1216-2574/USD 20.00

ACTA JURIDICA HUNGARICA
51, No 4, pp. 273–291 (2010)
DOI: 10.1556/AJur.51.2010.4.3

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Rules of Origin under U.S. Trade Agreements with Arab Countries: Are they Helping and Hindering Free Trade?

Abstract. Rules of origin mechanism used to determine the origin of a product. Rules of origin serve many purposes such as collecting data on trade flows, implementing preferential tariff treatment, and applying anti-dumping duties.[1] Rules of origin can be divided into preferential and non-preferential rules. Preferential rules of origin are used to determine whether a product originates in a preference-receiving country or trading area and hence qualifies to enter the importing country on better terms than products from the rest of the world.[2] Non-preferential rules of origin are used for all other purposes, including enforcement of product- and country-specific trade restrictions that increase the cost of, or restrict or prevent, market entry. Preferential rules of origin differ from non-preferential ones because they are designed to minimize trade deflection.[3] With rapid increase of bilateral and regional trade agreements, the role of rules of origin has become more evident. In the context of bilateral and regional trade agreements, rules of origin prevent free-riders from enjoying the benefits negotiated between the countries concerned. In other words, once the origin of a product is known, a country can extend the benefit of its free trade agreement to its trading partners thus excluding non-partners. In principle, rules of origin are supposed to be straightforward and easy-to-follow methods used to determine origin especially when a product is manufactured in one country, which rarely happens in reality. However, more than often, rules of origin are complex and protectionist method used a barrier to trade. As another case study, the purpose of this article is to examine rules of origin in the U.S.–Arab countries free trade agreements (FTAs). The article begins with a brief discussion of the concept of free trade, its evolution through the GATT and then the WTO, and the recently concluded FTAs between the U.S. and Arab countries. Then, in section three, the article analyzes in details rules of origin in the U.S.–Arab countries FTAs. The analysis includes, among other things, substantial transformation and value-added tests, product specific processes, and other relevant rules of origin. Sections four and five address the documentations and procedures required to prove origin and the costs involved in this process. Finally, the article provides a set of conclusions.

Keywords: Rules of origin, GATT, WTO, U.S.–Arab countries FTAs

I. Background: U.S.–Arab Countries Free Trade Agreements

Free trade resides on the notion of "comparative advantage," a theory promulgated by Adam Smith and advanced by David Ricardo.[4] Countries that produce certain products more efficiently than other countries have a comparative advantage and can provide those products to the needy countries in exchange for a different set of products that the needy

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See Inama, S.: *Rules of Origin in International Trade*. New York, 2009, 47.

[2] See LaNasa III, J. A.: Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating them. *American Journal of International Law*, 90 (1996) 4, 625, 627.

[3] Trade deflection occurs when a company undertakes minimal processing or assembly in a preference-receiving country to take advantage of preferences. See McCall, K. L.: What is Asia Afraid Of? The Diversionary Effect of NAFTA's Rules of Origin on Trade Between the United States and Asia. *California Western International Law Journal*, 25 (1995), 389, 393.

[4] See Davis, M. H.–Neacsu, D.: Legitimacy, Globally: The Incoherence of Free Trade Practice, Global Economics and their Governing Principles of Political Economy. *University of Missouri–Kansas City Law Review*, 69 (2001), 733, 749.

country has a comparative advantage for producing.[5] This system of exchange of products is designed to increase prosperity in each of the trading nations, to raise trading nations' standards of living by infusing them with goods, to increase the supply of unavailable products, and to increase competition.

The GATT was born on October 30, 1947, after an aborted attempt at creating the ITO. The GATT 1947 was the principal multilateral agreement regulating trade among nations by reducing tariffs.[6] The GATT 1947, an open, multilateral trading system, worked well.[7] However, the multilateral trading system had its limitations. GATT members launched the Uruguay Round in 1986 whereby they sought, among other things, to liberalize trade in textiles, apparel, and agriculture.

On April 14, 1994, trade ministers from more than 100 countries met in Marrakesh, Morocco, and signed "The Final Act Embodying the Results of the Uruguay Round of Multilateral Negotiations."[8] The Final Act was the culmination of the negotiations launched in Punta del Este, Uruguay in September 1986. Unlike the GATT 1947, the WTO is recognized as an organization.[9] In addition, unlike the GATT 1947 which covered trade in goods only, the WTO covers trade in services and intellectual property.[10] The WTO tries to lower barriers to world trade by negotiating and establishing rules to help facilitate and help increase world trade.[11] By lowering barriers to worldwide trade, the WTO is raising opportunities for increased global economic growth. More trade makes more individual choices possible. The WTO secures the smooth flow of trade among nations, settles trade disputes among governments, and organizes trade negotiations.[12] The WTO created a more potent dispute settlement process than had existed previously.

[5] *Ibid*. 754–755.

[6] See Kasto, J.: *The Function and Future of the World Trade Organization: International Trade Law between GATT and WTO*. London, 1996, 4.

[7] See Croome, J.: *Guide to the Uruguay Round Agreements.* Geneva, 1999. (Since 1950, world trade has grown fourteen times to more than $6.5 trillion in 1997. In the same period the proportion of world economic output attributed to trade increased from eight percent to twenty-six percent.)

[8] Over 100 Nations Sign GATT Accord to Cut Barriers to World Trade, see *International Trade Reporter* (BNA), Apr. 20, 11 (1994), 61.

[9] The WTO consists of primary and subsidiary organs. The four primary organs are the Ministerial Conference, the General Council, the Secretariat, and the Director General. The Subsidiary Organs of the WTO are the Council for Trade in Goods, the Council for Trade in Services, the Council for TRIPS, the Committee on Trade and Development, and the Committee on Budget, Finance, and Administration.

[10] See Quaeshi, A. H.: *The World Trade Organization*. 1996, 5.

[11] See Bacchus, J.: Lone Star: The Role of the WTO. *Texas International Law Journal*, 39 (2004) 3, 401, 403.

[12] The WTO agreement contained in approximately twenty-three thousand pages of agreements that incorporate by reference the GATT 1947, amendments to the GATT made in 1994 (GATT 1994), seventeen multilateral agreements, four plurilateral agreements, Ministerial Decisions and Declarations. The WTO agreements regulate tariffs on trade in manufactured goods and agriculture, services, intellectual property, food, customs, dispute settlement system, and government procurement. Special provisions for developing nations include longer time periods for implementing agreements and commitments, special measures to increase trading opportunities for these countries, provisions requiring all WTO members to safeguard the trade interests of developing countries, and technical assistance and support to help developing countries build their infrastructure. See General Agreement on Tariffs and Trade, opened for signature Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187.

