination, a change in tariff classification of

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69 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 11.

70 *Simpson J.P.,* Rules of Origin in Transition: A Changing Environment and Prospects for Reform, Law and Policy in International Business 22, no. 4 (1991), 667.

71 Rules of Origin Handbook, The World Customs Organization (WCO), 9-10.

72 Rules of Origin and Origin Procedures Applicable to Exports from Least Developed Countries, UNCTAD series, 2011, United Nations Publication, 3.

73 *Weiler J.H.H., Cho S., Feichtner I., Arato J.*, International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 4.

74 *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.,*The World Trade Organization Law,Practice, and Policy, Third edition, 2017, 238.

75 *Forrester I.S.*, EEC Customs Law: Rules of Origin and Preferential Duty Treatment, Part I, 167.

76 *SDI Technologies, Inc. v. United States*, 977 F. Supp. 1235 (Ct. Int'l Trade 1997), United States Court of International Trade, <https://casetext.com/case/sdi-technologies-inc-v-us>[10.01.2025].

77 *Torrington Co. v. United States*, 764 F.2d 1563 (Fed. Cir. 1985), United States Court of Appeals, Federal Circuit, <https://casetext.com/case/torrington-co-v-united-states> [10.01.2025].

78 *Matsushita M., Schoenbaum T.J., Mavroidis P.C., Hahn M.,* The World Trade Organization Law, Practice, and Policy, Third edition, 2017, 238

79 *Van den Bossche P., Zdouc W.,* The Law and Policy of the World Trade Organization, 2021, 502.

a product is assessed in accordance with the Harmonized System of Tariff Nomenclature and the corresponding convention of the World Customs Organization (WCO),[80] which is adopted by 90% of the countries engaged in world trade and establishes a uniform, hierarchical nomenclature used to determine the origin of all products involved in international trade.[81] Georgia acceded to this convention in 2008.[82]

In accordance with Georgian legislation, the criterion of a change in the first four-digit level of the commodity heading in the National Commodity Nomenclature of Foreign Economic Activities signifies that goods to be processed have undergone processing in a given country to the extent that at least one character from the first four digits (commodity heading) of the commodity code is altered (for example, from 2204 to 2205), and in such cases, the goods are considered to originate in the country where this change occurred.[83] When determining the country of origin of goods under this criterion, the "National Commodity Nomenclature of Foreign Economic Activities", approved by the Minister of Finance of Georgia, which was prepared on the basis of the aforementioned convention, is used.[84]

The tariff classification change criterion is considered the optimal means of determining substantial transformation due to its simplicity, as this method requires only an assessment of the Bill of Materials (BOM) of the goods to determine whether the imported materials meet the tariff change criterion.[85] It is a clear and objective method that only requires the identification of materials imported from a foreign country and their corresponding tariff classification.[86] However, the negative aspects of the tariff classification change criterion are often considered to be its limited transparency, strictness, and, in some cases, the potential for arbitrary application, as well as the general challenges associated with tariff classification.[87]

Since tariff classification was not originally designed for the purpose of determining origin, the criterion of a change in tariff classification does not always serve as an adequate and effective test for determining origin, and the regimes of rules of origin based on a change in tariff classification are often supplemented by a list of exceptions.[88] These exceptions identify cases where sufficient

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80 International Convention on the Harmonized Commodity Description and Coding System, 1988, WCO.

81 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 16.

82 Resolution of the Parliament of Georgia of December 23, 2008 No. 841 "On Accession to the International Convention on the Harmonized Commodity Description and Coding System", <https://matsne.gov.ge/ka/document/view/45730?publication=0> [10.01.2025].

83 Resolution of the Government of Georgia of September 16, 2019 No. 453 "On Approval of the Criteria for Determining the Country of Origin of Goods, the Form of the Certificate of Origin, the Procedure for its Completion and Issuance" (2019), Article 7, para. 1.

84 Order of the Minister of Finance of Georgia No. 21 of January 26, 2024, "On Approval of the National Commodity Nomenclature of Foreign Economic Activities (NCNO)", Annex, Article 1, para. 1.

85 Rules of Origin and Origin Procedures Applicable to Exports from Least Developed Countries, UNCTAD series, 2011, United Nations Publication, 4.

