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COMMENTS

BEYOND MARKING: COUNTRY OF ORIGIN RULES AND THE DECISION IN *CPC* *INTERNATIONAL*

DONNA L. BADE*

Do you consider yourself a savvy consumer? In purchasing a pair of leather shoes, would you select an Italian brand or one carrying a "Made in USA" label, given that they are comparable in quality and value? Do you prefer the Italian brand because of a belief that Italian leather is superior in quality or craftsmanship? Or do you prefer the shoes made in the United States out of a sense of national pride and responsibility in keeping Americans employed?

Now, put yourself in the position of an American manufacturer. Would you prefer that your products carry specific labels of origin based on their impact on consumer purchasing? If so, you are not alone. Many manufacturers do believe the origin of a product influences a buyer's decision. In fact, the effect of a product's country of origin on purchasers is one of the most widely-studied consumer-behaviors.¹ It has generated numerous marketing studies detailing the strong impact origin labeling has on consumers throughout the world.²

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1. Robert A. Peterson & Alain J.P. Jolibert, *A Meta-Analysis of Country of Origin Effects*, 26 J. INT'L BUS. STUD. 883, 883 (1995).

2. See, e.g., Durairaj Maheswaran, *Country of Origin as a Stereotype: Effects of Consumer Expertise and Attribute Strength on Product Evaluations*, 1994 J. CONSUMER RES. 354 (1994) (suggesting that information on the effect that country-of-origin has on consumers is of significant interest to advertisers); Marjorie Wall et al., *Impact of Country-of-Origin Cues on Consumer Judgments in Multi-Cue Situations: A Covariance Analysis*, 1991 J. ACAD. MKTG. SCI. 105 (1991) (noting that consumers favor low-priced, well-known brands from high reputation countries). Ms. Wall's study also discovered that consumers used country of origin markings to assess product quality, but origin appeared to be relatively unimportant when evaluating the likelihood of purchase. *Id.*; Editorial, *Consumer Product: Country of Origin*, MKTG. TO WOMEN, Oct. 1, 1994 (stating that 84% of Americans say that they prefer U.S. products over products made overseas and 34% always try to determine

The United States has required country of origin marking on products since the implementation of The Tariff Act of 1890.³ The Tariff Act of 1930⁴ codified the marking provision and the current statute remains essentially the same.⁵ Congress intended the marking statute to make the country of origin of an imported product known to the ultimate purchaser, thereby allowing him to make wiser purchasing decisions.⁶

The rules of origin take on greater significance with the realization that the nationality of a product determines, among others things, the preferential treatment, duty assessments, import restrictions and possible prohibitions that may apply to that product.⁷ Additionally, with the rise of multinational corporations, a product may pass through several countries and processes of manufacture before importation.⁸ The determination of that product's accurate country of origin for U.S. Customs purposes becomes extremely difficult.⁹

The implementation of the North American Free Trade Agreement (NAFTA) gave rise to new country of origin marking

product's country of origin before purchasing). *But see* Editorial, *Made in America is Fine, But . . . (Gallup Poll Shows Place of Origin Does Little to Influence Purchases)*, DAILY NEWS REC. May 27, 1994, at 4 [hereinafter *Made in America*] (suggesting that while most Americans consider U.S.-made products better in quality than those of foreign origin and over half prefer American made clothing, country of origin is not a factor at the top of their shopping list regarding other purchases). These and other studies suggest that while origin markings on imported products may not be the sole or even primary determinative factor, they do have an influence on consumer purchasing. *Id.*

3. Tariff Act of 1890, ch. 1244, § 2504, 26 Stat. 567, 613 (1891) (codified at 19 U.S.C. § 1304 (1994)).

4. *Id.*

5. 19 U.S.C. § 1304 (1994). The statute provides the following:

(a) Marking of articles:

Except as hereinafter provided, every article of foreign origin (or its container, as provided in subsection (b) hereof) imported into the United States shall be marked in a conspicuous place as legibly, indelibly, and permanently as the nature of the article (or container) will permit in such a manner as to indicate to an ultimate purchaser in the United States, the English name of the country of origin of the article.

Id.

6. *United States v. Friedlaender & Co.*, 27 C.C.P.A. 297, 302 (1940).

