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Rules of Origin and Trade Facilitation in Preferential Trade Agreements in Latin America

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ACRONYMS

ACP: Africa-Caribbean-Pacific
CAN: Andean Community, formerly known as the Cartagena Agreement
CCC: Customs Co-operation Council
CIF: Cost insurance freight
ECA: Economic complementation agreement
ECAs: Economic complementation agreements
ECLAC: Economic Commission for Latin America and the Caribbean (United Nations)
EIA: Economic integration agreement
EIAs: Economic integration agreements
EU: European Union
FDI: Foreign direct investment
FOB: Free on board
FTA: Free trade agreement
FTAA: Free Trade Area of the Americas
G-3: Group of Three (Free trade agreement between Colombia, Mexico and Venezuela)
GATT: General Agreement on Tariffs and Trade
GSP: Generalized System of Preferences
IDB: Inter-American Development Bank
INFOCENTREX: Centre for processing exports, El Salvador
LAIA: Latin American Integration Association
MERCOSUR: South American Common Market
NAFTA: North American Free Trade Agreement
OECD: Organization for Economic Co-operation and Development
PSA: Partial scope agreements (LAIA)
RSAs: Regional scope agreements (LAIA)
RTP: Regional tariff preference (LAIA)
SELA: Latin American Economic System
SOFOFA: Sociedad de Fomento Fabril (Chile)
UN/CEFACT: United Nations Centre for Trade Facilitation and Electronic Business
UN: United Nations
UNCTAD: United Nations Conference on Trade and Development
UNECE: United Nations Economic Commission for Europe
USA: United States of America
WCO: World Customs Organization
WTO: World Trade Organization

EXECUTIVE SUMMARY

The term "rules of origin" is an economic expression referring to a set of substantive rules for identifying the source of imported goods. As with any set of rules, certain formalities must be followed which entail public and private transaction costs. The public sector, has to enforce the rules of origin and implement proper controls with a view to monitoring external trade in goods, minimizing budgetary expenditures and maximizing the collection of tax revenues, while at the same time facilitating international trade. Likervise, private agents involved in external trade in goods are required to follow certain procedures, which should be efficient and expeditious.

There is already an abundance of economic literature relating to rules of origin; in this paper, we are concerned with the procedures involved in complying with such rules, in both the public and the private spheres. We approach the issue from the standpoint of trade facilitation. The matter of determining the origin of internationally traded goods inevitably comes up, however, so it will be discussed, although not in depth. Although there is no single definition of the term "trade facilitation", all working definitions take into account the matter of customs procedures, and many also explicitly refer to rules of origin. In both cases, the idea is to reduce the transaction costs associated with internationally traded goods.

This paper deals with rules of origin and related procedures as they apply to goods; very little work has been done so far on rules of origin as they relate to services. Further studies are needed in that area. Even in the case of final goods, however, commercial services must be reflected in the price of inputs, and are therefore one component of final export value. This study reviews the existing rules of origin, focusing on those embodied in the main economic integration agreements (EIAs) entered into by member countries of the Latin American Integration Association (LAIA), either among themselves or with other regions. Specific comments on certain ongoing negotiations are also included.

This study focuses especially on Chile and Mexico, because these two countries stand out from other LAIA members in that they have individually entered into quite a few EIAs with other countries, including a bilateral agreement between the two of them. To be more specific, we explore the question of why, although both Chile and Mexico are members of LAIA, their current EIA, does not follow the LAIA rules of origin or related procedures. Instead, it follows the North American Free Trade Agreement (NAFTA), model of rules of nationality and procedures. Moreover, Chile and Mexico are the only two LAIA members that have individually entered into bilateral EIAs with the European Union (EU), applying very similar rules of origin and procedures. Both Chile and Mexico have made a considerable effort to reform their customs structures and facilitate international trade.

This paper refers to the specialized literature and the texts of the relevant EIAs, as well as to personal interviews conducted by the author in Chile and Mexico with public and private officials concerned with the subject. A comparative study is made of the three families of rules of origin and related procedures, namely those applied by LAIA,

NAFTA and the European Union. The main conclusions are grouped under three thematic headings. The first refers to substantive issues arising from the rules of origin themselves. The second refers to related formal or procedural aspects. The third consists of some final reflections.

- ✓ **Conclusions on the content of the rules of origin examined**

1. The World Trade Organization (WTO) has not yet developed binding multilateral rules of origin; some progress has been made, although only in the field of non-preferential international trade. In this regard, it is worthwhile stressing the contributions of the World Customs Organization (WCO) and the United Nations Economic Commission for Europe (UNECE)/United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT). Countries will have to learn to live with different rules of origin, especially for international trade of a preferential nature.

2. The economic strategies of the individual members of an EIA are what determine their own particular rules of origin. Hence, such rules will necessarily be different in the different EIAs they have signed. Since rules of origin have different effects in the different countries belonging to an EIA, given the differences in their production structures and levels of economic development, it follows that special and differential treatment should be accorded to the less developed countries.

3. The NAFTA rules of origin and those applied under the EIAs between LAIA members and the European Union were negotiated product by product, which makes them very selective. On the other hand, LAIA rules of origin are general in nature, although product-specific rules are also allowed. At the same time, NAFTA rules of origin and those applied by EIAs between LAIA members and the European Union are more precise and not open to interpretation. Their very clarity has helped prevent unnecessary disputes. The LAIA text, which is brief, simple and lenient, allows for almost any product to meet the general rule of origin, which therefore can no longer be considered discriminating. Moreover, since it is wide open to interpretation, it often gives rise to problems that otherwise could have been avoided.

4. From the standpoint of substance, the NAFTA rules of origin and those applied in the EIAs between LAIA members and EU provide an adequate response to the challenges posed by globalization; not so with LAIA, which does not seem to have adjusted to the present circumstances. It is worth pointing out that the NAFTA rule of origin is especially interesting in that it provides for application of the *de minimis* criterion, of regional accumulation of value and includes special procedures relating both to goods and to fungibles.

- ✓ **Conclusions on the form of the rules of origin considered**

1. There is no reason to think that a thorough and specific rule of origin cannot be also simple and clear. In order for such a rule to work well, a sophisticated and efficient negotiating and administrative system will be needed. Therefore the rules of origin

applied under NAFTA and the EIAs between LAIA members and EU require efficient and detailed procedures and mechanisms to enforce them.

2. It appears that all the procedures associated with the rules of origin currently applied in the different EIAs, including those falling under LAIA, can be standardized and streamlined and electronic signatures can be adopted. This streamlining can be accomplished at every step, from the issuance of the certificate of origin up through the oversight and control functions.

3. In the case of NAFTA, certificates of origin are issued directly by producers or exporters (private law). In the remaining two families of rules considered, final responsibility for the certificates always falls on a governmental agency (public law). Solving problems in private law prevents political tensions between governments, but there is a greater potential for fraud.

4. In the case of EIAs under LAIA and EIAs between LAIA members and the European Union, issuance of this document is more complicated because the public sector is also involved. The fact that the NAFTA certificate of origin for a given product is valid for a whole year also facilitates trade and reduces transaction costs. In LAIA and the European Union, the certificate is valid for only one commercial transaction.

5. As regards administrative procedures relating to rules of origin, special bodies have been set up in NAFTA and in the EIAs with the European Union. It is easier to anticipate potential problems in NAFTA, since its objectives are more clearly spelled out. In the case of economic complementation agreements (ECAs) under LAIA, on the other hand, the only such case is that pertaining to the overall operation of the EIA, which means that these matters have to be dealt with more indirectly, thus slowing down the process.

6. As regards the settlement of disputes regarding origin, in NAFTA the parties concerned can use their own institutions to resolve this type of conflicts, or if previously agreed, have recourse to the specialized body in WTO. LAIA, on the other hand, does not have a dispute-settlement tribunal, so each ECA has to create its own dispute-settlement mechanism. If there were a centralized institution for this purpose, that would benefit all the ECAs, since it would be possible to eliminate the costs incurred in designing and administrating separate systems. The disputes that have arisen in EIAs between LAIA members and the European Union are not settled in a specialized tribunal, but rather in an administrative institution, on the basis of good faith. Proceedings associated with rules of origin in LAIA and NAFTA are considered to be administrative in nature, with NAFTA being the more efficient of the two. In the case of the European Union, the focus is on assistance and cooperation, which tends to lower the profile of any problems that might arise.

7. Oversight in connection with certificates of origin in the three families of rules is a complex and sometimes slow process. Oversight is undoubtedly more stringent in NAFTA, which uses two methods for verifying origin. The first involves the use of

questionnaires, which are widely used because of their low cost, although they are less efficient than the second method, which entails sending inspectors to the exporting country but is not often used because of the high costs involved.