Although the WTO remains as a relevant and important institution, the current era is characterized by the proliferation of regional trade agreements (RTAs) and bilateral free trade agreements (FTAs) around the world.[13] Most of these FTAs are triggered and concluded by the U.S.[14] In the process, the U.S. induced other countries to conclude more FTAs.[15]

Within Arab countries context, the U.S. has concluded several trade agreements. For example, the U.S. concluded FTA with Jordan in 2001 which was the first FTA to be ever concluded with an Arab country.[16] The U.S. has launched a 10-year effort to form a US-Middle East free trade area.[17] The U.S. will employ a "building-block" approach.[18] This approach requires, as a first step, a Middle East country to accede to the WTO or concluding Trade and Investment Framework Agreement(s) (TIFA). Then, the U.S. will negotiate FTA with individual countries. Finally, preferably before 2013, a critical mass of bilateral FTAs would come together to form the broader US-Middle East FTA. To achieve this end result, the U.S. negotiated and signed FTA's with Bahrain (2006), Morocco (2006), and Oman (2009).[19]

There are several reasons that led the U.S. to negotiate free trade agreements with Arab countries. The failed WTO Ministerial Conference in 1999 lead U.S. trade officials to analyze the possibilities for free trade agreements that would include certain provisions that

[13] Looking at regional integration, one can immediately see the upward pattern of the trend. Between 1978 and 1991, the number of RTAs remained nearly static. Since the beginning of the 1990s, the trend was reversed and one could observe a constant dramatic increase in the number of RTAs that are being formed. From 42 RTAs notified to the General Agreement on Tariffs and Trade (GATT) according to Article 7(a) of the GATT in 1991, the number increased by 107% to 87 Agreements in 1998. See Barrier, M. W.: Regionalization: The Choice of a New Millennium. *Currents International Trade Law Journal*, 9 (2000) 2, 25, 27. According to the World Trade Organization (WTO), there are currently 170 RTAs in force. The WTO expects the total number of RTAs to rise to nearly 400 by the end of 2015.

[14] See O'Neal Taylor, Ch.: Regional Trade Agreements: Current Issues and Controversies: The U.S. Approach to Regionalism: Recent Past and Future. *ILSA Journal of International and Comparative Law*, 15 (2009) 2, 411, 415–418. (The United States has developed an entire system for negotiating economic integration agreements over the last two decades. Before the 1980s, the United States focused more on multilateralism and unilateralism than regionalism. In every year from 2003 to 2007, the United States completed, and Congress approved, at least one free trade agreement.)

[15] These agreements include for instance North American Free Trade Agreement (NA FTA),the Southern Common Market (MERCOSUR) and Free Trade of the Americas (FTAA). See Gantz, D. A.: The Free Trade Area of the Americas: An Idea Whose Time Has Come–and Gone? *Loyola International Law Review*, 1 (2004), 179.

[16] See United States (U.S.)–Jordan: Agreement Between The United States of America and the Hashemite Kingdom of Jordan on The Establishment of a Free Trade Area, Oct. 24, 2000, 41 I. L. M. 63 (entered into force Dec. 17, 2001).

[17] See Yerkey, G. G.: President Bush Lays Out Broad Plan for Regional FTA with Middle East by 2013. *International Trade Reporter* (BNA), May 15, 20 (2003), 856.

[18] See Allen, M.–DeYoung, K.: Bush Calls Trade Key To Mideast; President launches Plan For U.S. Pact in Region. *Washington Post*, May 10, 2003, A01.

[19] See Office of the United States Trade Representative, U.S.–MENA Trade Facts, available at http://www.ustr.gov/countries-regions/europe-middle-east/middle-east/north-africa (last visited Feb. 20, 2010).

are resisted at the multilateral trading level.[20] Moreover, the U.S. has signed several trade and investment framework agreements, which are usually a precursor for FTAs.[21]

The selected Arab countries, thus far, were also the right candidates for FTAs in terms of economics and politics. Economically, based on regulatory impact analysis reports, U.S. exports to these Arab countries would increase as a result of the FTA while imports to the U.S. would not threaten U.S. industries.[22] The FTAs could also spur Arab countries' economic growth, allowing for the possibility that it would become less dependant on foreign aid-especially for Jordan and Morocco. Moreover, the U.S. needed to negotiate FTAs because it was losing ground to the EC which, which had concluded association agreements with several Mediterranean countries.[23] By signing these FTAs, the U.S. could catch up to the EC with respect to economic dominance in Arab countries.

Politically, the FTAs reflect a desire to further the historic bonds and friendship between participating countries.[24] Also, these FTAs reflect U.S.'s appreciation for the role of these Arab countries and their cooperation in international counter-terrorism activities. Economic growth will also enhance political stability and encourage peace in the Middle East. In sum, the FTAs would help alleviate or reduce potential security risks in the region.

[20] In the wake of protests by environmentalists and human rights activists at the WTO summit in Seattle in late 1999, then president Clinton promised to link future trade accords to labor, environmental, and human rights issues. See Uslaner, E. M.: The Democratic Party and Free Trade: An Old Romance Restored. *NAFTA: Law and Business Review of the Americas*, 6 (2000), 347, 359.

[21] See for example Yerkey, G. G.: U.S., Jordan Sign Framework For Trade and Investment Pact. *International Trade Reporter* (BNA), Mar. 17, 16 (1999), 468. See also Yerkey, G. G.: U.S., Oman Sign Framework Trade Pact, Agree to Begin Free Trade Negotiations. *International Trade Reporter* (BNA). July 8, 21 (2004), 1163.

[22] Arab countries' exports to the U.S. would not have a measurable impact on U.S. industries, U.S. employment, and production. For one sector, textiles and apparels, a likely rise in U.S. imports of apparel is expected to have a negligible effect on total U.S. imports. See The Office of Economics and the Office of Industries of the USITC, U.S. International Trade Commission, Economic Impact on the United States of a U.S.–Jordan Free Trade Agreement, 5–1 Pub. No. 3340 (Sep. 2000). See U.S. International Trade Commission, U.S.–Bahrain Free Trade Agreement: Potential Economy wide and Selected Sectoral Effects, Pub. No. 3726 (Oct. 2004). See U.S. International Trade Commission, U.S.–Morocco Free Trade Agreement: Potential Economy wide and Selected Sectoral Effects, Pub. No. 3704 (June 2004). See also U.S. International Trade Commission, U.S.–Oman Free Trade Agreement: Potential Economy wide and Selected Sectoral Effects, Pub. No. 3837 (Feb. 2006).

[23] The official movement towards a closer relationship between the EC and its Mediterranean neighbors was launched at a meeting of the European Council in Lisbon in 1992. It takes place between the EC and 12 countries to the east and south of the Mediterranean. The major premise of the partnership is to create an enormous zone of free trade between Europe and several countries of the Middle East by the year 2010. The Euro-Mediterranean Partnership was created in 1995 in Barcelona with the signing of the Barcelona Declaration by the EC and 12 Mediterranean Countries. The 12 Mediterranean countries are as follows: Morocco, Algeria, Tunisia, Egypt, Jordan, Israel, The Palestinian Authority, Lebanon, Syria, Cyprus, Malta, and Turkey. This partnership will lead to a series of Euro-Mediterranean association agreements. The purposes of this partnership is EC's recognition that peace and security in the Middle East is of great interest and concern to the EC and creation of the world's largest free trade zone–comprising more than 800 million people–by the year 2010 to rival NAFTA. See Klosek, J.: The Euro-Mediterranean Partnership. *International Legal Perspectives*, 8 (1996) 173.