7. Michael P. Maxwell, *Formulating Rules of Origin for Imported Merchandise: Transforming the Substantial Transformation Test*, 23 GEO. WASH. J. INT'L L. & ECON. 669, 669-70 (1990) (stating that the determination of origin of imported merchandise produced in two or more countries is profoundly significant to U.S. importers). *See also* N. David Palmetier, *Rules of Origin or Rules of Restriction? A Commentary on a New Form of Protectionism*, 11 FORDHAM INT'L L.J. 1, 2 (1987) (contending that rules of origin have become increasingly important because of the recent proliferation of country-specific import quotas and preferential tariff provisions).

8. Maxwell, *supra* note 7, at 669.

9. *Id.*

requirements that dramatically altered the traditional method used by the U.S. Customs Service since 1940.¹⁰ In January 1994, the U.S. Customs Service drafted interim regulations to comply with the new NAFTA requirements.¹¹ Recently, the Court of International Trade (CIT), in *CPC International, Inc. v. United States*,¹² had the opportunity to evaluate the changes that resulted from the new NAFTA regulations.¹³ Based on the specific language of the NAFTA agreement stating that "Nothing in the Act shall be construed to amend or modify [existing] law of the United States . . . unless specifically provided for in the Act," the court struck down the U.S. Customs' interim regulations.¹⁴ The court found the interim regulations were contrary to existing law because they required a shift in the HTSUS tariff headings as the basis for the determination of the ultimate purchaser for origin purposes.¹⁵ Customs failed to apply the traditional U.S. substantial transformation test whereby a product changes its origin if the

10. North American Free Trade Agreement Implementation Act, Pub. L. No. 103-182, 107 Stat. 2057 (1993) [hereinafter NAFTA Act].

11. 19 C.F.R. §§ 10, 12, 102, 134, 177 (1995).

12. 933 F. Supp. 1093 (Ct. Int'l Trade 1996), *petition denied*, CPC Int'l Inc. v. United States, No. 97-1, slip op. at 19 (Ct. Int'l Trade Jan. 6, 1997).

13. *Id.* at 1096. CPC International, manufacturer of Skippy™ brand peanut butter, imports peanut 'slurry' from Canada and further processes the slurry into peanut butter in the United States. *Id.* at 1094. Under the traditional substantial transformation guidelines, CPC International should be considered the ultimate purchaser of the imported product, therefore, origin markings are not required. *Id.* at 1095. After processing in the United States, the importer wanted the product to carry a "Made in USA" label based on the substantial transformation of the peanut slurry into the final product and requested a pre-importation ruling. *Id.* at 1094. The Canadian slurry represented only a small portion of the total product while the balance consisted of U.S. products and labor. *Id.* at 1095.

Applying the NAFTA Act rules of origin analysis, U.S. Customs required a shift between tariff numbers, used for classification and duty assessment purposes, in order to consider the commodity a new product for marking requirements. *Id.* at 1097. See *infra* note 52 for a detailed discussion of tariff classification. Since peanut slurry and peanut butter carry the same heading (Chapter 20) under the Harmonized Tariff Schedule of the United States (HTSUS), no shift occurred. *Id.* at 1098. Thus, the product was not a "good of the United States" and needed to carry a "Made in Canada" label. *Id.* at 1097-98. Under 2008.11.90 of the HTSUS, peanut slurry is classified as "other peanuts," whereas peanut butter is specifically provided for under 2008.11.10. *Id.* at 1098 n.5. Both products fall under the 2008.11 subheading ('20' is the chapter, '08' is the heading, and '11' is the subheading). *Id.* Under the NAFTA tariff shift provisions the change required to recognize an actual shift to subheading 2008.11 must come from any other chapter (for example, items in chapters 19, as in 1901.90). *Id.* See also U.S. INT'L TRADE COMM'N (USITC), PUB. NO. 3001, HARMONIZED TARIFF SCHEDULE OF THE UNITED STATES (1997) [hereinafter the HTSUS].

14. *CPC Int'l*, 933 F. Supp. at 1103.

15. *Id.* at 1098. See also *infra* note 52 for a more detailed explanation of the HTSUS classification.

manufacturing results on the product acquiring a new name, character, and use.¹⁶ The court required the Customs Service to continue applying the "substantial transformation" test in addition to using the NAFTA tariff-shift requirements to determine the ultimate purchaser and exemption from marking requirements.¹⁷ This decision is significant not only because of its impact on the rules of origin under NAFTA but also in terms of the ramifications on other origin determinations for foreign products based on trade agreements that employ the same criteria and include similar language purporting to adopt new rules and yet maintain current U.S. laws and regulations.