8. Consequently, when there are significant differences in the economic capabilities of countries belonging to an EIA, consideration might be given to adopting a system providing for equitable distribution of the costs of inspection visits and improvement of the administrative capabilities of the less developed partners. This is a vital question, since the NAFTA rules of origin call for economic operators, both exporters and importers, to provide complete and transparent information, and this does not always happen in the developing countries.

9. Despite the aforementioned operational weaknesses in NAFTA, which can certainly be solved, the NAFTA administrative system is more expeditious than the system applied in the EIAs between LAIA members and the European Union. LAIA itself lags behind, taking third place.

- ✓ **Final comments**

1. In determining how efficient a given set of rules of origin is, it is important to take into account not only the content of the rules, but also the formal procedures associated with them, given that the theoretical and the empirical aspects work together to determine their overall usefulness. Thus, from the overall standpoint of content and form, the NAFTA rules of origin seem to be more efficient that those applied by the European Union. Nevertheless, both systems could still be improved. In the case of LAIA, more radical changes might be in order.

2. It is understandable, therefore, that some EIAs between members of LAIA have dropped the LAIA rules of origin. These include the following: Bolivia-Mercosur, Chile-Mercosur, Chile-Peru and Mercosur itself. The same holds for the G-3 (free trade agreement between Colombia, Mexico and Venezuela) and the current Chile-Mexico EIA, which apply a system that is completely different from that of LAIA.

3. It is not surprising, therefore, that the current Chile-Mexico ECA follow the rules of origin applied by NAFTA. Another case worth mentioning is that of the Chile-Mercosur ECA, which has adopted, although without much success, some of the controls implemented by NAFTA. As it is currently applied, the latter ECA has led to problems that make it necessary to renegotiate the rules of origin and related procedures. It should be noted that renegotiation are bound to be slow and costly and should be avoided if possible.

4. Chile and the Republic of Korea recently entered into an EIA which envisages a mixed procedure for issuing certificates of origin. Thus, while Chile uses self-certification, in the Republic of Korea a public agency is responsible for issuing the certificates. Evidently, certification is an issue that has not yet been fully resolved.

5. The current negotiations on the Free Trade Area of the Americas (FTAA) provide a clear indication of the lack of consensus on certain operational issues relating to pareferential rules of origin. Thus, the United States has proposed a procedure that is different from that of NAFTA; under this proposal, certificates of origin would be issued by importers, who are most likely to be affected in cases of fraud. The problem with this is that it will be difficult for importers to obtain the necessary information from exporters, a situation that can discourage and complicate reciprocal preferential trade in goods. Canada, Chile and Mexico have proposed self-certification, while Mercosur has proposed yet another system, which is also different from that suggested by the Andean Community (CAN). As a result, despite the considerable progress that has been made so far, there is still no agreement on rules of origin within FTAA.

6. It would appear, therefore, that further work must be done on rules of origin, including the related operational and administrative aspects; in other words, the focus should be on trade facilitation. Not only is this an issue of vital importance for EIAs, but it also has implications for all existing rules of origin.

I. GENERAL FEATURES OF RULES OF ORIGIN

A. THE CONCEPT OF RULES OF ORIGIN

Conceptually, rules of origin are a set of requirements that must be met by a final good[1] in terms of the inputs and intermediate goods used in its production, in order to define the nationality of the product, in the case of an individual country, or of a geographic territory, in the case of a group of countries. Identifying the origin of a product is important from the standpoint of statistics, technical production issues, economic factors and international trade. The main reason for having such rules, however, is to determine whether the merchandise in question is eligible for tariff preferences granted by the importing country.

Rules of origin may be preferential or non-preferential. Preferential rules are applied in the context of a selective trade arrangement in which favourable treatment is accorded to only or more or all of the members. Preferential rules of origin may be contractual or autonomous (INFOCENTREX, 2002). Contractual rules are those that are applied under an EIA. Autonomous rules are those that are established in the context of international programmes, such as the Generalized System of Preferences (GSP) applied by some industrialized countries to imports from developing countries.[2] They may be applied by a single country or a group of countries. Thus, the United States applies the Andean Tariff Preferences Act and the Caribbean Basin Initiative, while the European Union applies the Lomé Agreement, now known as the Cotonou Agreement, in Africa-Caribbean-Pacific (ACP) countries. Finally, non-preferential agreements are applied to international trade conducted outside the scope of any agreement granting tariff or non-tariff privileges. These fall mainly within the legal scope of the World Trade Organization (WTO), given its multilateral structure.

B. BASIC PRINCIPLES OF RULES OF ORIGIN

It is generally agreed that in order to ensure efficiency in their application, rules of origin should fulfil the following basic principles:

1. Simplicity. Rules of origin should be clear and transparent, in order to minimize the potential for subjective-interpretative or fraudulent application.

2. Predictability. Rules of origin should be consistent in order to allow the production sector to anticipate the situation and plan their international operations strategically.

3. Manageability. The rules should be such that they can be managed efficiently, and they should allow for simple and expeditious verification procedures by a modern public administration.

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[1] For a history of rules of origin, see Kingston (1994, p. 7).

[2] For a summary of GSP rules of origin, see UNCTAD (1999). To review some national studies relating to GSP, see UNCTAD (2000) (USA); UNCTAD (2001) (Canada); and UNCTAD (2002) (Japan).

C. RULES OF ORIGIN AT THE GLOBAL LEVEL

Although the importance of rules of origin has been increasingly recognized, no internationally agreed definition has yet been reached on how to determine the origin of a given merchandise. The first international instrument to address this issue is the International Convention on the Simplification and Harmonization of Customs Procedures, which was originally drawn up by the Customs Co-operation Council (CCC) on 18 May 1973 and entered into force on 25 September 1974. Three of the annexes to this Convention, better known as the Kyoto Convention, deal with rules of origin. Nevertheless, the CCC rules are not binding. The Kyoto Convention establishes two criteria for defining origin, as follows:

1. When the merchandise is "wholly produced" in a given territory.

2. If that is not the case, and inputs from other origins have been used, in order for a good to be identified with the place of manufacture, it must have undergone "substantial transformation". This definition is usually – but not exclusively – supplemented with the following three fundamental criteria or methods:[3]

(a) Change of heading or nomenclature. This applies when the end product falls under a tariff heading other than the headings applicable to each of the imported intermediate goods used in its manufacture;

(b) List of manufacturing or processing operations. This method is usually applied by using general lists describing, for each product, the technical manufacturing or processing operations regarded as sufficiently important (" qualifying processes "); and

(c) Ad valorem percentage rule. In order to determine origin by this method, the minimum domestic value added of a product is determined as a percentage of its total cost or final market price.

The Customs Co-operation Council, created in 1952, is now the World Customs Organization (WCO). The Kyoto Convention was recently amended by the Protocol of Amendment to the International Convention on the Simplification and Harmonization of Customs Procedures, done at Brussels on 26 June 1999. The new rule, which has not yet entered into force, brings the previous Convention up to date in the light of major changes that have taken place on the world scene.

The WTO Rules of Origin Agreement was negotiated during the Uruguay Round, which formally ended on 15 April 1994. The purpose of the Agreement is to "harmonize and clarify rules of origin" relating to non-preferential trade and hence leaving out Article XXIV of GATT 1947,[4] which would cover EIAs. Two committees are established to

[3] For a discussion of the limitations of these criteria, see Gitli (1995).

[4] Nevertheless, reference is made to rules of origin for preferential trade and the need for EIAs to keep WTO informed of their rules of origin. This probably represents a first step for future consideration of such rules.

implement the programme of work, namely, the Committee on Rules of Origin, made up of WTO Members, and the Technical Committee on Rules of Origin, under the auspices of the Customs Co-operation Council. A great deal of work has been carried out under the WTO Agreement, but the tasks outlined at the Doha Ministerial Conference of WTO, which were scheduled for completion by December 2001, have not yet been concluded.

Consequently, the joint efforts of WTO and CCC should pave the way for the recommendations of CCC to be adopted as binding multilateral arrangements. This could also be the case with the nearly 30 recommendations on trade facilitation developed in the context of UNECE, which in 1961 created a working group on simplification of trade documentation with a view to expediting external transactions, a task which is still ongoing (Izam, 2001, p. 11). The recommendations are based on a system developed by the United Nations for electronic exchange of data on business, trade and international transport, i.e., the Centre for Trade Facilitation and Electronic Business (UN/CEFACT). Recommendation No. 18 deals with rules of origin.[5]

All the above notwithstanding, however, WTO is not likely to make much progress in this regard over the short term. Since each economy has its own particular circumstances and sensitive areas, rules of origin will probably be established at the discretion of the parties concerned, rather than multilaterally, for some time to come. National rules and those established by specific EIAs will continue to be applied.

D. THE MAIN FEATURES OF RULES OF ORIGEN

Within the broad range of concepts and issues covered by rules of origin, the following features stand out:

1. Definition of rules of origin. Rules of origin are a set of rules establishing requirements that must be met in order for a product to be considered as originating in a given country or region.