[24] See Lawrence, R. Z.: *A US-Middle East Free Trade Agreement: A Circle of Opportunity?* Washington, 2006, 4–9, 12–14.

In terms of their design, the U.S.–Arab countries FTAs include general definitions appearing at the beginning of the agreement text and every chapter, followed by a section on general obligations, and ending with lengthy tariff schedules and detailed annexes that contain either exceptions or reservations to the general obligations.[25] These FTAs also consist of chapters that cover trade in goods, trade in services, competition, investment, intellectual property rights, agriculture, sanitary and phytosanitary standards and technical barriers to trade, safeguard measures, dispute settlement mechanism, and rules of origin and customs procedures.[26]

II. Rules of Origin in the U.S.–Arab Countries FTAs

Among the most important provisions included in the bilateral trade agreements between the U.S. and Arab countries is the one related to rules of origin. Rules of Origin in the U.S.–Arab countries FTAs help the parties to the agreements to ascertain that goods traded between them "originate" in these countries. Since a principal goal of these FTAs is to eliminate or reduce the tariffs on goods traded between trading partners, rules of origin provide certain requirements for an article to be considered "originating" in the territory and entitled to preferential tariffs.

A. Wholly Obtained or Produced

Under the "wholly obtained or produced" rule of origin, in order for a product to qualify for preferential treatment, the product must be "wholly" the growth, production or manufacture of the FTA party.[27] The concept of "wholly" should be interpreted narrowly since all the inputs must be produced in the exporting country to qualify for preferential treatment; third party inputs are not allowed. Moreover, inputs of a product must not have undergone processing in any other country at any stage of production.

The "wholly obtained or produced" rule of origin is relatively straightforward since it provides that a product is obtained or produced in one country, the product originates in that country. The U.S.–Arab countries FTAs provide a list of products to be considered wholly obtained. The list covers primary products, raw minerals, lumber, and unprocessed agricultural commodities.[28]

[25] See United States–Jordan Free Trade Agreement, *supra* note 16; United States–Morocco Free Trade Agreement (2006), available at http://www.moroccousafta.com/ftafulltext.htm; United States–Bahrain Free Trade Agreement (2006), available at http://www.fta.gov.bh/categoryList.asp?cType=Texts; and United States–Oman Free Trade Agreement (2009), available at http://www.omanusfta.com/documents.html.

[26] *Ibid.*

[27] See United States–Jordan Free Trade Agreement, Annex 2.2, Article 1.a; United States–Morocco Free Trade Agreement, Article 5.1(a); United States–Bahrain Free Trade Agreement, Article 4.1; and United States–Oman Free Trade Agreement, Article 4.1. Wholly growth, product, or a manufacture of a party means a product that has been entirely grown, produced, or manufactured in a party and to all materials that are incorporated in the product, that have been entirely, grown, produced, or manufactured in the party's territory.

[28] A list of primary products for example would include mineral products, vegetable plants, and sea fishing products such as fish or shellfish. See United States–Jordan Free Trade Agreement, Annex 2.2, Article 1.a; United States–Morocco Free Trade Agreement, Article 5.14; United States–Bahrain Free Trade Agreement, Article 4.14; and United States–Oman Free Trade Agreement, Article 4.14.

B. Substantial Transformation Criterion

If a product is "not wholly the growth, product, or manufacture of the party", then it must be "substantially transformed" into a "new and different article of commerce", having a new name, character, or use distinct from the article or material from which it was transformed.[29] The language of the U.S.–Arab FTAs regarding substantial transformation is based on U.S. law.[30] Substantial transformation means fundamental change in form, appearance, nature "or" character of article which adds to value of article an amount or percentage which is significant in comparison with value which article had when exported from country in which it was first manufactured, produced or grown.[31]

The disjunctive "or" means that one of three parts of substantial transformation test (change in name, use, or characteristic) must occur.[32] Additionally, the phrase "substantial transformation" is composed of two words. First, "transformation", whether modified by an adjective or not, means a fundamental change, not a mere alteration, in the form, appearance, nature, or character of an article. Second, "substantial" means more than "fundamental" because if that were its only meaning it would be redundant because transformation also means fundamental change. Therefore, "substantial" means a very great change in the article's "real worth value".

There are factors that can be used to determine "substantial transformation" other than change in the "name, character or use". These factors include the value added to the product at each stage of manufacture, degree and type of processing in each country, manner in which the article was used before and after processing, durability of the article before and after processing, and tariff classification of the article before and after processing.[33]

While the U.S.–Arab countries FTAs apply the "substantial transformation" standard if a product is not wholly the growth, product, or manufacture of one party, North American

[29] See United States–Jordan Free Trade Agreement, Annex 2.2, Article 1; United States–Morocco Free Trade Agreement, Article 5.1(b); United States–Bahrain Free Trade Agreement, Article 4.1(b); and United States–Oman Free Trade Agreement, Article 4.1(b).

[30] See Tariff Act of 1930, 19 U.S.C.A. § 1304 (West 1930).

[31] The U.S. Supreme Court defined substantial transformation further in Anheuser–Busch Brewing Association case. See Anheuser–Busch Brewing Assn. v. U.S., 207 U.S. 556, 561 (1908) (the case involved corks imported from Spain to be incorporated in bottles for re-export. The court decided that manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labour, and manipulation. There must be transformation: a new and different article must emerge, having a distinctive name, character, or use. Therefore, the careful selection and thorough treatment of corks would render corks a new article of commerce).

[32] Change in name only could not be in and of itself the determinative factor to meet the "substantial transformation" test. The CIT decided that the name factor in meeting the "substantial transformation" test is the weakest evidence of meeting the test. See Juice Prod. Assn. v. U.S., 628 F. Supp. 978, 989 (Ct. Intl. Trade 1986). Change from producer's product to end-use product may not be of significance in determining that an imported product has undergone substantial transformation. See U.S. v. Murray, 621 F.2d 1163, 1170 (1st Cir. 1980) (Although Chinese glue was blended with other glues in Holland that changed from processor's good to consumer's good, it did not increase in value).

[33] See Maxwell, M. P.: Formulating Rules of Origin for Imported Merchandise: Transforming the Substantial Transformation Test. *George Washington Journal of International Law and Economics*, 23 (1990), 669, 673.

Free Trade Agreement (NAFTA) adopts the "tariff shift" rule, i.e. non-originating materials must shift from one tariff heading/subheading into another as a result of production that occurs in a NAFTA party.[34] In other words, the "tariff shift" rule examines specified changes in the tariff classification of the product before and after processing in a particular country. Under this rule, if the components or raw materials used to produce a product undergo the specified change in tariff classification for the imported product in a country, the product is deemed to originate in that country.

The "substantial transformation" test is subjective as it leaves to the custom authorities of the importing country the discretion to determine on a case-by-case basis whether a certain product has undergone substantial transformation. The "name, character or use" factors have been weighed and applied inconsistently, and that supplemental factors are selectively employed according to the context in which the substantial transformation test is applied.[35] Because of the "substantial transformation" subjectivity, it is unclear at what time and to what extent a product has to undergo a substantial transformation. Adopting several factors in the "substantial transformation" test would confuse importers and does not provide helpful precedents.