86 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 186.

87 Rules of Origin and Origin Procedures Applicable to Exports from Least Developed Countries, UNCTAD series, 2011, United Nations Publication, 4.

88 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 185.

transformation has occurred despite the absence of a change in tariff classification, or where a change in tariff classification alone is insufficient to confer origin, and also determine which production processes are not sufficient to confer a specific origin on a product, even though these processes result in a change in tariff classification.[89]

4.2.2. Value-Added Criterion

An alternative method for determining the origin of goods is the Value Added Rule, under which substantial transformation is assessed according to the value added to the goods in a specific country, excluding imported materials.[90] The total amount of value added to a product in a given country must reach a specific percentage threshold in order for the product to be considered originating that country.[91] The value added criterion can be expressed in two forms, namely, by setting a maximum permissible limit for foreign materials or by setting a minimum local content requirement in the product.[92] Consequently, the value-added criterion determines the extent of transformation required to confer origin on goods, which is carried out either by the minimum share of value that must come from the country of origin, or by the maximum amount of value that can be generated using imported parts and materials.[93]

Under Georgian law, when applying the ad valorem share criterion, goods are considered to originate in the country where the components and raw materials used in their manufacture originate, provided that the value of these components and raw materials constitutes at least 51% of the value of the final product; and in cases where the countries of origin of these components and raw materials differ, and their combined value exceeds 51% of the value of the final product, the final product shall be deemed to originate in the country where the components and raw materials with the largest percentage share of value originate.[94]

The downside of the value added criterion is often seen in its challenges with predictability and consistency, as it is believed that even minor fluctuations in the value of the currency can have a detrimental effect on the application of this criterion.[95] In addition, in many cases it is difficult to determine the true value of goods.[96] The ad valorem criterion for determining the origin of goods also

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89 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 16; see also Agreement on Rules of Origin, Article 9, para. 2, sub-paras. "c (i)" and "c (ii)".

90 *Simpson J.P.,* Rules of Origin in Transition: A Changing Environment and Prospects for Reform, Law and Policy in International Business 22, no. 4 (1991), 669.

91 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 186.

92 Rules of Origin Handbook, The World Customs Organization (WCO), 10.

93 *Weiler JHH, Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 13.

94 Resolution of the Government of Georgia of September 16, 2019 No. 453 "On Approval of the Criteria for Determining the Country of Origin of Goods, the Form of the Certificate of Origin, the Procedure for its Completion and Issuance" (2019), Article 8.

95 *Simpson J.P.,* Rules of Origin in Transition: A Changing Environment and Prospects for Reform, Law and Policy in International Business 22, no. 4 (1991), 669.

96 Rules of Origin Handbook, The World Customs Organization (WCO), 10.

imposes significant additional costs on companies, which find it difficult and expensive to comply with the associated administrative regulations, especially when these regulations require the identification and valuation of specific parts and materials within the final product.[97]

Furthermore, the application of the value added criterion may yield inconsistent results with respect to trading partners, in particular, when parts manufactured in a high-wage country (such as the United States) are sent to a country with a low average wage (for example, Mexico) to produce (assemble) a final product, the value added in Mexico for that product may not meet the required threshold; however, if these parts are manufactured in Mexico and the final product is assembled in the United States, the value threshold required for a change of origin may be satisfied.[98] This disparity arises from the greater inequality in labor costs compared to capital costs (as capital is more mobile and easily transferable than labor or raw materials); as a result, the value-added criterion discriminates against less developed countries, whose primary comparative advantage lies in inexpensive labor and materials.[99]

4.2.3. Specific Manufacturing/Processing Operation Criteria

The third method of substantial transformation is the Specific Manufacturing/Processing Operations criterion, under which a good is considered to be substantially transformed when it has undergone specific manufacturing or processing operations in a particular country.[100]

This criterion establishes specific manufacturing or processing methods for each product or group of products, which either determine the origin of the goods (positive test) or identify manufacturing or processing methods that do not confer origin on a product (negative test). Accordingly, these rules may require the use of products from certain origins or, conversely, prohibit the use of certain foreign products in the production of the final product.[101]

The main advantage of the specific processing criterion is that, once the relevant rules are established for it, this criterion is clear and unambiguous, and manufacturers can clearly determine from the outset whether their product originates from a specific country.[102] However, since the production methods are constantly evolving along with technological advancements, the rules on production-based criteria must also be updated accordingly.[103]

In accordance with Georgian legislation, considering the criteria of necessary conditions and manufacturing/technological operations, specific goods shall be considered to originate in the country

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97 *Weiler JHH, Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 13.