2. Implementation of rules of origin. This term refers to the administrative procedures associated with rules of origin, and may be subdivided as follows:

(a) Certification of origin. The documentary procedures to be followed in order to establish that a merchandise meets the requirements set forth in a rule of origin.

(b) Proof of origin. Establishing the form and accuracy of the certificate of origin, including economic and legal implications of forgery or fraud.

The definition of rules of origin has financial implications which have to do with prices and the allocation of productive resources, all of which has been fully discussed in the

[5] In this regard, we suggest a review of the following documents: UN (2001); UN (2002a) and UN (2002b), all of which refer to the most recent contributions of UN/CEFACT on the question of rules of origin.

specialized literature.[6] Some authors argue that rules of origin are discriminatory and are used as a mechanism for exclusion (Gutiérrez-Haces, 1998) and that they have an asymmetrical effect (Hirsch, 1998, p. 41). It seems hard to deny or refute those arguments (Falvey and Reed, 1998). Nevertheless, other authors have also pointed out that social wellbeing is maximized to the extent that rules of origin differentiate between sectors or products. This may be the case with certain categories of products in which there are economies of scale or externalities, that involve the use of state-of-the-art technologies or that are labour intensive. Rules of origin may be part of an economic policy aimed at diversifying the vertical and horizontal structure of industrial production in a given country or region or at attracting foreign direct investment (FDI).

As regards the two aspects of implementation of rules of origin, they also have economic implications for trade facilitation, since they have to do with transaction costs in both the private and the public sectors. The overall efficiency of a system of rules of origin also depends on oversight and administrative procedures being as simple as possible, i.e., on reducing the number of steps required of commercial agents, and on the efficiency of the institutions concerned, including the customs system. This applies to the certification of origin to verify accuracy in content and in form, and to the expeditious settlement of economic or legal disputes, when there is suspicion of questionable activity or fraud. All these aspects must be considered before any conclusion can be drawn as to the overall economic efficiency of a given system of rules of origin. Consequently, if rules are to be properly implemented, they must be clearly defined (Ríos, 1994, pp. 31 and 34).

Although the main focus of this study is to consider the trade-facilitation aspects of the rules of origin applied under regional or extraregional EIAs in which members of LAIA[7] are involved (see chapter III), we must begin by looking at the main characteristics of the rules of origin applied by those countries. This is done in the following chapter. It should be noted that, given the close interrelationship between the subjects of the next two chapters, they are actually inseparable, and hence, they will appear to overlap on some of the matters discussed.

[6] See, inter alia, Vermulst *et al* (1994); Krishna and Krueger (1995); and Estevadeordal (2002).

[7] Twelve countries are currently members of LAIA, namely: Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

II. THE MAIN FEATURES OF RULES OF ORIGIN IN PREFERENTIAL TRADE AGREEMENTS IN LATIN AMERICA

A. INTRODUCTION

We shall refer to specific EIAs without considering their depth or objectives, focusing instead on the formal regime of trade preferences they establish.[8] The scope of an EIA may be regional or subregional, bilateral, between two groups of countries or between groups of countries and one country, or interregional. The concept of regionalism is a very broad one and may include EIAs signed by LAIA members but also those signed by them with other trading partners. Since each individual EIA establishes its own rules of origin, if a given country is participating in several EIAs, it will be simultaneously applying different rules of origin. The global pattern of rules of origin will become even more complex in the near future, inasmuch as it is expected that by 2005, 55 per cent of all trade in goods will be conducted under preferential arrangements, some of which are still being negotiated (Heydon, 2002). The greater the requirement for local inputs, the less favourable will be the EIA, with the small and less industrialized countries being the most affected by such arrangements.

In such cases, the higher the external tariffs of the EIA partners, the greater will be their impact (Krueger, 1995, p. 120). The inequitable distribution of benefits among production sectors, economic activities and countries has been studied by Garay and Estevadeordal (1996, pp. 16-17). In this respect, an ECLAC study (1994, pp. 78-80) stresses the importance of bearing in mind the danger that rules of origin could turn into a hidden tool for protectionism, leading to discrimination against those countries that are least able to take advantage of the potential offered by the expanded market. Consequently, although such rules are necessary, it may be advisable, in the interest of competitiveness and equity, to limit the requirements imposed. Thus, it is essential not to overlook the potentially asymmetrical effect that rules of origin might have among the countries of the region. This concern was also raised by SELA (1993), which drew attention to the fact that rules of origin could affect the countries with relatively less developed economies and less integrated industrial sectors.

The procedures associated with rules of origin in the EIAs in the Americas are asymmetrical and have been applied discretionally (Devlin and Estevadeordal, 2001). The matter of rules of origin is one of the most complex issues arising in the negotiation of an EIA.[9] Indeed, they are almost as important as the liberalization regime itself. In a free trade agreement (FTA), rules of origin are also designed to prevent triangulation or diversion of trade, i.e., shipping goods via a member with lower tariffs in order to gain access to a country with higher tariffs. The rules of origin applied under EIAs in Latin America are quite complex and diverse (IDB, 2002, p. 15), and more thorough studies are needed (Estevadeordal, 2002, p. 20).

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[8] There are differences of opinion in the specialized literature as to whether or not rules of origin are necessary in a customs union. See Asdrúbal (1978, p. 6), Celedón and Sáez (1995, p. 8), Meller (1996, p. 45), Izam (1997, p. 37).

[9] On the question of complexity in NAFTA (Canada, United States and Mexico), see Krueger (1997, p. 172).

It is possible, however, to minimize the costs involved in rules of origin under an EIA with a large membership by applying the criterion of regional cumulation in respect of intermediate goods and inputs from any of the members.[10] Thus, a trilateral EIA is preferable to a bilateral one if, for example, the rules of origin require 50 per cent of regional or local value added. In that case, if a country can only comply with 25 per cent, it can still use imports from the remaining partners amounting to at least 25 per cent, so as to meet the 50 per cent requirement. This question will be discussed in greater detail later on.

B. MAIN CHARACTERISTICS OF THE LATIN AMERICAN INTEGRATION ASSOCIATION (LAIA) AND ITS RULES OF ORIGIN

The Latin American Integration Association (LAIA) created by the Montevideo Treaty of 1980 provides that at least two of its members may enter into a partial scope agreement (PSA) whereby tariff preferences are granted to participants. A PSA is the equivalent of an economic complementation agreement (ECA).[11] There are currently around 55 ECAs, most of them bilateral. In the beginning, the idea was that the ECAs would eventually be turned into multilateral agreements, so they were all required to include a clause indicating that they would remain open to and subject to negotiation with any other member of LAIA. However, ten years later, the organization noted that there was a high degree of compartmentalization that was quite complex, both in terms of how the agreements were applied by the national administrations of member countries and in terms of how the economic agents in the region used them (LAIA, 1990, p. 1). The same document proposes certain measures that might be taken to make the existing ECAs more consistent, but so far not much progress has been made in that direction. The 1980 treaty also allowed LAIA members to establish EIAs with non-LAIA partners, subject to their complying with certain conditions relating to other LAIA members.[12]

In brief, the 1980 Montevideo Treaty allows for ECAs entered into under its legal covering to include certain provisions on specific issues, including rules of origin. That is why the LAIA agreement itself did not include rules of origin until seven years later, given that a number of different methods were already being applied in the existing ECAs. Thus, the first official LAIA rule of origin relating to trade in goods was established in 1987 (Resolution 78), and was designed to help unify, non-retroactively, the criteria applied by ECAs (LAIA, 1987).

This rule of origin established by LAIA is brief and general in scope.[13] It explains the criteria for determining when a good originates in a given member country. These criteria have to do mainly with goods that are wholly produced in a country, with changes in

[10] In the case of autonomous or unilateral contractual preferences, three types of cumulation are used: full, diagonal or partial, and bilateral or granting-country content (UNCTAD, 1998, p. 31).
[11] As an EIA, LAIA goes beyond the purely legal scope of an ECA. Indeed, there are also two other basic and parallel instruments, namely, the regional tariff preference (RTP) and the regional scope agreement (RSA).
[12] This has caused some problems, notably the problem created by the participation of Mexico in NAFTA.
[13] The entire text is only three pages long.

tariff classifications and with the stipulation that the CIF value at the port of destination or the CIF value at the maritime port of materials from third countries must not exceed 50 per cent of the FOB export value of the final good, or 60 per cent in the case of countries with relatively less developed economies. Allowance is made in specific cases for certain requirements to prevail over the aforementioned conditions; if such specific requirements are not included in the LAIA rule of origin, they must be approved by the LAIA Committee of Representatives. This is a good provision since it allows for an ECA to include special rules of origin by category or product based on the special needs of participating countries. The situation arises most often in the automotive sector (LAIA, 2001, pp. 114-115). It should also be noted that where cumulation is concerned, the rule provides that domestic or local value only applies to value generated in countries belonging to a given ECA.