Origin determinations under the substantial transformation rule are highly individual fact intensive exercises. The "substantial transformation" rule imposes potentially higher transactions costs on importers because all components, ingredients, or inputs used in a manufacturing process will need to have their origin traced and documented. Moreover, "substantial transformation" is itself a complex, highly technical, and uncertain endeavor. As a result, these requirements may have a major adverse impact on companies importing products with components or inputs originating from different countries.

It is argued that the use of a specific tariff schedule to measure change in the commodity status enjoys transparency, predictivity and to an extent, objectivity.[36] There is less possibility to use rules of origin as instruments of industrial policy.[37] Thus, in its bilateral FTAs with Arab countries, the U.S. should have adopted a uniform system of "tariff shift" rules based on the NAFTA country of origin rules to simplify the process of country of origin determinations.

[34] For the first time in the U.S., the concept of change in tariff heading was used first in the U.S.–Canada FTA and then NAFTA. Chapter Four (rules of origin) in NAFTA has a general rule that applies to all products exported from one party to the other. The general rule determines that a good is considered to originate in North America if 1) the good is wholly obtained or produced entirely in the territory of one or more of the parties to NAFTA 2) the non-originating materials used in the production of the good undergoes an applicable "change in tariff classification" as a result of production occurring entirely in the territory of one or more of the parties to NAFTA. See St. Fort, M. K.: A Comparison of the Rules of Origin in the United States under The U.S.–Canada Free Trade Agreement (CFTA), and Under the North American Free Trade Agreement (NAFTA). *Wisconsin International Law Journal*, 13 (1994), 183.

[35] See Cao, L.: Corporate and Product Identity in the Postnational Economy: Rethinking U.S. Trade Laws. *California Law Review*, 90 (2002) 2, 401, 463, 471.

[36] See Favely, R.–Reed, G.: Economic Effects of Rules of Origin. *Review of World Economics*, 134 (1998) 2, 209, 212–213.

[37] See Bhagwati, J.–Hudec, R. E. (eds): *Fair Trade and Harmonization: Prerequisites for Free Trade*. Cambridge (MA), 1996, 306–309 (the United States has not had an avowed industrial policy. However, some critics have contended that the U.S. does in fact have an industrial policy in the broad sense. The U.S. has an implicit and decentralized industrial policy. Instruments of industrial policy include subsidies and tax breaks).

C. Value-Added Test

The substantial transformation rule may not suffice by itself to confer origin. Specifically, substantial transformation rule may not ensure that a sufficient amount of local materials and value-added processing would be required in order to qualify for preferential treatment.[38] Arab countries partners may be used as a platform for shipment of products to the U.S. though the products in question could have gone through minor processing. Thus, the U.S.–Arab countries FTAs contain a mathematical requirement, known as the value-added or percentage rule.[39] A value-added test commonly stipulates a minimum percentage of the total value of a product which must be accounted for by the value of materials, labor, and other processing costs originating or performed in a particular country in order for that product to qualify as originating in that particular country.

The U.S–Arab countries FTAs applied the value-added test in conjunction with or in lieu of the substantial transformation rule. Under the value-added test, thirty-five percent of the appraised value to produce the good must be based upon costs incurred in the FTA partner country.[40] The appraised value is defined to include materials and direct cost of processing operations.[41] Thus, according to these FTAs, the value excludes overheads, expenses for sales promotion, royalties, shipping and packing costs, and non-allowable interest costs. By way of comparison, the local value requirement of the U.S.–Arab countries FTAs is similar to the net cost method of calculating regional value content under NAFTA, except that only thirty-five percent of the value must be local.[42]

[38] In some instances substantial transformation may confer origin by itself, but with low value such as 10 percent.

[39] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 1(c); United States–Morocco Free Trade Agreement**,** *supra* note 25, Article 5.1(b); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.1(b); and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.1(b).

[40] *Ibid*. The appraised value of an imported product will be its transaction value. The transaction value generally approximates the ex-factory price of a good sold to an independent buyer on an arms-length basis.

[41] There are indirect materials that are deemed to be originating regardless of their origin. An "indirect material" is defined to mean a product that is used in the production of a good which is not physically incorporated into the good, or which is used in the maintenance of buildings or in the operation of equipment used to produce the good and any good that is not incorporated but whose use can be demonstrated to be part of the production of the good. Examples of indirect materials are fuel, dies, and safety equipment. See United States–Jordan Free Trade Agreement, Annex 2.2, Article 6(a) and (b); United States–Morocco Free Trade Agreement, Article 5.6; United States–Bahrain Free Trade Agreement, Article 4.16; and United States–Oman Free Trade Agreement, Article 4.6.

[42] NAFTA provides that if the good is produced entirely in the territory of one or more of the parties to NAFTA but one or more of the non-originating materials provided for "as parts" of the good does not undergo a change in tariff classification because the good 1) was imported into the territory of a party in an unassembled or a disassembled form but was classified as an assembled good or 2) the heading for the good describes both the good itself and its parts and is not further subdivided into subheadings, or the subheading for the good describes both the good itself and its parts provided that the regional value content (RVC) is not less than 60 percent under transaction value method or 50 percent under net cost method. Under the transaction value method, RVC = TV –VNM / TV X 100. RVC is the regional value content, expressed as a percentage, TV is the transaction value of the good adjusted to a F.O.B. basis, and VNM is the value of non-originating materials used by the producer in the production of the good. Under the net cost method, RVC = NC – VNM / NC X 100. NC is the net

The previous discussion of the value-added test is simplification of what happens in practice. Calculation of value-added depends upon complex accounting issues which can raise significant uncertainty. The reason for this uncertainty is due to the fact that an origin is never finally determined until audits are completed, a process that can take years. If the auditors disagree with the calculations of the parties involved, enormous and unexpected demands for payment of duties may result.[43] In addition, there is a need to verify value added claims as it is necessary to carry out audits after the event to certify the costs of work carried out.

The value-added test is designed to ensure that the process of transformation has resulted in the inclusion of a significant degree of Arabian content. However, operations that will confer origin in one country may not do so in another because of fluctuation in costs of materials and different labor costs. For example, if a U.S. worker applies eight hours labor to an imported input, the valued-added test could be met easily because of high productivity and wage. An Arab worker, on the other hand, may fail to raise the value of the product when employing the same amount of hours because of lower level of productivity and wage. Therefore, the value-added test may be internally discriminatory when evaluated in light of Arab countries' wages and productivity.[44] In summation, the value-added test takes into account factors relevant to the total production cost of the product and not relevant to the nature of the producing country' economy with its varied economic development.

D. Specific Rules of Origin for Certain Product(s)

The U.S.–Arab countries FTAs include specific rules that confer origin when certain production methods have been carried out.[45] These rules apply for a variety of products such as milk, vegetable product, foodstuffs, plastics, and automotive products. In addition, these FTAs have specified production methods for textiles and apparels.[46]

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cost of the good and VNM is the value of non-originating materials used by the producer in the production of the good. NAFTA defines the net cost as the total cost less the following specific costs: sales promotion, marketing and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs that are included in the total cost. In calculating the net cost, the producer may use several allocation methods. The difference between the two RVC methods in NAFTA is that the transaction–value method includes some costs that are excluded in the net cost method. NAFTA bases the transaction–value method on the price actually paid or payable for a good or material, and may thus include all costs plus profits. To compensate for this difference, the transaction value method requires a higher percentage of RVC. NAFTA rules provide for calculations based on the total price or the total cost, with deductions for certain cost items and/or the value of non-originating materials. See Ramirez, J. A.: Rules of Origin: NAFTA's Heart, But FTAA's Heartburn. *Brooklyn Journal of International Law*, 29 (2004) 2, 617, 624–633.