Part I of this Comment discusses the history of marking regulations in the United States and the interim regulations that went into effect under the NAFTA agreement.¹⁸ Part II of this Comment discusses the basis for the CIT's decision in *CPC International* requiring the continued use of the traditional "substantial transformation" criteria for determining marking requirements, and why it effectively rejected the NAFTA marking regulations.¹⁹ Part II also analyzes and evaluate the ramifications of the court's decision as it applies to other origin determinations and the various other trade agreements into which the United States has entered, specifically the General Agreement of Tariffs and Trade (GATT) on Textile Products.²⁰ This Comment also looks at potential problems the United States may face as the WTO strives to develop universal country of origin and marking regulations based on similar criteria to the NAFTA regulations.²¹ Finally, Part III proposes that country of origin criteria be unified for all purposes. The criteria should be based on a change in tariff classification but supplemented by analysis based on value and processing that will determine when a sufficient transformation occurs despite the lack of shift in the tariff assessment.

16. *CPC Int'l*, 933 F. Supp. at 1098.

17. *Id.* See also *infra* note 52 for a more detailed explanation of HTSUS classification.

18. See 19 C.F.R. §§ 12, 102, 134 (1996).

19. See *CPC Int'l*, 933 F. Supp. at 1103.

20. See The Uruguay Round Agreements Act, Pub. L. No. 103-465, § 101(d)(4), 108 Stat. 4809 (1994) (effective Jan. 1, 1995) [hereinafter Uruguay Round].

21. See Agreement on Rules of Origin, Apr. 15, 1994, Final Act Embodying the Results of the Uruguay Round Multilateral Trade Negotiations, ANNEX I, AGREEMENT ON RULES OF ORIGIN, art. 9(2), 33 I.L.M. 1125, 1166. [hereinafter AGREEMENT ON RULES OF ORIGIN]. The Agreement on Rules of Origin clearly reflects a preference for the tariff-shift approach as the primary basis for defining when a product has undergone a substantial transformation. *Id.*

I. HISTORY OF U.S. ORIGIN MARKING REGULATIONS PRIOR TO *CPC INTERNATIONAL, INC.*

American trade strategy changed dramatically during the post-Civil War era.²² President Grover Cleveland altered a traditionally protectionist stance by calling for duty-free status on raw materials and promoting the export of American made finished commodities.²³ Both the McKinley Act of 1890 and the Wilson-Gorman Tariff of 1894 actively pursued these goals with Latin American countries.²⁴ Simultaneously, the first regulations requiring country of origin marking appeared during this transitional era with the Tariff Act of 1890.²⁵ This part of the Comment traces the history of the country of origin marking statute from its initial inception through the recent trade agreements that have attempted to alter the traditional criteria, resulting in the recent *CPC International* case. This section begins with a look back at the early 20th century definition of "substantial transformation" and how it evolved. It then discusses the weaknesses of using the "substantial transformation" test and concludes with the evolution of the tariff-shift approach during the development of the Canadian-Free Trade Agreement (CFTA) and NAFTA.

A. *Country of Origin Marking - A Brief History*

The Tariff Act of 1890 first implemented country of origin marking on imported products.²⁶ The Act required that each item of imported merchandise bear the name of its country of origin in plain English or the Act required re-exportation of the article.²⁷ By 1922, an importer who failed to mark foreign merchandise was subject to penalties and fines.²⁸ Congress codified these earlier principles in section 304 of the Tariff Act of 1903, and the marking provisions remain virtually unchanged today.²⁹ Generally, the statute requires marking all imported products of foreign origin in such a manner as to indicate to the ultimate purchaser the origin of the article.³⁰ The purpose of the marking statute, as first ex-

22. DAVID A. LAKE, *POWER, PROTECTION, AND FREE TRADE*, 6 (1988).

23. *Id.*

24. *Id.*

25. Tariff Act of 1890, ch. 1244, § 2504, 26 Stat. 567, 613 (1891) (codified at 19 U.S.C. § 1304 (1994)).

26. *Id.*

27. *Id.*

28. Law of Sept. 21, 1922, ch. 356, § 321, 42 Stat. 947 (codified at 19 U.S.C. 1304 (1994)). This statute created a \$5000 fine for violation of the marking statute. *Id.* See also Tariff Act of 1922, ch. 356, Pub. L. No. 67-318, 48 Stat. 936 (1923) (codified at 19 U.S.C. § 1304(f) (1994)) (assessing 10% marking duty in addition to the regular duty for any article not marked). The 10% marking duties still apply today. 19 C.F.R. § 134.2 (1996).