98 *Simpson J.P.,* Rules of Origin in Transition: A Changing Environment and Prospects for Reform, Law and Policy in International Business 22, no. 4 (1991), 669.

99 *Weiler J.H.H., Cho S., Feichtner I., Arato J.,* International and Regional Trade Law: The Law of The World Trade Organization, Unit III: Rules of Origin, 2016, 14.

100 Rules of Origin Handbook, The World Customs Organization (WCO), 10.

101 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 186.

102 There.

103 *Simpson J.P.,* Rules of Origin in Transition: A Changing Environment and Prospects for Reform, Law and Policy in International Business 22, no. 4 (1991), 669.

where they have undergone significant and economically justified processing, or where the goods have been worked on in a facility equipped for these purposes, resulting in the production of a new product or constituting an essential stage in the production process.[104]

5. The Classification of Rules of Origin and their Scope of Application

In international trade law, there are two primary types of rules for determining the origin of a product, namely, preferential and non-preferential rules of origin.[105] Preferential rules of origin are associated with significant trade policy instruments, such as Free Trade agreements (FTAs) and the Generalized System of Preferences (GSP), which grant preferential market access (reduced or zero tariffs) to imports from countries that are either members of the FTA or developing countries (that are beneficiaries of the GSP system).[106] In contrast, the non-preferential rules of origin pertain to trade instruments of a broader, more general nature, addressing both neutral and politically sensitive objectives, without offering preferential market access.[107]

5.1. Concept of Preferential Rules of Origin and their Relevance in International Trade

The preferential rules of origin constitute a regulatory framework established in trade agreements to provide preferential trade treatment to goods originating in member countries, which requires a differentiation between goods produced within these countries and those imported from non-member countries. Preferential rules of origin are defined as a set of laws, regulations and administrative decisions relevant to practical application that are used by member countries to determine whether goods are subject to preferential treatment specified under contractual or autonomous trade regimes,[108] thereby granting trade (tariff) preferences to trading partners, beyond the obligations arising from the most-favoured-nation regime.[109] It is important to note that more than 50% of global trade is conducted on a preferential basis.[110]

Preferential rules of origin are established by preferential trade agreements designed to facilitate trade with developing countries (under the Generalized System of Preferences (GSP)) and trade agreement partners (e.g. under a Free Trade Agreements (FTAs) or Regional Trade Agreements (RTAs)) by offering reduced or zero tariffs to GSP beneficiary countries or FTA partner countries on goods they export.[111]Accordingly, in order to benefit from these preferential trade regimes, exported goods must originate from either a GSP beneficiary country or a country that is a signatory to a free

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104 Resolution of the Government of Georgia of September 16, 2019 No. 453, "On Approval of the Criteria for Determining the Country of Origin of Goods, the Form of the Certificate of Origin, and the Procedure for Its Completion and Issuance" (2019), Article 9.

105 *Weiß W., Ohler C., Bungenberg M.*, Welthandelsrecht. 3. Auflage, 2022, Rn. 445, 177.

106 *Barcelo J.J.,* Harmonizing Preferential Rules of Origin in the WTO System (December 19, 2006), Cornell Legal Studies Research Paper no. 06-049, 3.

107 Ibid.

108 Agreement on Rules of Origin (ARO), World Trade Organization, Annex II, para. 2.

109 *Van den Bossche P., Zdouc W.,* The Law and Policy of the World Trade Organization, 2021, 502.

110 *Weiß W., Ohler C., Bungenberg M.*, Welthandelsrecht, 2022, Rn. 445, 177.