[43] See Palmeter, D.: The Honda Decision: Rules of Origin Turned Upside Down, Free Trade. *Observer,* June 1992, 32A.

[44] See Vermulst, E.–Waer, P.–Bourgeois, J. (eds): *Rules of Origin in International Trade: A Comparative Study*. Ann Arbor, 1994, 446–448.

[45] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 9; United States–Morocco Free Trade Agreement, *supra* note 25, Annex 4-A and Annex 5-A; United States–Bahrain Free Trade Agreement, *supra* note 25, Annex 3-A and Annex 4-A ; and United States–Oman Free Trade Agreement, *supra* note 25, Annex 3-A and Annex 4-A.

[46] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 9; United States–Morocco Free Trade Agreement, *supra* note 25, Chapter Four; United States–Bahrain Free

Although U.S.–Arab countries FTAs claim duty free access for textile and apparel products, the specific rules of origin for these products are protectionist and enacted to mitigate the likely effects of textiles and apparels trading on the U.S. clothing industry.[47] These rules were taken verbatim from U.S. regulations on rules of origin for textile products. When analyzing rules of origin for textiles and apparels one must distinguish between the U.S–Jordan FTA on the one hand and U.S.–Bahrain FTA, U.S–Oman FTA, and U.S.–Morocco FTA on the other hand. Rules of origin for textiles and apparels under the latter FTAs are far more restrictive when compared with the U.S.–Jordan FTA.

The old U.S. rules of origin for textiles and apparel products are found in subparagraph 9.b.iv of annex 2.2 of the U.S.–Jordan FTA.[48] The old U.S. rules of origin for textiles and apparels are known as the "four operations" rule.[49] Under the "four operations" rule, a textile product will be considered a product of Jordan if the fabric is dyed *and* printed in Jordan and the dyeing *and* printing is accompanied by two or more of the following operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing or moireing. Under the "four operations" rule, it does not matter if the fabric is actually woven in Jordan. For example, the fabric could be woven in Syria, but the dyeing, printing, bleaching, and shrinking can occur in Jordan.

Under the U.S.–Jordan FTA, the application of the "four operations" rule is limited to silk, cotton, man-made fiber, or vegetable fiber. Wool is excluded from the "four operations" rule, but subject to the Breaux-Cardin rule.[50] Under the Breaux-Cardin rule, it may not

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Trade Agreement, *supra* note 25, Chapter Three and United States–Oman Free Trade Agreement, *supra* note 25, Chapter Three.

[47] The reasons for protectionist policies in the textile sector are to be found in the importance of the textile sector for employment policy in developed countries. Textile is a labor-intensive industry which requires low skilled workers who if laid off could encounter hard time to find a new job. Dehousse, F. et al.: The EU–USA Dispute Concerning the New American Rules of Origin for Textile Products. *Journal of World Trade*, 36 (2002) 1, 69.

[48] See Textiles and Textile Products, 19 C.F.R. § 12.130.(e) (i) (2005).

[49] In a case of first impression, first before the U.S. CIT and then the United States Court of Appeals for the Federal Circuit in 1987 elaborated more on the U.S. textiles country of origin rules. The Court decided that "marginal operations" performed on the cotton fabric in Hong Kong did not substantially transform the fabric originated in China allowing it to enter to the U.S. duty-free. An article usually will not be considered to be a product of a particular country by virtue of merely having undergone dyeing and/or printing of fabrics or yarns. The court decided that there must substantial transformation: dyeing of fabric and printing when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing. See Mast Indus., Inc. v. U.S., 882 F. 2d. 1069 (Fed. Cir. 1987) (the case involved cotton fabric in greige form [fabric before it is bleached, dyed, or processed] from China processed in Hong Kong. The court noticed that the textile regulation was adopted in a regulatory vacuum where *ad hoc* determinations had been the rule of the day, resulting in inconsistent import treatment).

[50] In order to offset the liberalization the U.S. took by agreeing to the WTO Agreement of Textiles and Clothing, it hardened the rules of origin for textile. The new U.S. rules of origin for textile products, the same as in Annex 2.2 of the US–JO FTA subparagraph (a)(i), (a)(ii), or (a)(iii), under title "general rule", states that a product is considered to originate in Jordan for example if the product is 1) wholly obtained or produced in Jordan 2) the product is a yarn, thread, twine, cordage, rope or braiding, and the "constituent staple" fibers are spun in Jordan or the continuous filament is extruded in Jordan 3) the product is a fabric and the "constituent fibers", filaments or warns are woven,

enough for the fabric to be dyed and printed in Jordan rather in some cases the constituent fibers must be actually woven in Jordan.

The restrictive rules of origin for textiles and apparels in the U.S.–Jordan FTA are not an exceptional. The U.S.–Bahrain, U.S.–Oman, and U.S.–Morocco FTAs have even more restrictive rules of origin for textiles.[51] Under these FTAs, textiles and apparels must be produced from yarn or fiber produced in the partner country, known as the "yarn or fiber forward" rule.[52] This means that everything from the yarn forward up the production chain of an article must be of U.S., Bahraini, Omani, or Moroccan origin. The "yarn forward" rule restricts the ability of a manufacturer to source its inputs. Furthermore, the "yarn or fiber forward" rule may cause tariff escalation since the cost of using foreign yarn from a non-FTA party results in a higher tariff for the entire product. In comparison, the U.S.–Jordan FTA allows the use of unlimited third-country yarn, fiber, or fabric components in the making of apparels that may be eligible for preferential treatment.

As an exception, known as Tariff Preference Level (TPL), the U.S.–Bahrain, U.S.–Oman, and U.S.–Morocco FTAs allow for importation of apparel containing third-party content.[53] This exception is similar to the TPL in NAFTA which allowed up to 25 million square meter equivalents of apparel made from yarn originating outside NAFTA region to be imported into the U.S. duty-free as long as the fabric is first cut in the U.S. and then sent to Mexico for assembly before shipped again to the U.S.[54] However, unlike NAFTA, the TPL under U.S.–Bahrain, U.S.–Oman, and U.S.–Morocco FTAs is temporary. The TPL in these FTAs is scheduled to expire after ten years from the date on which the agreements enter into force.[55]

The specific rules of origin incorporated into the U.S.–Arab countries FTAs are detailed and complex due to the variety of products covered. Moreover, the specific rules of origin can be seen as having been driven by the protectionist interests of domestic U.S. industries. These specific rules have their own limitations which deny their usefulness as a technique to determine origin.

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knitted, needled, tufted, felted, entangled or transformed by another fabric-making process in Jordan or 4) the product is any other textile or apparel product that is "wholly assembled" in Jordan from its component pieces.