29. 19 U.S.C. § 1304 (1996).

30. 19 C.F.R. § 134.11 (1996).

plained in the 1940 case of *United States v. Friedlaender*,³¹ was to allow consumers to "buy or refuse to buy" products if the country of origin mattered to them.³²

For products that originate in one country and are processed in another country, the origin of the article is less clear. The Federal Regulations define the "ultimate purchaser" as the last person in the United States who receives an article in its imported condition.³³ If the article is intended for manufacture within the United States, the U.S. manufacturer is the "ultimate purchaser."³⁴ However, the U.S. manufacturing process must then substantially transform the product in order for the U.S. manufacturer to remark the product as "Made in U.S.A."³⁵ In 1908, the Supreme Court defined the concept of "substantial transformation" in *Anheuser-Busch Brewing Association v. United States*.³⁶ The Court determined that for a substantial transformation to occur, a new and different article must emerge "having a distinctive name, character, or use."³⁷ The Court considered whether the processing of beer bottle corks altered their country of origin and held that cleaning, sanitizing, and coating the corks did not result in a new product with a distinctive name, character or use.³⁸ Therefore, there was no substantial transformation.³⁹ Contrastingly, in 1940, the U.S. Customs Court determined in *United States v. Gibson-*

31. 27 C.C.P.A. 297, 297 (1940).

32. *Id.* This 1940 case determined the country of origin status on products from Czechoslovakia after the German invasion. *Id.* at 298-99. The articles bore the Czechoslovakian origin markings, but U.S. Customs held that they should be re-marked to establish that they were from Germany. *Id.* at 298. It is important to note that Germany had invaded Czechoslovakia subsequent to the manufacture and prior to the importation of the merchandise at issue in *Friedlaender*. *Id.* at 300. The court held that because the products were therefore of German origin, a purchaser who might refuse to buy German goods, but would be perfectly willing to purchase Czechoslovakian goods would be misled. *Id.* at 303. The U.S. Court of Customs and Patent Appeals for the first time held in this case that the congressional intent of the marking statute was to inform the ultimate purchaser of the country of origin of imported products so the purchaser would "be able to buy or refuse to buy them, if such marking should influence his will." *Id.* at 302. *See also* *Globemaster v. United States*, 340 F. Supp. 974, 975-76 (Cust. Ct. 1972) (holding that Congress was aware that consumers prefer merchandise produced in the United States and sought to provide domestic manufacturers some competitive advantage).

33. 19 C.F.R. § 134.1(d) (1996).

34. 19 C.F.R. § 134.1(d)(1) (1996).

35. *Id.*

36. 207 U.S. 556, 562 (1908). *See also* *Hartranft v. Wiegmann*, 121 U.S. 609, 615 (1887) (articulating the phrase "distinctive name, character, or use" for the first time).

37. *Anheuser-Busch*, 207 U.S. at 562.

38. *Id.*

39. *Id.* The court stated that a cork put through the Anheuser-Busch manufacturing process was essentially still a cork. *Id.*

*Thomsen Co., Inc.*⁴⁰ that wood blocks processed into toothbrush and hair brush handles did undergo a “substantial transformation” during processing since the result was a new product having acquired “a new name, character, and use.”⁴¹ This became known as the *Gibson-Thomsen* substantial transformation test and has been the traditional basis for evaluating the country of origin for marking processed articles since that time.⁴²

B. *The Weaknesses of the Substantial Transformation Test*

The *Gibson-Thomsen* substantial transformation test, however, was not without its detractors over the years. The test has been characterized as highly subjective and difficult to administer.⁴³ Currently U.S. Customs uses a number of highly discretionary factors to determine if a substantial transformation takes place.⁴⁴ In some cases Customs has applied the same criteria in-

40. 27 C.C.P.A. 267, 267 (1940).

41. *Id.* at 270. The Customs Court changed the phrasing of its definition of transformation to articles having a “new name, character, and use.” *Id.* (emphasis added). In the *Gibson* case the court held that the importer was the ultimate purchaser of the wood blocks; therefore, marking of origin was not required. *Id.* at 273.