111 Rules of Origin Handbook, The World Customs Organization (WCO), 16.

trade agreement.[112] Preferential trade agreements encompass autonomous trade regimes (e.g. the Generalized System of Preferences, GSP) and contractual trade regimes (e.g., North American Free Trade Agreement – NAFTA).[113]

It is essential to note that both types of trade regimes contravene a fundamental principle of the World Trade Organization (WTO), specifically the prohibition of unequal treatment (discrimination).[114] However, the establishment and functioning of free trade areas and regional trade agreements is permitted as an exception under WTO law, in accordance with the conditions set forth in Article XXIV of the General Agreement on Tariffs and Trade (GATT), and as for the Generalized System of preferences, the legal basis for its operation of the GSP systems is the "Enabling Clause",[115] which was adopted by GATT members in 1979 and allows developed countries to extend more favorable treatment to developing countries, thereby granting them preferential benefits over other countries.[116]

Preferential rules of origin generally include stricter requirements and are more difficult to implement than non-preferential rules of origin.[117] As for the structure of preferential rules, in preferential trade agreements, their key elements typically include not only the criteria for determining origin (such as "wholly obtained goods criterion" and "substantial transformation" criterion), but also the requirement for direct transportation of goods between the relevant countries (Direct Consignment Rule) and the prohibition of refunding duties paid on imported goods used in production (Prohibition of Duty Drawback).[118]

An essential component of most preferential trade schemes is the Direct Consignment Rule, which stipulates that in order for a product to qualify for preferential treatment, it must be transported directly from its place of production to the destination where the preference is granted.[119] The primary objective of this rule is to ensure that imported goods, particularly "bulk cargo", which can be difficult to identify precisely, are identical to those that departed from the exporting country, and to reduce the risk of unwanted mixing of preferential goods with non-preferential goods.[120] The goods for which specific trade benefits are sought must be transported directly to the destination market, and if they pass through another country in transit, documentary evidence may be required to demonstrate that the goods remained under the supervision of the customs authorities of the transit country, did not enter the domestic market there, and underwent no operations beyond unloading and reloading procedures.[121]

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112 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 191

113 Rules of Origin Handbook, The World Customs Organization (WCO), 16.

114 *Barcelo J.J.,* Harmonizing Preferential Rules of Origin in the WTO System (December 19, 2006), Cornell Legal Studies Research Paper no. 06-049, 12.

115 Ibid, 11.

116 Decision (l/4903) of the Contracting Parties of GATT on "Differential and More Favorable Treatment Reciprocity and Fuller Participation of Developing Countries", adopted November 28, 1979. <https://www.wto.org/english/docs_e/legal_e/enabling_e.pdf> [10.01.2025].

117 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 191.

118 Rules of Origin Handbook, The World Customs Organization (WCO), 16.

119 *De Wulf L., Sokol J.B,* Customs Modernization Handbook, 2005, 205.

120 Rules of Origin Handbook, The World Customs Organization (WCO), 17.

121 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 205.

An important aspect of preferential rules pertains to the issue of duty drawback.[122] When national legislation provides for the possibility of customs duty drawback, this refers to the refund of customs duties paid on foreign components used in the production of a final product, which is exported to the market of a partner country of a free trade agreement (FTA) or preferential trade agreement (PTA).[123] When trade agreements include explicit provisions prohibiting duty drawback, it affects companies exporting to the trade area and influences the sourcing decisions regarding their product inputs, which may alter their approach and lead to a shift from using materials imported from non-participating countries to those originating from countries that are participants in the trade agreement instead.[124]

Beneficiary countries of preferential trade regimes are frequently subject to limitations that prevent them from exempting exporters from customs duties on raw materials and supplies originating outside the preferential system when these materials are incorporated in products that qualify for preferential trade treatment upon export of the final product.[125] Under the current trade regime between the European Union and Georgia, in accordance with the PEM Convention, it is not permitted to receive reimbursement for customs duties previously paid in a Convention member country on non-originating materials that are used in the production of a product exported under preferential tariffs.[126]

While many preferential trade agreements prohibit the reimbursement (drawback) of customs duties paid on materials or components originating from a foreign (non-partner) country and subsequently used in the production of final products imported into the market of a preferential trade agreement partner, numerous developing countries leverage this mechanism to attract investment and encourage exports.[127]

5.2. The Essence of Non-Preferential Rules of Origin and their Importance in Trade Law

In international trade law, non-preferential rules of origin serve to assign economic nationality to specific goods.[128] Unlike preferential rules of origin, non-preferential rules do not grant any tariff advantage to goods. According to the WTO Agreement on Rules of Origin (ARO), non-preferential rules of origin are defined as the set of laws, regulations and administrative decisions employed to determine the country of origin of goods in international trade relations.[129]