[51] See United States–Morocco Free Trade Agreement, *supra* note 25, Chapter Four; United States–Bahrain Free Trade Agreement, *supra* note 25, Chapter Three and United States–Oman Free Trade Agreement, *supra* note 25, Chapter Three.

[52] See Gantz, D. A.: A Post-Uruguay Round Introduction to International Trade Law in the United States. *Arizona Journal of International and Comparative Law*, 12 (1995) 1, 7, 141.

[53] See United States–Morocco Free Trade Agreement, *supra* note 25, 4.3(9); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 3.2(8) ; and United States–Oman Free Trade Agreement, *supra* note 25, Article 3.2(8).

[54] See Legierski, R. T.: Out in the Cold: The Combined Effects of NAFTA and the MFA on the Caribbean Basin Textile Industry. *Minnesota Journal of Global Trade*, 2(1993), 305, 314. See also Escoto, J. A.: Technical Barriers to Trade under NAFTA: Harmonizing Textile Labeling. *Annual Survey of International and Comparative Law*, 7 (2001), 63, 82.

[55] See United States–Morocco Free Trade Agreement, *supra* note 25, 4.3(14); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 3.2(12); and United States–Oman Free Trade Agreement, *supra* note 25, Article 3.2(12).

E. De Minimis *Rule of Origin*

A *de minimis* rule allows for a specified percentage of non-originating materials to be used in producing the final product without affecting its origin.[56] The U.S.–Jordan FTA does not mention a *de minimis* rule. Accordingly, a product would be disqualified from being "wholly originating" if it contains any foreign input, no matter how insignificant. As for non-wholly originating products, the product in question has to qualify according to the value-added test, among other criteria, if any non-originating part did not undergo the required substantial transformation.

The other U.S.–Arab countries FTAs also do not include a *de minimis* provision. However, these FTAs adopt a *de minimis* exception for textiles and apparels. If a textile or apparel good does not qualify for preferential treatment because a non-originating material did not undergo the specified tariff classification change, the good will still be considered originating in these Arab countries as long as the total weight of non-qualifying materials is not more than seven percent of the total weight of the good.[57] In other words, at least ninety-three percent of the textiles or apparel components must undergo the required tariff change; only seven percent may be exempted. In these U.S.–Arab FTAs, the *de minimis* provision is limited in scope since it covers only textiles and apparel and excludes all other products.

The *de minimis* rule of origin permits products to benefit from preferential treatment provided in FTAs even if these products contain minimal amounts of non-originating materials. In this context, a *de minimis* rule provides clemency by making it easier for products with non-originating materials to qualify. However, the U.S.–Arab countries complicate already complex rules of origin by ignoring any reference to a *de minimis* clause. Even when these FTAs mention the *de minimis* rule, it is limited in application to textiles and apparels and does not extend to some or all other products. The inflexibility provided in the U.S.–Arab countries FTAs regarding *de minimis* rule raises huge alarm.

F. Cumulation

Cumulation allows producers of one FTA country to use non-originating materials from another FTA member without losing the preferential status of the final product. There are three types of cumulation.[58] Bilateral cumulation operates between the two FTA partner countries and permits them to use products that originate in the other FTA country as if they were their own when seeking to qualify for preferential treatment. Diagonal cumulation means that countries tied by the same set of preferential origin rules can use products that

[56] See Hirsch, M.: International Trade Law, Political Economy and Rules of Origin: A Plea for a Reform of the WTO Regime on Rules of Origin. *Journal of World Trade*, 36 (2002) 2,171.

[57] See United States–Morocco Free Trade Agreement, *supra* note 25, 4.3(7); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 3.2(6); and United States–Oman Free Trade Agreement, *supra* note 25, Article 3.2(6). The language in these FTAs is similar to that of NAFTA. For textiles and apparel, the item will be considered NAFTA-originating if the non-originating material constitutes not more than seven percent of its weight. See North American Free Trade Agreement, Dec. 17, 1992, Article 405(5), 32 I.L.M. 289.

[58] See Baldwin, R.–Evenett, S.–Low, P.: *Beyond Tariffs: Multilaterising Deeper RTA Commitments*. 2007, available at http://www.wto.org/english/tratop_e/region_e/con_sep07_e/baldwin_evenett_low_e.pdf (last visited May 20, 2010).

originate in any part of the area as if they originated in the exporting country.[59] Full cumulation extends diagonal cumulation.[60] Full cumulation provides that countries tied by the same set of preferential origin rules among each other can use goods produced in any part of the area, even if these were not originating products. All the processing done in the free trade area is then taken into account as if it had taken place in the final country of manufacture. As such, diagonal and full cumulation can notably expand the geographical and product coverage.

In terms of bilateral cumulation, all U.S.–Arab countries FTAs provides that a producer may cumulate the production value in each country for purposes of establishing that the good is originating, provided that all non-originating materials used in the production of the product have undergone substantial transformation and that the other applicable requirements are satisfied.[61] The presence of bilateral cumulation helps developing trade relations between FTA countries.

However, in terms of regional cumulation or cumulation with other trading partners, the U.S.–Arab countries FTAs show differences. The FTAs with Morocco and Bahrain, which use identical language, contain only a commitment for a discussion on the issue at some future date.[62] In the FTAs with Morocco and Bahrain, the language on regional cumulation was drafted broadly. It does not carry any specific methods, any legal obligation, and has no timeline within which the discussion must be completed or implemented. In summation, the language is vague and exhortatory.[63] By contrast, the FTAs with Jordan and Oman include a commitment to develop a regional cumulation within six months of the agreement coming into effect.[64] Until this date, no regional cumulation regime was developed.

[59] *Ibid*. See also De Wulf, L.–Sokol, J. B.: *Customs Modernization Handbook*. Washington, 2005, 194–195.

[60] In bilateral cumulation, the use of the partner country components is favored; in diagonal cumulation, all the beneficiary trading partners of the cumulation area are favored. While diagonal cumulation and, even more so, bilateral cumulation, promote the use of materials originating within the FTA, full cumulation is more liberal than diagonal cumulation by allowing a greater use of third-country materials. It is, however, rarely used.

[61] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 5; United States–Morocco Free Trade Agreement, *supra* note 25, 5.4; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.4 and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.4.

[62] The US–Morocco FTA and US–Bahrain FTA state that at a time to be determined by the parties, and in the light of their desire to promote regional integration, the parties shall enter into discussions with a view to deciding the extent to which materials that are products of countries in the region may be counted for purposes of satisfying the origin requirement under the agreement as a step toward achieving regional integration. See United States–Morocco Free Trade Agreement, *supra* note 25, 5.13; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.13.

[63] One may argue that leaving the language without specificity would work better rather than being *ceteris paribus*. It ought to be vague to remain flexible and useful because it could be adapted to necessary changes. However, lack of specificity lends itself to uncertainty and insecurity. The reason for this uncertainty is the lack of test that would guide the parties leading to discretionary interpretation.

[64] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 13; and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.13.

G. Other Relevant Provisions

The U.S.–Arab countries FTAs include several provisions that have an impact on the determination of product origin. These provisions relate to packing operations, transshipment, non-qualifying operations, drawback, and roll-up.