The main problems that arose from the application of this rule had to do with the vagueness of the criteria for establishing the origin of merchandise that was not shipped directly from the exporting country to the importing country and to the fact that the rule did not accept the origin of a good when an invoice issued by a third country was attached to the certificate accompanying the merchandise, a practice that was fairly widespread practice throughout the world. LAIA took notice of these and other shortcomings in the rule and recognized that because of these legal gaps, members were interpreting the rule inconsistently and applying different and often inequitable criteria (LAIA, 2000). Some partial improvements were made, and the entire rule was finally updated in 1999, by Resolution 252.

The new rule, which is still in force, is more specific and less open to interpretation than the previous one, but is far from adequate in the present international context. This is so obvious that the aforementioned LAIA document suggests some additional improvements. More recently, LAIA (2002) also discussed the need to review a different problem area, i.e., that of intermediate materials and *de minimis* provisions. The latter term has to do with exceptions designed to allow for flexibility in the application of rules of origin. LAIA has also discussed the need to improve criteria relating to containers and packing materials for shipment, and packaging materials and containers for retail sale, a subject that is now included in most EIAs (OECD, 2002, p. 10).

If LAIA were to centralize these aspects, it would avoid having to deal with problems separately through the rules laid down in the different ECAs. This would be a positive step, not only because a standardized system would facilitate trade but also because a single rule would be less costly than the sum of expenditures involved in the ECAs (economies of scale). In brief, these rules will probably be updated in LAIA. In fact, it has been suggested that the present anachronism is partly responsible for the fact that some ECAs follow systems that are different from the LAIA system. This is the case, for example, of Mercosur[14] and the FTAs that Mercosur has entered into with Bolivia and

[14] In Mercosur (Argentina, Brazil, Paraguay and Uruguay) and in LAIA ECA No. 18, the general rule originally required a 50 per cent local content, with preferential systems for Paraguay and Uruguay, considering they were less developed. At present, however, they all include a standard requirement of 60 per cent.

with Chile, and of the ECA between Chile and Peru. Other ECAs have departed completely from the LAIA rule, such as the G-3 and the current Chile-Mexico EIA (ECA No. 41), which is different from the previous bilateral EIA between those two countries (ECA No. 17), which followed the LAIA rule.

The question therefore arises: if the LAIA rule was applied in the previous Chile-Mexico ECA, why does the current one depart from it completely? This is an important point, considering that these two countries are the LAIA members that have signed the most EIAs with countries inside and outside LAIA. Indeed, they are the only two countries in LAIA that have signed (separately) ECAs with the European Union and with Central American countries. Moreover, although Mexico is already a member of NAFTA, which includes the United States, the United States is about to sign an EIA with Chile, which has already entered into an FTA with Canada.

Although Chile and Mexico have very different interests when it comes to trade,[15] they have both made considerable progress in regard to customs reforms and modernization. Indeed, it is well known that both countries have been made great strides in their efforts to facilitate trade. Another reason why Chile and Mexico deserve special recognition is that they have increased their trade substantially and have very good prospects for their own mutual trade. In brief, the common experiences of these two countries would seem to point to the need to take another look at the rules of origin of the LAIA family and compare them with those of NAFTA and the EIAs signed by Chile and by Mexico with the European Union. These two countries may have made their choices based on better results than those obtained within the context of LAIA. A comparative analysis of rules of origin is presented in the following section.

C. THE THREE FAMILIES OF RULES OF ORIGIN

This section is divided into two parts. The first refers to the extent to which the families of rules of origin provide detail and clarity, while the second focuses on how the rules have worked under the circumstances prevailing in the international economy.

1. DETAIL AND CLARITY IN RULES OF ORIGIN

A common feature of the rules of origin of the NAFTA family and those of the EU family is that they were both negotiated for specific products. There are advantages and disadvantages to this approach. One disadvantage is that the negotiation process is protracted and complicated and the text produced is a very lengthy one. This can be a good thing, though, since the requirements for individual goods are very clear, leaving little room for interpretations that might create conflict. Thus, when requirements are spelled out product by product, the conditions that must be met are quite clear.

Fundamentally, the rules of origin applied by these two families do not have much impact on Latin American and Caribbean producers. Since most of them only sell a limited range

[15] In fact, while a high percentage of Chile's external trade in goods is conducted with members of LAIA, over 90 per cent of Mexico's external transactions in goods are with the United States.

of products, they only have to learn the rules of origin for the goods that matter to them; thus, dealing with these two families is quite easy. This is not the case with producers or exporters who sell a wide range of goods, of whom there are few in the region. Nevertheless, since they are usually large exporters, they have considerable experience in international trade, so the NAFTA and EU rules do not represent an impossible hurdle for them.

The LAIA rules of origin are different from those of NAFTA and EU in that they establish certain basic criteria for defining the nationality of products while allowing members to enter into separate agreements within the LAIA framework which provide for exceptions to be made in respect of certain products. The general criteria are quite basic, especially from the standpoint of compliance. This system is open to criticism, since it is very easy to meet the general criteria of origin. Thus, almost all goods traded under the EIAs are eligible for customs preferences. There is no provision for further screening to determine the exact nationality of a product. Such laxity leaves the rules open to different interpretations, so that sometimes they have to be brought before a specialized dispute-settlement tribunal.

Although the Chile-Mercosur EIA basically follows the general criteria of the LAIA family with regard to origin, it also has some similarities with the NAFTA family, since it includes specific rules of nationality for a wider range of products than other ECAs. A similar situation obtains with regard to the Chile-Peru EIA. The Chilean EIAs and the EIAs between Mexico and the Central American countries are closer to the NAFTA model, since specific criteria prevail over general ones.

2. ADAPTING RULES OF ORIGIN TO THE NEW INTERNATIONAL ECONOMY

Given that the LAIA rules of origin easily give rise to contradictory interpretations, it would appear that they are not sufficiently clear and predictable. This creates insecurity among the trade and production sectors of member countries, which means that external economic agents are not able to plan ahead their investment and production strategies. Obviously, those countries that have entered into a large number of ECAs are more vulnerable to the conflicts arising from the vagueness of the rules. Nevertheless, there are some advantages to having more general rules, since members of a given ECA are able to make exceptions. Even so, the rules should be further developed in order to prevent disputes.

The rules of origin established by NAFTA and the European Union are much more advanced than the LAIA rules. In fact, the lengthy texts containing the NAFTA and EU rules are not only more detailed and thorough, but they also include more specific conceptual definitions and procedural instructions. In addition, they include a greater number of criteria for establishing the nationality of merchandise; these criteria are explained in easy-to-understand terms, even in the case of subtle and seemingly insignificant details. They also cover a wide range of new issues that are only now being dealt with on the international economic scene.

All things considered, the NAFTA family seems to work better than the other two, since it includes an article spelling out the requirements that must be met by exporters in order to apply the *de minimis* criterion, takes a very useful approach to the cumulation method, and deals with fungible goods and materials. Considering the importance of these issues, we shall discuss each one, using the Chile-Mexico EIA as a point of reference.

(a) *De minimis*. Two criteria are used to allow for flexibility. The first provides that, with a few exceptions, a good is originating, even if it does not meet the change-of-tariff-classification requirement, if the value of all non-originating materials used in producing it is less than 8 per cent of the transaction value or, in certain cases, of the total value of the product. If the final product is subject to a value requirement and the non-originating value is no higher than one of the two 8-per-cent figures just mentioned, it may be imputed as originating. The second criterion has to do with goods that must meet the value requirement. In such cases, the merchandise does not have to meet the requirement if the value of non-originating materials is no higher than 8 per cent of the transaction value or, in certain cases, of the total cost.

(b) Cumulation. This point is not covered at all in other EIAs, since cumulation usually only adds value when merchandise or materials from other partners in an EIA are used in the final phase of production of the final good. This is the case with the Chile-Mexico agreement, but this EIA has an advantage in that it allows for a good to be considered originating even if it does not meet the rules pertaining to materials used in the final phase of production. Thus, when a material used in production of the final good originates in a third trading partner, that part of the material may be broken down and considered originating, and the same is true of all non-originating materials used, up to the first stage in the production chain. This criterion also operates in the Mexico-EU EIA, but individual partners may only impute values prior to the final stage of production when they are local and do not originate somewhere else.

(c) Fungible goods and materials.[16] The text of the Chile-Mexico EIA defines fungibles as goods that are interchangeable for commercial purposes when they have identical properties, i.e., it is not possible to differentiate between them by mere visual observation. This applies, for example, to products like coffee, when they are stored in the same place without making any distinction as to their provenance, since a centralized system is more profitable (economies of sale). Thus, if a country exports such products, it must comply with the rule of origin in order to benefit from tariff preferences, but in a case like this, since the originating goods are stored together with similar products that do not meet the rules, the exporter may not sell under a preferential tariff regime any amount above that which is truly originating. This EIA includes provisions for such situations, for which reliable documentation is required.