42. See *Uniroyal, Inc. v. United States*, 542 F. Supp. 1026, 1029 (Ct. Int'l Trade 1982) (holding that imported shoe uppers manufactured from sheets of leather into substantially complete shoes had not lost their identity in the manufacture of the finished shoes; on the contrary, the uppers were the essence of the finished shoes); *Koru N. Am. v. United States*, 701 F. Supp. 229, 235 (Ct. Int'l Trade 1988) (holding that headed and gutted fish caught off the coast of New Zealand that were filleted in Korea were transformed by both a new name and character); *National Juice Prod. Ass'n v. United States*, 628 F. Supp. 978, 989 (Ct. Int'l Trade 1988) (holding that the manufacturing process of turning orange juice concentrate into orange juice did not result in a substantial transformation by applying the *Gibson-Thomsen* “new name, character, and use” test). See Maxwell, *supra* note 7, at 672 (stating that the country of origin for preferential treatment when merchandise is produced in two or more countries, is the last country where the merchandise was “substantially transformed”).

43. Maxwell, *supra* note 7, at 671. Application of the current rules of origin is considered by importers to be “ambiguous” and “problematic.” *Id.* See also Joseph A. LaNasa III, *Rules of Origin Under the North American Free Trade Agreement: A Substantial Transformation into Objectively Transparent Protectionism*, 34 HARV. INT'L L.J. 381, 386 (1993) [hereinafter *Origin Under NAFTA*]. The critics describe the current U.S. system as weak and easily manipulated leaving Customs officials with too much discretion and subjectivity. *Origin Under NAFTA*, *supra*, at 386. The only consistency in U.S. customs decisions is that they always result in either higher duties or fewer imports. Palmeter, *supra* note 7, at 4.

44. Maxwell, *supra* note 7, at 673. Customs considers a wide range of factors in determining origin including: (1) the value added during processing, (2) the type of processing involved, (3) the effect of the processing, (4) how the product was used both before and after the processing, (5) the tariff classifications before and after processing, and (6) the product's identity before and after processing. *Id.* Use of the substantial transformation test gives U.S.

consistently.⁴⁵ Critics suggest that this agency discretion reflects more protectionism than anything else.⁴⁶ However, this same discretionary flexibility of the substantial transformation test is also considered the test's greatest asset by allowing for continued application in the face of ever-increasing technology.⁴⁷

Over the years, the simple purpose of the country of origin determination has significantly expanded to the point that today the rules of origin are divided into two groups: preferential and non-preferential. Non-preferential rules of origin apply to marking, quota restrictions, prohibitions, antidumping and countervailing duties,⁴⁸ whereas preferential rules of origin determine favored treatment under the proliferation of trade agreements designed to provide country-specific non-tariff discrimination to imported products.⁴⁹ Ultimately, the burden of erroneous determination of origin, for either preferential or non-preferential purposes, falls to the importer with significant ramifications.⁵⁰

C. *The Evolution of the Tariff-Shift Approach in the Canadian-Free Trade and NAFTA Agreements*

The United States adopted the Harmonized Tariff Schedules on January 1, 1989, pursuant to the signing of the Omnibus Trade and Competitiveness Act of 1988.⁵¹ The theory behind a worldwide harmonized system is that the same commodity carries the same tariff number and description in any country, even though

Customs the ability to subjectively evaluate origin on a case-by-case basis. *Origin Under NAFTA*, *supra* note 43, at 385.

45. *Origin Under NAFTA*, *supra* note 43, at 406 n.15. In *Midwood Indus., Inc. v. United States*, 313 F. Supp. 951 (Cust. Ct. 1970), the Customs Court held that the transformation of a product from a producer's-only product to a consumer product was dispositive. *Id.* at 957. Whereas in *Uniroyal, Inc. v. United States*, 542 F. Supp. 1026 (1982), a similar transformation was not dispositive. *Id.* at 1027.

46. *Origin Under NAFTA*, *supra* note 43, at 386. See also Joseph A. LaNasa III, *Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating Them*, 90 AM. J. INT'L L. 625, 631 [hereinafter *Origin and Uruguay*] (stating that the inconsistency of application allows for political pressure by lobbying groups for protectionist purposes); Palmeto, *supra* note 7, at 2 (stating that country of origin determinations have become increasingly important because of quotas). Import quantitative restrictions cover more merchandise today than ever before, and determination of its origin may restrict an article's importation from a specific country. Palmeto, *supra* note 7, at 3. Increasingly, countries use the rules as vehicles of protectionism. *Id.*

47. *Origin Under NAFTA*, *supra* note 43, at 385.