Non-preferential rules of origin are not associated with contractual or autonomous trade regimes that form the basis for granting tariff preferences to trading partners.[130] However, this does not mean that they have an insignificant role in international trade law. These rules are used as instruments in non-preferential trade policy mechanisms, including Most-Favoured-Nation treatment (MFN), anti-

122 *Estevadeordal A., Suominen K.,* Rules of Origin in the World Trading System (2003), 7.
123 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 196.
124 Ibid.
125 Rules of Origin Handbook, The World Customs Organization (WCO), 18.
126 Pan-Euro-Mediterranean Regional Convention on Preferential Origin, 26 March 2012, Article 14.
127 *Estevadeordal A., Suominen K.,* Rules of Origin in the World Trading System (2003), 7.
128 Rules of Origin Handbook, The World Customs Organization (WCO), 6.
129 Agreement on Rules of Origin (ARO), World Trade Organization, Article 1, para. 1.
130 Rules of Origin Handbook, The World Customs Organization (WCO), 12.

dumping and countervailing measures, safeguard measures, origin marking requirements, discriminatory quantitative restrictions and tariff quotas, trade statistics and government procurement.[131]

Under the Most-Favoured Nation (MFN) regime, any advantage, promotion, privilege or immunity granted by any party to the Agreement (GATT) to any good originating in or destined for any other country must be immediately and unconditionally extended to like products originating in the territories of all other Member States or destined for the territories of all other parties to the Agreement.[132] By defining clear and objective criteria for determining the origin of goods, non-preferential rules of origin help prevent discrimination between trading partners and ensure equal treatment of all members. However, it important to take into account the significant exceptions that allow for unequal treatment, such as those arising within the framework of regional trade agreements.[133]

Within the framework of the World Trade Organization, the practice of dumping, where goods are imported from one country into another at a price below their normal value, is considered unfair if it results in material injury to the industry of a GATT member country, threatens to cause such injury, or substantially hinders the development of the domestic industry of a member country.[134] In order to counter or eliminate dumping, a party to the agreement may impose an anti-dumping duty on dumped goods of any kind, the amount of which shall not exceed the dumping margin for these goods.[135] Non-preferential rules of origin play a crucial role in accurately determining the origin of dumped goods and are essential for enforcing anti-dumping measures to combat unfair trade practices. The proper determination of product origin helps maintain the integrity of markets and protects domestic industries from unfair competition.

With regard to indications of origin, each GATT Party shall accord to goods originating from the territory of another Party to the Agreement treatment no less favorable than that accorded to like products from any third country, specifically with respect to marking.[136] When the laws and regulations concerning appellations of origin are enacted, they should be implemented in a manner that minimizes any difficulties and obstacles they may cause for the trade and industry of the exporting country, while also paying attention to the need to protect consumers from false and misleading indications.[137] By accurately determining the origin of goods, rules of origin ensure that the relevant products are properly labeled, which provides the consumers with transparent information about the products they purchase. This, in turn, boosts consumer trust and enhances market transparency.

In addition, non-preferential rules of origin provide the foundation for the effective application of safeguard measures. By accurately determining the origin of goods, these rules help identify rising import flows into the market that could potentially harm domestic industries, allowing governments to

131 Agreement on Rules of Origin (ARO), World Trade Organization, Article 1, para. 2.
132 General Agreement on Trade and Tariffs (GATT), 1994, Article I para. 1.
133 Ibid, Article XIV.
134 Ibid, Article VI, para. 1.
135 Ibid, Article VI, para. 2.
136 Ibid, Article IX, para. 1.
137 Ibid, Article IX, para. 2.

respond with appropriate safeguard actions, for example, by setting quotas.[138] Furthermore, non-preferential rules of origin help prevent the abuse of discriminatory practices, such as quantitative restrictions.[139]

By establishing objective criteria for determining the origin of goods, rules of origin ensure that such measures are applied in a fair and transparent manner in practice, without the unduly restriction of individual trading partners. Consequently, non-preferential rules of origin play an important role in fostering fair, transparent, and non-discriminatory trade practices across various areas of international trade regulation.