With regard to this point, some additional remarks are in order. The Chile-Mexico EIA is more advanced than the other ECAs under LAIA in that it is designed for present

[16] It is also worthwhile mentioning the criteria that apply to a final product that is liquid and consists of mixtures or combinations of inputs or intermediate materials.

economic conditions. Of the three families studied, LAIA is the one that has had the greatest difficulty keeping current; its rules need to be improved, taking into account the Chile-Mexico case and bearing in mind the possibility of extending cumulation under an ECA to value added throughout LAIA. The more product-specific the rules of origin are, the greater will be the effort the State must make to disseminate the relevant information to the private sector, so as to enable it to take advantage of the opportunities this opens up.

Finally, it is a mistake to think that a rule of origin that is thorough and detailed cannot also be clear and easy to understand. In order for such a rule to work properly, however, more sophisticated and efficient system of negotiation and implementation is required. This strengthens the argument that attention must be paid to the procedural aspects of rules of origin in EIAs; in the absence of expeditious mechanisms, even the clearest rule would not only be inoperative but would actually complicate trade. This observation leads us directly into the next chapter, in which the focus is on trade facilitation.

III. ADMINISTRATIVE PROCEDURES

This chapter, which continues with the comparison between the three families of rules of origin, is divided into two sections. The first refers to the issuance of certificates of origin. The second deals with customs procedures pertaining to oversight, control and verification of origin, as well as the legal implications of non-compliance.

A. ISSUANCE OF CERTIFICATES OF ORIGIN

As mentioned above, in order to be eligible for preferential tariffs in an EIA arrangement, the exporting country must make a statement on a certificate of origin especially designed for this purpose, to the effect that the good meets the requirements regarding origin. In this section, we explain the differences in procedures for issuing such a document. In addition to the formalities themselves, there are also differences in the financial and legal implications of this procedure. So far, no best procedure has been devised for issuing certificates of origin that also enhance trade facilitation. As noted below, the discussion on this point has not ended.

1. THE LATIN AMERICAN INTEGRATION ASSOCIATION

In this case, certificates must be issued by a single public authority, which is always named in the text of the EIA. However, this authority may delegate this duty by signing it over to a national producers' or exporters' association. This has been done for raw materials, intermediate products and manufactured goods. In the case of more complex goods, such as those pertaining to health or sanitation, the public authority may delegate this duty to a specialized technical institution. In any event, the certificate of origin must be reviewed and signed by the public institution, which always bears final responsibility for the certificate. Under LAIA, a separate certificate of origin is required for each commercial transaction.

Consequently, all ECAs under LAIA require that every partner belonging to the ECA must state which of their officials are authorized to sign the certificates. As regards the form, the countries must provide LAIA and its individual members with a list of authorized signatures. They must also report, in timely fashion, any changes to this list, in order to keep the information up to date. This requirement is not always met, however, and problems arise because the signature that has been officially reported is not the one that appears on the certificate of origin received by the importing country.

In such cases, the authority in the importing country rejects the certificate of origin because it has not been properly issued. Thus, because of negligence on the part of the public authority, the process is inefficient and will not improve until the situation is officially corrected. This causes unnecessary expense and delay for importers, through no fault of their own. The same problem arises when the authorized official is sick or on leave, and the document is filled out and signed by someone else who is not qualified to do so and whose name probably would not even be included in an updated list of authorized signatures. This procedural problem, which may also be attributed to inefficiency on the part of the authorities responsible for monitoring the export transaction,[17] complicates trade not only for importers but also for the public sector of the country concerned, which has to clarify the situation.

The clarification process usually takes time, since exporters, acting through their customs agents, are required to re-apply for the certificate of origin in their country. The exporter usually covers the cost of this application,[18] which in some countries is slowed down by excessive red tape. This is not the case with Chile, where SOFOFA, the main private certifying agency, which deals with over 90 per cent of exports of goods to LAIA countries, has made significant progress in streamlining the process, which is now fully computerized. However, the fact that electronic signatures are still not accepted in all LAIA countries is a hindrance, preventing SOFOFA from issuing the document more efficiently and making it necessary for the exporter to pick it up personally. Rapid approval of electronic signatures by LAIA would greatly facilitate this whole process.

Another important aspect of the Chilean arrangement is that SOFOFA works with a high degree of professionalism; its customs agents require producers to provide the information considered necessary to verify whether or not the product complies with the rule of origin. Some Chilean exporters object to this, although one might think the opposite would be the case, i.e., that they would be interested in promoting the country's international image. The strategy implemented by the Chilean authorities has clearly brought savings that significantly benefit the country, in both the private and the public sectors, over the short, medium and long terms.
It is important, however, to consider the criticisms put forward by some in the private sector, who believe that SOFOFA is overzealous, given that the standards it enforces are

[17] Problems with certificates of origin are also caused by other factors which, to a greater or lesser extent, affect all the EIAs considered in this study. For example, the complications that arise when merchandise passes in transit through a third country, when different criteria are applied for customs valuation or for defining product categories or classifying goods.
[18] At a cost of about US$ 10 per transaction, 2% of which is for public-sector oversight.

high compared with those applied by certifying agencies in some other LAIA countries. This is clearly unfair to Chilean exporters, as well as to importers, who face the risk of having to pay customs duties, as they do if the customs authorities of their country doubt the origin of a product. Moreover, any suspicion by the authorities of an importing country that the exporting country has issued a certificate of origin containing errors, of content or of form, has legal implications for the public authorities of all members of the ECA.

An efficient and suitable solution to this whole issue would be for LAIA to take such institutional measures as may be necessary to raise standards and make them consistent, and to require compliance with those standards by all authorized domestic certifying agencies, ensuring that the criteria used are equivalent in all cases. This would also improve the economic image of the region as a whole on the international scene, with all the benefits that would bring. It would also be a good thing for the individual members of LAIA.

2. THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

The NAFTA system is radically different from the one applied by LAIA. The underlying philosophy in NAFTA is that the role of the public sector should be minimized in order to allow for greater participation by the private sector; this is based on the assumption that the fiscal authority trusts the private sector to perform this role effectively. Thus, the method applied is self-certification, which means that the certificate of origin is issued directly by the exporter or the producer who sends the product to the EIA partner. In this process, the authorities of the exporting country do not participate and are not responsible for the form or the accuracy of the information provided in certificates. This system is more efficient that the one applied by LAIA, since it is more expeditious. Another advantage over LAIA and EU, where a separate certificate has to be issued for every transaction, is that in NAFTA the certificate is valid for similar transactions over a period of one year. This is significant inasmuch as it greatly reduces transaction costs to private agents and thus facilitates external trade.

Another positive aspect of NAFTA is that when questions arise concerning origin or possible fraud, the responsibility falls on the individuals concerned, not on the EIA signatories. This means that the problem is not a matter of public law, as it is in LAIA and EU, but rather it must be settled under private law, since it is the entrepreneurs themselves who have to deal with it. For a variety of reasons, it is better if the dispute is between individuals than between governments, especially since it is desirable to avoid unnecessary friction, with the resulting political cost to government authorities of the EIA signatories. The economic cost of non-compliance with origin requirements is borne by the importer, who is not legally liable unless it is demonstrated that he or she participated in a fraudulent action, in complicity with the exporter. If documents are altered or an offence is committed, the issuer of the certificate of origin, i.e., the exporter, is always held liable under the law.

The text of the NAFTA rule of origin clearly stipulates that in such cases, both the importer and the exporter must be prosecuted under the legislation of each of the countries involved. Every country that has entered into an EIA of this type has legislation in force for punishing importers. However, that is not the case when it comes to prosecuting exporters, as is the case of Chile. Indeed, even though Chile has signed EIAs with Canada and with Mexico, it still has not enacted legislation to prosecute exporters who commit this type of offence. Consequently, the aforementioned EIAs tend to favour the Chileans; unless changes are made, that will be the case with the EIA that Chile is about to sign with the United States.[19]

Another positive aspect of rules of origin in the NAFTA family of EIAs is the fact that, although, as in LAIA, there is a specific administrative committee for each EIA, in NAFTA there are also other special committees, one of which deals with trade in goods. This committee has four subcommittees, two of which are pertinent to our discussion, i.e., the committees on customs and the committee on rules of origin. Both have clear objectives and meet regularly or at the request of a partner. These bodies are very important from the standpoint of trade facilitation. It is a great advantage to be able to identify problems quickly and work on settling disputes as soon as they arise.

Despite the aforementioned positive features of the NAFTA arrangements, there are some problems. These arise from the fact that the declaration of origin can easily be altered by producers or exporters in order to make it appear that their goods are in compliance. Partners in an EIA may apply two types of controls, which are basically different in terms of their form and their substance. The first works through the private sector and the second through the public sector.