No product is deemed eligible for the FTA's benefits merely by undergoing simple operations such as sorting, assembling, or packing.[65] Thus, packing will disregarded when applying the required rules of origin whether substantial transformation or value-added tests. There are trivial operations that even if they are undertaken will not affect the origin of the product and this will be discounted. For instance, a product may not be deemed originating by virtue of either an operation involving mere dilution with water or other substances which does not materially alter the characteristics of the product.[66]

A product will lose its originating status if, subsequent to meeting applicable rules of origin, the product undergoes further production outside the territories of the FTA parties, other than operations related to shipment of the good when in transit to the territory of a party, such as loading or unloading.[67] The purpose of these rules is to prevent non-FTA parties from enjoying its fruits through trivial processing methods and transshipment to claim origin.

The U.S.–Arab countries FTAs do not mention anything about drawback.[68] In other words, these FTAs do not reimburse tariffs paid on non-originating components that are subsequently included in a final product exported to another FTA country. There is no obvious reason why the FTAs in question exclude from their coverage duty drawback. It could be that any drawback rule in the FTA could favor producers who direct their products–using non-originating components- toward export over producers who direct their products to the domestic market. Producers for the domestic market are put at disadvantage. Thus, to ensure equal footing in treatment, the FTAs parties ruled in favor of excluding duty draw back from coverage. However, the absence of duty drawback leads an increase in the cost of final product as a result of incorporating non-originating components with no drawback.

[65] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 2; United States–Morocco Free Trade Agreement, *supra* note 25, 5.3; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.3 and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.3.

[66] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 9; United States–Morocco Free Trade Agreement, *supra* note 25, 4.3(9); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 3.2(8) and United States–Oman Free Trade Agreement, *supra* note 25, Article 3.2(8).

[67] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 8; United States–Morocco Free Trade Agreement, *supra* note 25, 5.9; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.9 and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.9.

[68] Drawback can be defined as the refund or remission, in whole or in part, of a customs duty which was imposed on imported merchandise under because of its importation. See Page Hall, M.–Lee, M. S.: International Trade Decisions of the Federal Circuit. *American University Law Review*, 57 (2008) 4, 1145, 1158. Countries use duty drawback to attract investment and encourage exports. See Easson, A. J.: *Tax incentives for foreign direct investment*. The Hague, 2004, 155–156. See also Panagariya, A.: Input Tariffs, Duty Drawbacks, and Tariff Reforms. *Journal of International Economics*, 32 (1992) 1–2, 131.

Moreover, the U.S–Arab countries FTAs do not mention the roll-up or absorption principle. The roll-up principle is a process whereby non-originating materials are subsumed during the manufacture of new and different products.[69] When shipped across borders, the new product is said to originate where the conversion occurred.[70] Thus, the costs of non-originating material are rolled-up into the value of the final product. Again, there is no obvious reason why U.S.–Arab countries FTAs excluded from their coverage the roll-up principle. It could be to reduce the possibility of counting the full value of the components incorporated into a finished product as originating or non-originating even though these components may consist of a combination of originating and non-originating inputs. Because of the roll-up absence, non-FTA input remains non-originating throughout the manufacturing process until the calculation of value-added is made.

III. Certificate of Origin and Customs Matters

The U.S.–Arab countries FTAs provide interested parties with a balanced framework for resolving customs matters. Regarding certificate of origin, when a product meets the required rules of origin, the trader then seeking preferential tariff treatment must declare that his product is originating and obtain certification(s) that verify his declaration.[71] A trader must maintain records related to origin claims for five years.[72] Thus, the burden is placed upon the trader to satisfy origin requirements and prove it rather than on the customs authority of the importing country. Additionally, it can be deduced that these FTAs are based on good faith by first entrusting the documents presented by traders. However, if there are doubts regarding the origin of a product and any associated claims, the U.S.–Arab countries FTAs established mechanisms for verifying origin claims.

To verify origin, the importing country can verify origin through written determinations that include facts of the matter and issues of law.[73] The U.S.-Arab countries FTA tackle administrative review procedures. For example, interested parties are entitled to inquire about the application of rules of origin.[74] Also, these FTAs provide a notice-and-comment

[69] The opposite of roll-up is roll-down which allows for a component to be treated as non-originating merely because it included third country parts. When such a component was incorporated into a finished good, the component sometimes was treated as containing zero percent originating goods, even though it actually contained substantial originating parts. Cantin, F. P.–Lowenfeld, A. F.: Rules of Origin, The Canada–U.S. FTA, and the Honda Case. *American Journal of International Law*, 87 (1993) 3, 375, 379.

[70] *Ibid.*

[71] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 10; United States–Morocco Free Trade Agreement, *supra* note 25, 5.10; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.10 and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.10.

[72] *Ibid.*

[73] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 10; United States–Morocco Free Trade Agreement, *supra* note 25, 5.11; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.11 and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.11.

[74] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 11; United States–Morocco Free Trade Agreement, *supra* note 25, 6.1(2); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.1(2) and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.1(2).

opportunity for affected parties prior to issuance of regulations or customs determination.[75] The FTAs require customs authorities first to provide administrative review and second to allow access to judicial review.[76] Civil, administrative, and criminal penalties may be imposed for non-compliance with the requirements of local customs laws including rules of origin.[77]

With the exception of the U.S.–Jordan FTA, other U.S.–Arab countries FTAs provide that the customs authorities of each party shall provide written advance rulings concerning matters such as tariff classification, customs valuation, and rules of origin.[78] Advance ruling allow traders to obtain an origin ruling prior to the importation of a product. Hence, advance ruling saves time and energy. The FTAs require customs authorities to issue advance ruling within 150 days of a request.[79] The 150 days seem a long period. Therefore, expeditious determination is required to maximize the benefits of advance ruling. Penalties are imposed against a requesting party that has omitted or misrepresented material facts in its request for a ruling.[80] Thus, parties seeking an advance ruling must exercise caution in formulating their requests.

U.S. companies are very familiar with the mechanisms of advanced rulings but for Arab companies the concept and its mechanics could seem novel. Thus, FTA parties agreed that the U.S. would provide technical assistance that help Arab countries implement the advance ruling provisions.[81] However, the technical assistance provision is lacking the methodological and operative specificity to ensure that Arab countries implement the advance ruling efficiently.

[75] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 11; United States–Morocco Free Trade Agreement, *supra* note 25, 6.1(3); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.1(3) and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.1(3).

[76] See United States–Morocco Free Trade Agreement, *supra* note 25, 6.8; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.8 and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.8.

[77] See United States–Morocco Free Trade Agreement, *supra* note 25, 6.9; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.9 and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.9.

[78] See United States–Morocco Free Trade Agreement, *supra* note 25, 6.10(1); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.10(1) and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.10(1).

[79] See United States–Morocco Free Trade Agreement, *supra* note 25, 6.10(2); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.10(2) and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.10(2).

[80] See United States–Morocco Free Trade Agreement, *supra* note 25, 6.10(7); United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.10(7) and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.10(7).