6. The Economic Implications of Rules of Origin in International Trade and the Associated Practical Challenges

The economic implications of preferential and non-preferential rules of origin are multifaceted and depend on various factors, including the stringency of these rules, the complexity of supply chains, and the level of economic development.

Rules of origin can serve as a trade barrier in two ways. Firstly, based on rules of origin administrative costs may be imposed on exporters in the market, secondly, companies may be forced to change their suppliers in order to comply with the requirements of the rules of origin in the specific country.[140] The existence of rules of origin is necessary to ensure that the scope of preferential tariffs is limited to members of a preferential trade agreement, while non-member countries are excluded from such a preferential treatment, for which it is useful to establish and enforce strict rules of origin.[141] The inherent "discriminatory capacity" of rules of origin enables the parties to a free trade agreement or preference-granting countries to restrict the duty free entry of products exported by a particular party, as well as restrict their access to other preferential benefits.[142]

When signing a free trade agreement, bilateral tariffs are reduced to zero, however, companies must prove the origin of their products in order to be qualified for duty-free treatment on the market, hence, the administrative burden of meeting these rules often “offsets” the positive impact of the reduced tariff, which can be mitigated by non-preferential tariffs, as companies may decide to pay them to avoid the administrative costs associated with proving the origin of goods, especially where non-preferential tariffs are low (e.g. in Europe).[143]

When two countries sign a free trade agreement (FTA), they reduce tariffs on bilateral trade and also establish rules of origin for goods. As a result, an FTA causes a certain portion of supply to shift

138 Ibid, Article XIX.

139 Ibid, Article XI.

140 *Augier P., Gasiorek M., Lai Tong C., Martin P., Prat A.,* The Impact of Rules of Origin on Trade Flows, Economic Policy, Jul., 2005, Vol. 20, No. 43, 576.

141 *Harilal K.N., Beena P.L.,* Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly, Vol. 40, No. 51 (2005), 5420.

142 Rules of Origin and Origin Procedures Applicable to Exports from Least Developed Countries, UNCTAD series, 2011, United Nations Publication, 2.

143 *Augier P., Gasiorek M., Lai Tong C., Martin P., Prat A.,* The Impact of Rules of Origin on Trade Flows, Economic Policy, Jul., 2005, Vol. 20, No. 43, 576.

from a third country to FTA suppliers, while preferential tariffs change the relative prices of imports from partner countries compared to those from third countries.[144]

It is noteworthy that the rules of origin have a greater impact on trade in intermediate goods than in final goods, they also affect small countries more than large countries (due to their greater dependence on imported intermediate goods), and their impact is also more significant on trade in countries where the so-called vertical specialization is prevalent.[145]

The application of the rules of origin to determine the origin of a product significantly influences the trade policy of states, as they can be employed to safeguard specific domestic sectors or industries, potentially leading to the protection of domestic manufacturing industries and the substitution of imported materials with domestic alternatives, and an increase in the costs and prices of final goods.[146]

Compliance with rules of origin can affect companies' supply and investment decisions, as these rules may require the use of domestic products rather than imported ones, thereby reducing the benefits of low-tariff exports and potentially increasing the cost and prices of final goods.[147] Additionally, the rules of origin can play a crucial role in shaping the investment decisions of multinational companies, as the nature and manner of application of rules of origin can increase uncertainty regarding the preferential market access, potentially leading to a reduction in investment.[148]

Rules of origin can reduce the utilization of trade privileges granted by preferential agreements or the GSP, leading to the occurrence of "unused preferences", as producers may opt to pay tariffs rather than navigate the administrative barriers associated with compliance, thereby favoring domestic products and increasing the costs and prices of final goods.[149] Moreover, the rules of origin can also lead to investment diversion, as producers of final goods may set up factories within the region governed by the rules of origin to meet the compliance requirements of the rules of origin, potentially resulting in higher costs and trade diversion, as well as the redirection of investment within the territory subject to the rules of origin.[150]

While the rules of origin are necessary to maintain the existing external protection of countries under a preferential trade agreement (PTA), depending on how these rules are designed, they may also serve to increase that level of external protection, and the actual impact of rules of origin will ultimately depend on a number of factors, such as the nature of the relevant market structure, or the definition of "sufficient working or processing".[151]