It should be noted that the private sector is implicitly encouraged to exercise oversight by the very philosophy underlying the NAFTA system. To the extent that NAFTA delegates oversight responsibilities to the private sector, it is trusting that private economic agents will want to implement the best possible controls. There are two different ways to exercise this oversight. Firstly, when a producer or exporter expresses misgivings, having information that causes them to suspect or know that a domestic competitor is exporting goods under the tariff preferences of a partner country but that the product in question does not really meet the origination requirements. Secondly, when a producer or importer in the importing country who is a competitor of the firm carrying out the transaction, suspects that a product imported with tariff preferences does not meet the origination requirements for such preferences. In other words, they believe they are the victims of unfair competition.

All this is based on the assumption that both the export and the import markets operate with absolute transparency and that there is a free and timely flow of information between economic agents. It is further assumed that importers in one country have full confidence in exporters in the partner country; otherwise, if it were shown that there was

[19] The relevant bill, which was drafted after Chile had signed an EIA with Canada, is still pending in the Chilean legislature, along with other bills relating to commitments undertaken by Chile in connection with some of the Uruguay Round agreements.

fraud on the part of the exporters, they (the importers) would have to pay non-preferential prices for their imports. This would not be profitable, since the actual cost of the product would be higher than what they had expected to pay with the tariff preferences, causing them to lose their competitive edge on the local market. The system is not as equitable as one might think, since it is based on the assumption that an economic agent – large or small – who is affected by unfair practices would have the necessary information, time and money to detect irregularities and take action, and this may not always be the case.

The second type of control is that which is exercised by the public sector. In this regard, it may be worthwhile to touch briefly on a few matters that will be discussed more fully in the next section. These issues have significant implications, especially for the less developed countries. Since the emphasis in NAFTA oversight is on the private sector, the public sector does not play as strong a role in that regard as it does in those families of rules in which the public sector of the importing country plays a vital oversight role. This is the case especially in countries where the public sector does not have the human, economic and electronic resources needed to implement oversight efficiently.

Since public oversight by customs authorities is selective on the matter of origin, no matter how efficiently they may work, they will never be able to guarantee that every case of fraud will be discovered. The fact that up to now very few disputes have arisen in connection with the Chile-Mexico EIA may be interpreted as an indication either that the system has worked well or that it has not allowed for problems to be identified. This is vital, given that not failure to discover a customs offence regarding origin has a social cost for the importing country as a whole. Consequently, the NAFTA family requires, especially in the case of developing countries participating in this type of EIA, that these countries strengthen their customs oversight capacity, in order to improve efficiency. In order for this to be possible, the countries need to develop the necessary administrative and technical capabilities. This means, inter alia, that they need financial resources in order to train the staff needed and improve electronic systems for ensuring the accuracy of controls.

3. THE EUROPEAN UNION FAMILY

As expected, the procedure for issuing certificates of origin in this family is more like that used in LAIA than like NAFTA. No provision is made for self-certification, given that the participation of public agencies is required. Although in practice certificates of origin are filled out by exporters, they must be endorsed by a public agency, particularly as regards content. Unlike the situation in LAIA, no private entities are authorized to perform this task. During the negotiations on this issue, the Chileans argued that their public sector did not have the economic capacity necessary to take responsibility for all these duties. They managed to get the European Union to agree that private subcontractors could be hired to fill out the certificate of origin, provided that they would be subject to oversight by the public agency, which would still have the ultimate responsibility in the matter. This was the first time such an arrangement was allowed under an EIA with the European Union.

In the European Union family, whenever the authority of the importing country discovers a problem with a certificate of origin, the importer is held liable and is given 30 days to complete a new certificate, which must be requested from the exporter. When this has happened in Mexico, the Mexican importers have had tremendous problems getting a new certificate of origin from exporters in the European Union, who usually either do not send it at all or do so after the deadline. In such cases, the Mexican customs authorities require the importer to pay the full tariffs. This creates uncertainty about the future among importers.

According to the Mexicans,[20] the reason some European exporters are reluctant to correct a certificate of origin or send a new one is that they are not willing to incur the costs involved in the additional procedures, since that would reduce their profits from the export transaction. Some of the European exporters claim that the Mexican market is not very important to them. The question arises as to what will happen with the Chile-European Union EIA, since the Chilean market is even smaller than the Mexican one. It might be possible to correct this asymmetry, which works against the countries with smaller economies, by amending the texts of the two EIAs to include a clause requiring exporters to complete the certificate correctly. This would facilitate mutual trade and offer greater stability to importers. We will return to the matter of EIA renegotiation later on.

When the government agency has substantive questions about the origin of a given merchandise, it cautiously requests information from the public institution of the exporting country. If after a proper investigation, this entity finds that the origin of the product was correctly stated, the public authority of the country requesting verification usually accepts that reply. One might wonder about this procedure, but the system works this way because of the implicit trust between the official parties concerned, usually the customs authorities.[21] Questions may still arise, given that neither the form nor the depth of control is clearly stated. Moreover, the governmental agency responsible for oversight of exports is carrying out a formality, at the request of the importing country, which is viewed almost as a favour or a diplomatic gesture of good will.

In fact, the application of rules of origin in the texts of EIAs between LAIA members and the European Union is referred to as administrative cooperation, and is even viewed as mutual assistance. In the NAFTA family, on the other hand, the text refers to customs procedures. In the two families mentioned, the issue is raised towards the end of the text, which refers solely to the implementation of procedures. In LAIA, where procedures are not included in a separate section of the rules but rather at the end, it is understood that procedures will be implemented in the context of administration rather than of cooperation or mutual assistance.
This suggests that up to now LAIA has underestimated the matter of trade facilitation, at least where origin is concerned; so have most of the member countries, since practically

[20] Personal interviews conducted by the author of this study with individuals in the public and private sectors of Mexico.
[21] Except in the case of Chile, in respect of which the European Union agreed that this responsibility would be assumed by the Ministry for Foreign Affairs through its Directorate of Economic Affairs.

all their ECAs follow the LAIA pattern of not putting operational procedures in a separate section. This shows that they still have difficulty identifying the analytical differences between the rules and their application so as to ensure that they complement each other efficiently.

In the EU family, certificates of origin have to be issued on paper of a certain colour and quality, which are clearly spelled out.[22] This is done as a precaution against forgery. However, this creates some problems, since there is not much chance that this format could be used with electronic signatures; also, the right certificate might not always be available on the market. It is sometimes possible to get around this problem by using certificates that are similar but not of the colour stipulated in the EIA. This situation has arisen often with Mexican imports of goods from the European Union, causing unnecessary delays and cost to importers, several of whom have had to pay the full customs duties when no solution was found.

Finally, we shall refer to the issuance of certificates of origin in existing EIAs or those under negotiation which involve LAIA members but envisage procedures other than those of the three families considered above. We shall begin with the EIAs signed by Chile with Mercosur and with Peru, which apply a NAFTA-type procedure in addition to that of LAIA. In these EIAs, exporters request the certificate of origin from the specialized agency authorized by the corresponding public entity (LAIA), for which purpose they must submit a sworn statement that includes background information to support their claim that the merchandise in question meets the origin requirements of the EIA. This means that, to some extent, the direct producer or the exporter of the merchandise is also held accountable for the accuracy of the claim of origin. It may also be an indication that the LAIA criteria in this regard could be improved.

Secondly, there is the case of the EIA between Chile and the Republic of Korea, which provides the first example of a mixed system for issuing certificates of origin. Products that are exported from Chile to the Republic of Korea are self-certified, while the certificate of origin for products exported from the Republic of Korea to Chile are issued by the public agency in the Republic of Korea. This solution satisfies both parties, since both the Government and the importers in the Republic of Korea trust the Chilean exporters. Chilean importers are also satisfied, since they would rather have a public authority be responsible for issuing certificates of origin for exports from the Republic of Korea. Both the Government and the exporters in the Republic of Korea feel the system works well – the Government, because it ensures that the country projects a good image, and the exporters, because they avoid costly procedures and simplify their operations.

In the third place, the question of origin has been the subject of an ongoing discussion in the negotiations to establish the Free Trade Area of the Americas (FTAA).[23] The main problem that has to be addressed is the issue of administrative procedures, given that a decision has to be taken as to who should be responsible for issuing certificates of origin.

[22] The format of the certificate of origin is similar to that which has traditionally been used in the LAIA countries for goods to enter the European market through the GSP, although the colours are different.

[23] FTAA would include all LAIA members except Cuba.

In the final draft of the FTAA text (FTAA, 2002), the chapter on rules of origin has not yet been fully developed; although some significant progress has been made,[24] much remains to be done before consensus can be reached. The same is true of the chapter on customs procedures, where some countries hold very different positions. The most controversial issue is that of the form of certificates of origin. For example, Canada, Chile and Mexico are in favour of self-certification, while Mercosur and CAN insist on using their own systems.[25] The biggest surprise is the position of the United States, which wants the certificate to be issued by importers.