[81] US–Morocco FTA, Chapter Six, Article 6.11. See United States–Morocco Free Trade Agreement, *supra* note 25, 6.11; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 5.11 and United States–Oman Free Trade Agreement, *supra* note 25, Article 5.11.

The FTA parties agreed to consult regularly with respect to the administration of rules of origin.[82] Where a party believes that a modification to a provision in is required due to a change in production processes or other developments, the party may submit a request for modification along with supporting arguments and materials such as studies for consideration of the concerned parties.

IV. Administrative Costs of Rules of Origin

There are administrative costs associated with fulfilling rules of origin requirements. These relevant costs include maintaining book-keeping procedures to trace origin of inputs, issuance of certificate of origin, and providing all necessary invoices and information. Unfortunately, there are no specific studies that address costs of rules of origin for U.S.–Arab countries FTAs.[83] However, costs for such agreements are expected to be high. This conclusion is based on studies of other FTAs to which the U.S. is party and similar in content to the U.S.–Arab countries FTAs. For example, the administrative costs for NAFTA's rules of origin account for approximately approximate two per cent of the value of Mexican exports to the U.S. market.[84] While in some countries origin certification is free of charge, in many the costs are hardly trivial and can cost $40.[85]

Producers face the added administrative complexity of fluctuations in exchange rates and changes in production costs.[86] Besides increasing unpredictability, changes in relative prices complicate the verification of origin by customs, and may give rise to subjective administrative discretion on the part of the importing country customs.

In theoretical terms, compliance with rules of origin in the U.S.–Arab countries FTAs could prove as complex and expensive process for the parties involved (producers and exporters). For small firms in Arab countries, the FTAs seem to be out of reach, due to administrative costs among other things, and thus they opt out of enjoying the FTAs preferential treatment. Rules of origin make it difficult or even impossible for otherwise

[82] See United States–Jordan Free Trade Agreement, *supra* note 16, Annex 2.2, Article 12; United States–Morocco Free Trade Agreement, *supra* note 25, 5.12; United States–Bahrain Free Trade Agreement, *supra* note 25, Article 4.12 and United States–Oman Free Trade Agreement, *supra* note 25, Article 4.12.

[83] This is a natural feature of papers dealing with rules of origin. Indeed, the paucity of empirical studies may reflect methodological difficulties as well as inadequate recognition of the potential importance of rules of origin. If tariffs are used, the impact of rules of origin is relatively straightforward to measure: it could be calculated as the proportion of imports that in principle satisfy the rule but which pay the duty. The problem is to determine which exports satisfy the rule, something that will generally be difficult for a researcher to determine. If quotas are used rather than tariffs it is even more difficult to measure the effect of origin rules. See Hoekman, B.: Rules of Origin for Goods and Services. *Journal of World Trade*, 27 (1993) 4, 81, 86.

[84] See Cadot, O.–Estevadeordal, A.–Suwa-Eisenmann, A.–Verdier, Th. (eds): *The Origin of Goods: Rules of Origin in Regional Trade Agreements*. London, 2006, 230–243. A study in connection with EC–EFTA agreement suggested that the cost of border formalities to determine the origin of products has amounted to at least three percent of the value of the goods. See Vermulst, *supra* note 43, 158.

[85] See Choi, W.-M.: Defragmenting Fragmented Rules of Origin of RTAs: A Building Block to Global Free Trade. *Journal of International Economic Law*, 13 (2010) 1, 111, 115.

[86] Augier, P.–Gasiorek, M.–Lai Tong, Ch.: The Impact of Rules of Origin on Trade Flows. *Economic Policy*, 20 (2005) 43, 567, 578–594.

qualified parties to obtain the preferential duties under these FTAs. The technical nature of rules of origin and the high the costs for an exporter or producers to comply with these rules mean lower incentives to seek preferential treatment offered by these FTAs.

Conclusions

The U.S.–Arab countries FTAs include several kinds of rules of origin. These rules of origin relate to substantial transformation, value-added, specific rules for certain products, cumulation, transshipment, and packing and non-qualifying operations. The most challenging aspect of these rules is the "substantial transformation" test, which is based on U.S. common law. The rule of substantial transformation is too imprecise, too subjective requiring further interpretation.[87] Furthermore, substantial transformation requires case-by-case determination. Minimum differences in manufacturing processes or techniques may affect the treatment of products exported from Arab countries.

The FTAs rules of origin for textiles and apparels are restrictive rules designed to protect the U.S. textiles industry. Not only the U.S. adopted the "four operations" and "yarn-forward" rules for most textiles and apparel products, but also the U.S. designated that textiles and apparels are subject to longer tariff phase-outs.

The inclusion of other rules of origin–*de minimis* and advance ruling for origin–in the FTAs tends to balance against the objectives of predictability and flexibility. In addition, the favorable method to implement is the "tariff shift" rule adopted in the case of NAFTA. Theoretically, in the "tariff shift" rule, customs authorities of the importing country can look at the tariff schedule to see if non-originating materials shifted from one heading to another as a result of the manufacturing process.[88] Even with the inclusion of other rules of origin, every rule or test has its own shortcomings and is subject to discretionary powers in implementation resulting in the fact that rules of origin can act as a trade barrier thus hindering trade. The selection of a "tariff shift" rule seems to be in many ways the selection of a lesser evil rule.

Reform measures should be adopted to ease the complexity and costs of rules of origin in the FTAs. One reform measure is to liberalize rules of origin for certain products that are subject to very low or zero Most-Favored-Nation (MFN) tariff rates. Whether these products are exported from FTA party or a non-FTA party is irrelevant because these products will enter the U.S. at a low tariff rate. Alternatively, the U.S. and Arab countries may conduct a study of different industries and use the results as a basis to potentially allow deviations from rules of origin of the FTAs.

U.S.–Arab countries FTAs should implement full cumulation which allows for the development of regional production networks and deeper integration. The roll-up principle, which permits materials that have acquired origin by meeting specific processing requirements to be considered an originating good when used as input in a subsequent transformation, should also be adopted to simplify rules of origin.

Another reform measure that pertains to *de minimis* rules which allow for a specified maximum percentage of non-originating materials to be used without affecting origin. Currently, the *de minimis* rule is used for certain products. A wider use of the *de minimis* rule,

[87] See Simpson, J.: Reforming Rules of Origin. *Journal of Commerce*, Oct. 4, 1988, 12A.

[88] As a matter of fact, the advantage of the harmonized tariff schedule is its classification of goods into heading and subheading of four digits that would make it easier to certify shifting among headings as a result of manufacturing processes.

not only for specific products, will simplify rules of origin. There is also a need for a concrete and mutual agreement between the U.S. and Arab countries to improve and streamline customs procedures in order to facilitate trade.

These reform measures seem to be workable when compared with other suggestions, such as lowering value-added content, creating a government-sponsored trade manuals published via the internet, or establishing FTA education and outreach activities to educate small and medium size firms about these FTAs.

The U.S. could have adopted a more enlightened, transparent, and fairer approach tailored to Arab countries' specific circumstances. Simpler, least restrictive rules of origin accompanied with streamlined customs procedures would greatly reduce the cost of compliance and maximize benefits from the FTAs. Ultimately, these FTAs will promote trade and international competitiveness of Arab countries.