48. *Origin and Uruguay*, *supra* note 46, at 626.

49. *Id.*

50. Maxwell, *supra* note 7, at 670 (stating that erroneous determination as to the country of origin of a product may additionally lead to seizure, forfeiture, and penalties by the U.S. Customs Service).

51. 19 U.S.C. § 3001 (1988) amended by Pub. L. No. 103-465 (1994), Subtitle B-Implementation of the Harmonized Tariff Schedule (1988).

the tariff rate might differ from country to country.⁵² The concept of a universal country of origin rule based on a shift in the tariff

52. *Id.* One of the purposes of this section was "to approve the International Convention on the Harmonized Commodity Description and Coding System." *Id.* At an international level the Harmonized system establishes a six-digit tariff number and description for all products. Ralph H. Sheppard & Robert J. Leo, *NAFTA Rules of Origin - Improvement on Past Rules?*, 6-AUT INT'L L. PRACTICUM, 24, 25 (1993). The first two digits of the tariff number identify the "chapter" in which the article is listed. *Id.* The Harmonized System contains 97 different chapters covering all products from live animals to complex machinery. *Id.* Each additional two numbers refine the description of the product further. *Id.* The first four numbers together are considered a "heading" and the next two signify a "subheading." *Id.* The last two digits refine the description even further. *Id.* Each country may also add additional digits for statistical and tariff rate purposes. *Id.* The U.S. tariff numbers have a total of 10 digits. *Id.*

As an example, in Chapter 20 one of the headings is as follows:

2007 Jams, Fruit Jellies, Marmalades, Fruit or Nut Puree and Fruit or Nut Pastes, Being Cooked Preparations, Whether or Not Containing Added Sugar or Other Sweetening Matter:

2007.10.0000 Homogenized preparations

Other

2007.91 Citrus fruit:

2007.91.1000 Pastes and purees

2007.91.4000 Orange marmalade

2007.91.9000 Other

2007.99 Other:

Jams:

2007.99.0500 Ligon berry and raspberry

2007.99.1000 Strawberry

2007.99.1500 Currant and other berry

2007.99.2000 Apricot

2007.99.2500 Cherry

2007.99.3000 Guava

2007.99.3500 Peach

2007.99.4000 Pineapple

2007.99.4500 Other

Pastes and purees:

2007.99.4800 Apple, quince and pear

2007.99.50 Guava and mango

2007.99.5010 Guava

2007.99.5020 Mango

2007.99.5500 Papaya

2007.99.6000 Strawberry

2007.99.6500 Other

Fruit Jellies

2007.99.7000 Currant and berry

2007.99.7500 Other

USITC Pub. 3001 (1997).

The first six-digits of these tariff numbers (either 2007.10, 2007.91 or 2007.99) are universal and the remaining numbers are for U.S. statistical purposes. Sheppard & Leo, *supra*, at 25. Each of the above classifications has several different duty rates depending on their country of origin ranging from duty-free to a maximum of 29.5¢ per kilogram plus 40% depending on their country of origin. See USITC Pub. 3001 (1997) (listing the duty rates).

classification arose out of the implementation of this standardized system.⁵³

The United States took its first step toward using the Harmonized Tariff Schedule as a basis for determining country of origin under the CFTA implemented in 1989.⁵⁴ Under the CFTA there were two separate rules of origin: one for the determination of preferential treatment, and the other for the determination of marking requirements.⁵⁵ The CFTA used a shift in the tariff classification plus additional value-added rules as the basis for determining origin for preferential treatment.⁵⁶ However, the basis of origin for marking purposes was the traditional substantial transformation test, requiring the importer to use two separate determinations of origin for preferential and marking treatments.⁵⁷

The framers of the NAFTA agreement attempted to overcome some of the problems that arose under the CFTA by altering the rules of origin for NAFTA goods.⁵⁸ Under the NAFTA agreement, the nationality of a processed article is based on a specific change in tariff classification with limited regional value-added criteria.⁵⁹ The marking regulations essentially apply to products in three categories: those "wholly obtained" or "produced," those made exclusively of domestic materials, and those requiring specific