The United States proposal has a positive side and a negative side. The positive aspect is that the importers themselves will always be responsible for bearing the economic and legal costs, as the case may be, of an improperly issued certificate of origin; consequently, it will be in their interest to ensure that proper procedures are followed. This argument is based on the fact that some United States importers do not have full confidence that self-certification would work in the 34 countries that would comprise FTAA, given that most of them have not enacted legislation to punish customs fraud committed by exporters.[26] The negative aspect of the United States proposal is that it is difficult for importers to obtain the information needed to verify compliance with origination requirements, since that information must come from the exporting country.

Clearly, this negative aspect is not an insignificant matter. Aside from the positive aspect of the proposal, this procedure could further complicate mutual trade in goods in the framework of FTAA and actually discourage transactions. Finally, it should be noted that what is happening in FTAA on this issue is typical of what is happening in other spheres of negotiation, given that it is still not clear which one of the existing procedures is best or whether it would be preferable to combine several of them. More thinking is required in order to clarify the remaining questions.

B. CUSTOMS OVERSIGHT, VERIFICATION AND CONTROL

1. CUSTOMS OVERSIGHT IN GENERAL AND IN REGARD TO ORIGIN

In the past, customs agencies throughout the world focused mainly on oversight duties aimed at preventing fraud and smuggling and ensuring the collection of taxes on imports and exports. Indirectly, customs enforcement also helped improve the collection of domestic taxes levied when a product entered the national territory. Although customs agencies are still responsible for enforcement and oversight, the importance of these duties has lessened over time. Customs is an age-old institution and must evolve in order to keep up with the times.

In this regard, two crucial issues must be considered. In the first place, at present there are virtually no customs duties on exports; those that still exist are an exception, and

[24] An ad hoc group was set up in September 2002 to examine the LAIA rules of origin. In this regard, see Cerro (2002).
[25] CAN is made up of Bolivia, Colombia, Ecuador, Peru and Venezuela.
[26] As far as legislation is concerned, those countries have still not advanced as much as Chile.

under binding agreements already in force in WTO, they are slated to be eliminated in the near future. Moreover, the collection of customs duties has become less important owing to the significant reduction, throughout the world, of import duties, thanks to the progress made in the Tokyo and Uruguay rounds, the last two conducted by what is now WTO.

The second point is that customs authorities have gradually been taking on an additional responsibility which has now become a central one, owing to the need to modernize their operations. They are striving to facilitate administrative procedures relating to external trade, the volume of which has grown dramatically in recent decades, especially as a result of the liberalization processes mentioned above. The basic purpose of this effort is to reduce the transaction costs of internationally traded goods by expediting procedures. The globalization of the international economy makes it all the more necessary to facilitate customs procedures. It should be borne in mind that the forthcoming WTO negotiations on facilitation of customs procedures may result in binding multilateral rules in this regard.

Recent advances in technology also point to the importance of customs procedures in trade facilitation. Thanks to the latest generation of electronic processes, the quality of customs operations can be greatly improved; this will automatically improve the efficiency of oversight, given that the two processes are interrelated. This will make it possible to reduce customs fraud and offences, discretional application of rules and corruption among customs officials, and to streamline customs procedures relating to international trade. The adoption of up-to-date technical and administrative tools enhances customs oversight, and this in turn affects all other customs operations, including those relating to trade facilitation.

Customs oversight is a broad category of activities carried out in every area of customs work relating both to exports and to imports. Imports receive more oversight, given that they entail bringing goods into the national territory. One of the main subjects of oversight where imports are concerned is that of valuation of merchandise, the purpose of which is to prevent over- or under-invoicing and to identify practices that might involve unfair competition. Another central area of oversight has to do with whether or not a given product meets origination requirements, especially if preferential tariffs are being requested.

Since there is no real need for oversight of exports, as far as origination is concerned, they are not inspected. Hence, the discussion of oversight regarding origin only refers to imports. There are different ways to conduct oversight, and the specific tasks involved in each case may be carried out simultaneously or separately; each one is important in itself. There are four main types of customs oversight; three involve random inspections, while the fourth is a non-random and simpler, more routine, inspection. These tasks are described below, in non-hierarchical order.

The first type of oversight, which is not random, is physical inspection, also referred to as physical appraisal. This consists of a rapid inspection by a customs agent (when the merchandise does not arouse suspicion), with documents in hand, of the merchandise

imported. This inspection is carried out as soon as the shipment is unloaded. A second type of inspection, which is carried out on a random basis, begins before the product reaches the border. This consists of performing a computer analysis of risk, using a program that has previously been fed with pertinent information obtained by the customs authority and with documents associated with both the specific import and previous imports shown in the importer's history. This analysis may point to the need for a more exhaustive physical appraisal to be conducted once the import arrives. In this case, the physical inspection itself is similar to the first one described herein, but it is more thorough.

A third type of oversight, which is also random, consists of putting the imported merchandise (which has already been through the preliminary inspection) through a process of selection by the red light/green light method. If the red light turns on, a more thorough inspection is carried out, similar to the second type just described. The fourth type of inspection is different from the other three in that the others are all conducted upon arrival of the merchandise, whereas in this case, the inspection, also random, is carried out after the goods have been removed from the customs area. The public authority usually has up to three years in which to complete this inspection. Since it involves reviewing documentation, all documents relating to the import must be kept for five or six years, as stipulated in the legislation of the importing country. Either the customs agent in charge of the commercial transaction in question, or the importer himself, is responsible for keeping a record of the relevant data. The random aspect of this inspection is quite interesting, since it involves a broad set of variables that are all fed into a complex computer programme.

Some general comments are in order with regard to the above oversight activities. Firstly, in order to ensure efficiency, the customs authorities need financial resources so as to be able to acquire the necessary technologies and hire a professional staff of agents specializing in the different economic sectors. This is not easy, given the limited budgets of the customs authorities in the region. Secondly, since customs oversight is carried out by a State agency, financing should not be subject to a cost-benefit criterion, although this is usually what happens. In fact, there are even cases in which the continuation of an investigation is made contingent upon a cost-benefit criterion, i.e., the commercial transaction must be a fairly large one and there must be a high probability of fraud, or even an assurance of a positive finding. In such cases, there is a direct relationship between the difficulty of enforcing origin requirements and the magnitude of the economic cost associated with oversight. To get around this and avoid exhaustive oversight, some importers have chosen to carry out several small imports instead of a single large transaction.

The third comment applies to cases where a country has several ports of entry for merchandise and hence, several customs facilities. If rules of origin are vague and open to interpretation, the customs agents posted at the different points of entry might apply them discretionally, i.e., different ports might apply different criteria, and this can lead to discriminatory or unfair treatment. Fourth, the countries use all the aforementioned types of oversight regardless of whether the rules or criteria for determining origin are specific to a given country or are part of an EIA arrangement.

The fifth comment is that there is a direct relationship between the difficulty of enforcing rules of origin and the number of EIAs a country has signed.[27] Moreover, there is an reverse relationship between the number of EIAs a country has signed and the extent to which trade is facilitated.[28] And finally, it is pertinent to mention that in addition to the oversight methods described above, the EIAs have also set up their own oversight procedures. This is the subject of the next section.

2. OVERSIGHT AND VERIFICATION OF ORIGIN IN ECONOMIC INTEGRATION AGREEMENTS AND LEGAL IMPLICATIONS OF NON-COMPLIANCE

Although some of the topics covered in this section have been mentioned separately above, we shall now take a more systematic approach.

(a) The LAIA family. This system has limitations when it comes to oversight. Verification of the origin of merchandise takes place when a country belonging to an EIA considers that a certificate of origin filled out by an authorized trade organization and issued by the competent public authorities does not meet the substantive requirements of origin. The authorities of the importing country report this to the public agency of the exporting country, so that it can take such measures as it deems necessary to solve the problem. As far as the importing country is concerned, it is allowed to apply the necessary fiscal safeguards.

This is the only verification process provided for in the LAIA family, and this is clearly a weakness. Thus, a unilateral interpretation can lead to disputes because there are no criteria on how to proceed or what action should be taken. No time limits are established, and there is no indication as to what body should deal with the problem. These shortcomings have made it necessary for all the ECAs in LAIA to try to fill the gap left by these omissions; as mentioned earlier, this effort would be facilitated if there were a clearer general rule on the matter in LAIA.[29] An example illustrating this situation is provided at the end of this section.

(b) The NAFTA family. In this system, the importing authority may request the exporter to provide information on the origin of a good. Three non-exclusive procedures may be followed: written questionnaires may be sent directly to producers or exporters; verification visits may be made to an exporter or a producer, in order to examine the documentation showing compliance with the rules and inspect the facilities used in producing the merchandise and, if necessary, the locations where the materials are produced; and other procedures may be followed as agreed by the partners. The first of these is used most often, and the third has not yet been used.

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[27] Interviews conducted by the author with some Chilean officials in this area showed that this is the situation in Chile. This is evidenced in the fact that Chile is presently working with eight different types of rules and formats for certifying the origin of a product.