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144 Ibid, 578.
145 Ibid, 581.
146 *Harilal K.N., Beena P.L.,* Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly, Vol. 40, No. 51 (2005), 5421.
147 *De Wulf L., Sokol J.B.,* Customs Modernization Handbook, 2005, 200.
148 Ibid.
149 *Estevadeordal A., Suominen K.,* Rules of Origin in the World Trading System (2003), 9.
150 Ibid, 10.
151 *Augier P., Gasiorek M., Lai Tong C., Martin P., Prat A.,* The Impact of Rules of Origin on Trade Flows, Economic Policy, Jul., 2005, Vol. 20, No. 43, 580.

It is important to note that the preferential rules of origin are more restrictive than non-preferential ones, with the theoretical rationale being to prevent trade "diversion", which specifically refers to the practice of transporting goods through a country with a preferential regime so that the goods can obtain the preferential treatment available under a preferential trade agreement (PTA) upon import.[152] The function of rules of origin is to prevent such trade "diversion", where foreign (non-privileged) goods are supplied to a free trade agreement party with the lowest external tariffs and then re-exported to a country with higher tariffs,[153] thereby avoiding the payment of higher tariffs or enabling products originating from non-beneficiary countries of unilateral preferential schemes to be transported through beneficiary countries.[154]

Preferential trade tariffs and rules of origin can lead to trade diversion, which negatively affects non-members, while rules of origin, especially those requiring local components in the product composition, can further exacerbate the situation of non-members of the agreement.[155] In free trade agreements, downstream producers are forced to purchase necessary inputs from regional producers of intermediate products at a higher price, which potentially increases costs and leads to trade disruptions. Thus, for non-member producers of intermediate products, the rules of origin resulting from an FTA can constitute a significant non-tariff trade barrier (NTB), the tariff equivalent of which may be higher than the general external tariff of the FTA.[156]

In addition, there is a legitimate concern in international trade law that rules of origin may be used for protectionist purposes.[157] Originally intended as a neutral trade policy instrument to determine the country of origin of goods, rules of origin are increasingly being used in practice as a protectionist trade policy instrument, and the abuse of rules of origin for protectionist purposes is often observed in preferential trade agreements (PTAs) between developed countries, such as the European Union and NAFTA.[158]

Rules of origin can be effectively used as a means of protectionism, implemented in the following ways: On one hand, an overly restrictive interpretation or application of preferential rules of origin may deny trade preferences to products that have undergone last substantial processing in a preferential country or trading area, arguing that the product in question does not originate in the preferential country.[159]

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152 Rules of Origin Handbook, The World Customs Organization (WCO), 16.

153 *Krajewski M.*, Wirtschaftsvölkerrecht, 4. Auflage, 2017, Rn. 975.

154 Rules of Origin and Origin Procedures Applicable to Exports from Least Developed Countries, UNCTAD series, 2011, United Nations Publication, 2.

155 The Impact of Rules of Origin on Trade, Report, Kommerskollegium 2012:1, 14.

156 *Harilal K.N., Beena P.L.,* Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly, Vol. 40, No. 51 (2005), 5420.

157 *LaNasa J.A. III.,* Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating Them, The American Journal of International Law, Oct., 1996, Vol. 90, No. 4, 631.

158 *Harilal K.N., Beena P.L.,* Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly 40, no. 51 (2005), 5426.

159 *LaNasa J.A. III.,* An Evaluation of the Uses and Importance of Rules of Origin, and the Effectiveness of the Uruguay Round's Agreement on Rules of Origin in Harmonizing and Regulating Them (1995), Chapter I.