53. Ralph H. Sheppard, *Rules of Origin: Their Role in NAFTA*, 1 No. 3 MEX. TRADE & L. REP. 26 (1991).

54. Sheppard & Leo, *supra* note 52, at 26.

55. U.S.-Can. Free Trade Agreement Implementation Act of 1988, 102 Stat. 1851 (1988) [hereinafter U.S.-Can. FTA].

56. Maxwell, *supra* note 7, at 692. The CFTA defined two methods of determining origin for merchandise transformed in either country. *Id.* at 691. The first method requires the merchandise to undergo a change in tariff classification as a result of the manufacturing operation. *Id.* at 692. A second category grants country of origin status to those goods which are not sufficiently transformed so that there is a change in the tariff classification but which nonetheless have over 50% of their value attributable to either materials or labor added in the United States or Canada. *Id.*

57. Sheppard & Leo, *supra* note 52, at 25-27.

58. Proposed Rules of Origin Applicable to Imported Merchandise, 59 Fed. Reg. 141 (1994).

59. 19 C.F.R. § 102.19 (1996). This part of the regulations contains 31 pages of specific origin criteria based on tariff-shift requirements and supplemented by regional value-added requirements predominantly for chemicals, plastics, footwear, machinery, electronic, and automotive products. *Id.* See also USITC Pub. 3001, GN12(t)/1-GN 12(t)/97. For example, the NAFTA rules of origin state under Chapter 30 that a tariff-shift occurs when the following transpires:

A change to subheadings 3003.10 through 3003.90 from any other heading within heading 3003, whether or not there is also a change from any other heading, provided there is a regional value content of not less than:

- (1) 60 percent where the transaction value is used, or
- (2) 50 percent where the net cost method is used.

Id.

marking rules.⁶⁰ Products that require additional processing in the United States would fall into the third category based on the tariff-shift principles.⁶¹ U.S. Customs' NAFTA-compliant interim regulations were codified under 19 C.F.R. § 134.35 (a) and (b).⁶² The Customs Service divided the section on marking for articles substantially changed by manufacturing into two sections dealing separately with non-NAFTA articles and NAFTA articles.⁶³

In July 1996, the Court of International Trade had its first opportunity to evaluate the new NAFTA marking criteria and the separate provisions for NAFTA versus non-NAFTA manufactured articles in *CPC International*.⁶⁴ The court determined that the new regulations were contrary to Congress' intent when ratifying NAFTA.⁶⁵

II. THE RAMIFICATIONS OF THE *CPC INTERNATIONAL* DECISION

While the decision in *CPC International* addressed only the country of origin issue for marking purposes,⁶⁶ it paves the way for increased judicial scrutiny over the contrary provisions of our trade agreements and international skepticism as to the sincerity of the United States' negotiating position. This part of the Comment discusses the rationale behind the Court of International Trade's holding that the NAFTA marking regulations are contrary

60. Carol Osmond & Claire Wright, *Regional: Customs: Marking Rule Changes Have Broad Implications*, U.S. MEX. FREE TRADE REP., June 15, 1996, available in 1996 WL 10175465.

61. *Id.*

62. 19 C.F.R. § 134.35 (a),(b) (1996).

63. *Id.* The provisions read as follows:

§ 134.35 Articles substantially changed by manufacture.

(a) *Articles other than goods of a NAFTA country.* An article used in the United States in manufacture which results in an article having name, character, or use differing from that of an imported article, will be within the principle of the decision in the case of *United States v. Gibson-Thomsen Co. Inc.*, 27 C.C.P.A. 267 (C.A.D. 98). Under this principle, the manufacturer or processor in the United States who converts or combines the imported article into the different article will be considered the 'ultimate purchaser' within the contemplation of section 304(a), Tariff Act of 1930 . . .

(b) *Goods of a NAFTA country.* A good of a NAFTA country which is to be processed in the United States in a manner that would result in the good becoming a good of the United States under the NAFTA Marking Rules is excepted from marking. Unless the good is processed by the importer or on its behalf, the outermost container of the good shall be marked in accord with this part.

Id.

64. *CPC Int'l Inc. v. United States*, 933 F. Supp. 1093, 1094 (Ct. Int'l Trade 1996).

65. *Id.* at 1101 (explaining the contradiction between the proposed regulations and the congressional intent).