[28] This was also confirmed by the author in personal interviews with people in the private sector of Chile.

[29] It should be noted that practically all the 55 ECAs have created their own dispute-settlement tribunals. This is clearly more costly than it would be to have a single central tribunal.

The least used procedure is that of verification visits. It would appear that the questionnaire has proven quite adequate, so visits have only been necessary in special cases. However, that is not necessarily true. It should be borne in mind that in order for direct verification to take place, the importer, through the competent customs authority, is required to notify in writing its intention of carrying out a visit. This notification must be sent to the exporter or producer and to the customs authority in the exporting country. Finally, the customs authority must obtain the written consent of the exporter or producer. If this authorization is not received within a given time limit, which is set by the parties concerned, imports will not be subject to the tariff preferences established in the EIA. This directly affects the importer, who will have to pay non-preferential tariffs.

The verification visit is conducted by customs officials from the importing country. However, the exporter or producer is entitled to appoint two observers to be present during the visit, strictly as observers. If the customs authority of the importing countries finds that there has been non-compliance with origin requirements, before that finding can be implemented, both the importer and the person who filled out and signed the certificate of origin must be notified. As far as the legal aspects are concerned, each trading partner applies the penal, civil or administrative sanctions provided for in its domestic legislation or regulations. Should it be necessary, the parties can always resort to a specialized agency to settle the dispute. In that event, the parties may choose whether to use the institutions established under the EIA or those of the WTO.

In brief, a verification visit involves the participation of a team of highly specialized officials of the importing country's customs authority. Such a visit lasts on average around four working days. The process entails a considerable financial cost, including not only the air fare and subsistence expenses for the visiting officials, but also the cost of the officials' absence from work at their own customs facility. This may be why the system is not often used, given that the cost of using questionnaires is much lower. One might conclude that the few problems that have arisen regarding origin in this family are caused by the weaknesses in the oversight system which does not have the level of financing that might be required.

This may be the case with the Chile-Mexico EIA. Chile tries to avoid these visits, either because of the expense involved or because the transaction which is the subject of inspection does not involve large sums; in addition, there must be some assurance that the visit will make it possible to identify non-compliance. Despite the tremendous efforts that have been made to improve the budget of the Chilean customs authority, the financing available for oversight is still inadequate, and this affects the number of visits to be made, especially when there are also budgetary restrictions relating to the performance and results of oversight regarding origin. In other words, careful consideration has to be given to the question of whether or not an inspection visit is worth the expense. This is also the case with Mexico, although to a lesser degree. All this should be taken as an important warning for FTAA. Indeed, if the developing countries have budgetary restrictions which hinder customs oversight, they should be concerned about the possibility of the NAFTA system of inspection visits being carried over to FTAA without some kind of adjustments and safeguards.

In the case of Chile, there is another factor, involving pressure, that discourages efficient oversight. If the customs authority does not meet a certain economic goal for revenue collections resulting from oversight, the staff will not receive an annual bonus (an additional month's salary). This bonus is given to the staff when they surpass the goal. Moreover, although the budget is not quite as limited as in the past, the Chilean customs authority still has difficulty purchasing equipment and up-to-date computer systems. It is still understaffed, so there are not enough qualified officials to improve the efficiency of oversight activities that could make expensive verification visits unnecessary.

Finally, it should be borne in mind that it is not enough for rules of origin to be properly negotiated and clearly established in the text of an EIA if the text does not describe in detail the administrative procedures to be followed in order to implement the rules. In addition, the types of oversight provided for in EIAs should be "user-friendly". In brief, the administrative procedures involved in implementing rules of origin, which are so important to trade facilitation, play a fundamental role in determining whether rules of origin, seen as a whole, are truly effective.

(c) The EU family. In this case, the competent national authorities are responsible for issuing certificates of origin and for taking the measures necessary to verify compliance. They are empowered to require any kind of proof and to inspect exporters' books as well as to carry out any other kind of verification they may consider necessary for a proper investigation. Verification itself is conducted at random or whenever the authorities of the importing countries have reasonable questions about the form of the certificate of origin.

When there is suspicion regarding the content of the certificate, the customs authorities of the importing country must return the relevant documentation to the authority of the exporting country, stating the reasons why an investigation is in order and attaching all necessary background information. All this documentation is sent along with a request for a posteriori verification. The authorities of the exporting country then conduct the investigation as they see fit. During this process, although questions may be raised as to whether the authority of the importing country is taking a passive approach, it is empowered to temporarily suspend preferential tariffs for the products under investigation.

The authority of the exporting country must present a report to the importing country as soon as possible and within 10 months at the latest. If the reply is received in time and suspicions remain, the tariff benefits may be permanently suspended. The 10-month deadline seems too long from the standpoint of trade facilitation. If the authorities involved do not reach an agreement after the verification process has been completed, the case must be submitted to the ad hoc committee on customs cooperation and rules of origin of the EIA. This is a limitation resulting from the fact that customs procedures in this family of rules of origin fall within the scope of "administrative cooperation".

If the dispute continues after verification, it is not taken to a dispute-settlement tribunal, as would normally be the case in an EIA, but rather to the aforementioned committee.

The duties of this committee have not been explicitly spelled out, even though it is similar to the NAFTA body mentioned earlier, except that the NAFTA one has clearly stated objectives. In order to avoid diplomatic conflicts and political friction between signatories of an EIA, the importer may, at its own Government's suggestion, cover economic costs that are not really its responsibility. Finally, differences between importers and their national authorities are settled in accordance with the domestic legislation of the country concerned.

Finally, from the standpoint of oversight and verification of origin in the EIAs studied, as well as of the legal implications of non-compliance, it is obvious that overall, NAFTA, even with all its weaknesses, is the most efficient system; it is followed by the EU, with LAIA coming in third. NAFTA and EU can be improved without too much effort, in order to facilitate trade. The weaknesses of LAIA in this regard seem to point to the need for more radical change.

One example of the weakness of LAIA is illustrated by the EIA between Chile and Mercosur. This EIA includes a section on oversight and control relating to rules of origin which basically is taken from the NAFTA family. However, owing to lack of experience, the signatories did not clearly define the time limits for certain procedures. The shortcomings in this ECA have led to considerable friction between the partners, to the point that they have had no choice but to renegotiate the agreement.

The more general issue of renegotiation of an EIA is discussed in Box 1. In this particular case, according to the Chilean negotiators, the renegotiation, which began quite some time ago, will last for several months more, at considerable economic cost. The entire chapter on rules of origin of the ECA will have to be redrafted; that task is currently being carried out by Chilean professionals. The process will be a lengthy one, given that each of the four Mercosur countries must first approve the changes, after which they must all agree, and the negotiations will continue until consensus is finally reached with Chile.

Box 1

GENERAL CONSIDERATIONS ON THE RENEGOTIATION OF A PREFERENTIAL TRADE AGREEMENT

No matter how insignificant the text to be amended may seem once an EIA is signed, the amendment process is quite costly in terms of time and money. This is a matter that should be considered in advance. This also applies in the case of rules of origin, in respect to both content and form; when new elements are included, the formal aspects of the rules must also be revised, or new points may have to be added. For obvious reasons, the cost of the process is directly related to the number of countries belonging to an EIA, as well as to the complexity of the issues to be renegotiated and the number of formalities that must be complied with.

Certain points that at first seem to be insignificant will often turn out to be extremely important. Indeed, this is often the case with simple details, administrative processes or procedures, which however are of vital importance to ensure that the EIA as a whole will work efficiently. An EIA is essentially an unfinished and perfectible phenomenon and should therefore be drafted in such a way that it can be changed on a regular basis in order to ensure that it fits the changing environment in which it operates. When the changes relate to issues or procedural aspects that could not have been foreseen at the time the original agreement was negotiated, these problems should be rectified as soon as they are identified. It makes sense to anticipate the costs that arise from the need to renegotiate specific points or the EIA as a whole.

Experience shows, however, that this is not often done. What usually happens is that during the initial negotiations, the importance of certain aspects is underestimated, although the negotiators may be aware of them. Sometimes they do not realize that some issues raised in the text could create an unnecessary bottleneck. This is often due to the fact that, when faced with political pressure to sign an EIA quickly, the negotiators do not have time or are not able to cover all the details as thoroughly as necessary in order to facilitate mutual trade in the future.

In such cases, it might be better to address difficulties that arise during negotiations and to think strategically about every detail, even if this takes longer. Otherwise, it will be necessary later on to make changes that could have been anticipated and avoided before the EIA was signed, with all the cost that renegotiation entails, especially when several countries are involved. At any rate, if an EIA has to be signed quickly, for political reasons, without allowing the necessary time for the negotiators and the private sector of the economies concerned to review it thoroughly, it would at least be a good idea to make allowances for the expense that will be incurred by the inevitable renegotiation.

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