On the other hand, an overly liberal interpretation and application of non-preferential rules of origin may extend country-specific trade-restrictive measures to products that would otherwise be exempt from them, based on the argument that, despite having undergone last substantial processing in a third country, the product originated in a non-privileged country.[160]

It is also worth noting that the ongoing "privatization" of trade policy, which is a significant aspect of protectionism based on rules of origin, is often influenced by industrial lobbyists who, due to their power and influence, play a decisive role in determining the level of protection granted to individual products.[161]

Due to the absence of standardized preferential rules of origin con, the more than 300 preferential trade agreements currently in force include different regulations on rules of origin, leading to substantial fragmentation in international trade law and the so-called "Spaghetti Bowl Effect".[162] Preferential trade agreements usually establish specific criteria for determining rules of origin, and these rules differ not only between agreements, but also across sector, which makes the system of rules of origin even more complex and further complicates the process of harmonizing preferential rules of origin.[163]

7. Conclusion

In the dynamic and complex landscape of international trade law, rules of origin play an indispensable role in determining which goods are eligible for preferential treatment under various trade agreements. These rules significantly shape global trade, influence trade flows, and protect the interests of countries engaged in free trade.

Rules of origin serve as the principal criteria for establishing the national origin of a product. Their importance stems from the fact that trade duties and restrictions are often contingent upon the origin of the imported product. The rules of origin apply to a wide array of trade measures, including anti-dumping duties, quantitative restrictions, tariff quotas, origin designations, etc. Over time, the significance of rules of origin have become increasingly important in trade relations, as countries often treat similar imported goods differently depending on their origin.

Rules of origin are of paramount importance in international trade law, as they provide criteria for determining the origin of goods, ensure compliance with trade agreements and prevent trade restrictions. Where they exist, the rules of origin promote fair competition among trading partners, enhance trust and cooperation, and contribute to economic growth and development. They also play an important role in protecting domestic industries from unfair competition and in fostering economic stability.

Notwithstanding their fundamental importance, rules of origin also present a number of challenges. In particular, the lack of harmonisation between governments on the application rules of

160 Ibid.

161 *Harilal K.N., Beena P.L.*, Reining in Rules of Origin-Based Protectionism: A Critique of WTO Initiatives, Economic and Political Weekly, Vol. 40, No. 51 (2005), 5421.

162 The Impact of Rules of Origin on Trade, Report, Kommerskollegium 2012:1, 6, 14.

163 Ibid, 15.

origin makes it difficult for businesses to comply with various rules. In addition, the misuse of rules of origin can turn them into a hidden weapon of protectionist trade policies that impede free trade. The challenges associated with rules of origin include the lack of harmonisation between countries, the potential for misuse and the coexistence of preferential trade agreements alongside national non-preferential rules of origin, leading to fragmentation. The Agreement on Rules of Origin (ARO) seeks to address these issues by harmonizing non-preferential rules of origin and establishing a more transparent, streamlined, and predictable implementation procedure for the assessment of origin. However, it is worth noting that harmonizing rules of origin alone is not enough, and as long as countries continue to distinguish between similar ("like") products originating from different countries, rules of origin will remain a controversial but necessary tool in international trade relations.

In light of these challenges, the global system of rules of origin requires systematic improvement and reform. First, there is a need for broad harmonization and standardization of rules of origin across trade agreements, which can be achieved through multilateral efforts within the World Trade Organization or through regional initiatives aimed at approximating rules of origin criteria. Harmonization of rules of origin would allow companies to benefit from simplified procedures and reduced compliance costs, and would also contribute to increased transparency and predictability in trade relations. Furthermore, capacity building and technical assistance for customs authorities and companies would be a crucial factor for enhancing compliance and enforcement.

Moreover, it will be important to improve stakeholder engagement and consultation procedures to ensure that rules of origin align with to business needs. By involving relevant stakeholders in the decision-making process, trade policymakers will be better equipped to understand the challenges faced by businesses and tailor rules of origin to address these needs.

In conclusion, the rules of origin play a fundamental role in international trade law, despite the challenges and complexities associated with them. By addressing these issues and implementing necessary reforms, trade policymakers and stakeholders can ensure that rules of origin continue to serve as a cornerstone of international trade law, fostering global economic growth and development. Improving and reforming the rules of origin for goods can enhance transparency, fairness, and efficiency in international trade, thereby strengthening the ability of the parties involved to adapt to the ever-evolving dynamics of global trade and facilitating their management of complex supply chains. The presence of effective and well-defined rules of origin ensures the development of a predictable and harmonized system for exporters and importers, making their analysis and implementation less complex and reducing the risk of trade disputes.

Thus, rules of origin of goods will continue to play an important role in the future in shaping a balanced and equitable global trade landscape that benefits all stakeholders and facilitates economic integration and cooperation at the global level.

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