66. *Id.* at 1098.

to U.S. law. It goes on to compare how that decision affects the recently implemented GATT Textile country of origin requirements and the potential impact on the World Trade Organization's efforts at developing universal country of origin rules.

A. *The CPC International Case*

The first judicial test of the new rules of origin came in the *CPC International* case.⁶⁷ The U.S. Court of International Trade evaluated Customs' rationale for segregating NAFTA articles substantially changed by manufacture against the traditional rules that were still applicable for non-NAFTA articles.⁶⁸ While the court concurred with Customs' authority to promulgate regulations to implement the Act, the court held that Customs had exceeded its authority by abolishing the long-standing *Gibson-Thomsen* substantial transformation test for NAFTA articles.⁶⁹ The congressional intent in ratifying the NAFTA agreement, according to the court, was not to alter current U.S. law.⁷⁰ The court stated that, in passing the NAFTA Agreement, Congress presumably "was well aware of *Gibson-Thomsen* and the long line of judicial authority codifying" this test.⁷¹ On appeal, the Court of International Trade

67. *Id.* at 1103. The court stated that Customs developed the tariff-shift concept as an alternative to the substantial transformation rule' in order to "obviate various problems in origin determination." *Id.* at 1104. The plaintiff did not disagree that under NAFTA the tariff-shift principles apply for determination of origin but additionally argued that Customs should also apply the *Gibson-Thomsen* test in its final determination. *Id.* at 1099.

68. *Id.* at 1101.

69. *Id.* at 1098. Section 3314 of the NAFTA Implementation Act granted the U.S. Customs Service the authority to promulgate the necessary regulations to ensure that the Act was "appropriately" implemented. *CPC Int'l, Inc. v. United States*, No. 97-1, slip op. at 12 (Ct. Int'l Trade Jan. 6, 1997). In order for the court to determine if a specific regulation "appropriately" implements the Act it must observe the effect of that regulation under the statutory prohibitions specified in § 3312(a). *Id.* Section 3312(a) "expressly precludes construing or applying any provision of the Implementation Act as an amendment or modification of any law of the United States, unless specifically provided for in the Act." *Id.* at 11.

70. *CPC Int'l*, 933 F. Supp. at 1106. In the appeal, U.S. Customs argued that the NAFTA marking rules did not alter U.S. law but were a codification of the substantial transformation test. See *CPC Int'l*, No. 97-1, slip op. at 8. The court soundly rejected this argument by finding that even Customs used a dual approach to marking. *Id.* First, the Customs Service prescribed under § 102.20 that a tariff shift had to result in a "substantial transformation" and then went on to define that term under § 102.1(p) as a product which results in a "new name, character, and use" description. *Id.* at 9. Section 3312(a) of the NAFTA Implementation Act specifically precludes applying any provision of the Act as amending or modifying any law of the United States. *Id.* at 11. The Court held that Customs' rule-making authority does not extend to the implementation of a regulation in contravention of § 3312(1). *Id.*

71. *CPC Int'l*, 933 F. Supp. at 1102. The CIT went on to state that the substantial transformation test is so methodologically distinct from the tariff-

held that if Congress had intended to bifurcate the marking treatment for NAFTA versus non-NAFTA products there would be some expression of that intent in the statute as Congress had included in other parts of the NAFTA Agreement.⁷² In reaching its decision, the court held that the U.S. Customs interim regulations under the NAFTA agreement were “arbitrary and otherwise not in accordance with law.”⁷³

The significance of the *CPC International* decision is broad.⁷⁴ This decision requires Customs to evaluate country of origin markings under both the tariff-shift requirements specified in the NAFTA agreement and under the traditional *Gibson-Thomsen* substantial transformation principles for the determination of marking origin.⁷⁵ Thus, the American importer, as the party legally responsible, must also face dual processes of determination in order to comply with this decision: one for the determination of preferential treatment and duty status, and the other for marking requirements.⁷⁶ Additionally, Customs must still analyze country of origin designation for markings on a case by case basis using first the tariff-shift principles and then the elements resulting in a new name, character, and use.⁷⁷

The evolution of preferential trade agreements has resulted in greater emphasis on the country of origin rules well beyond these

shift format of § 134.35(b) that it makes a “mockery of the use of the term ‘codification’”. *Id.* at 1104. Congressional approval of the Implementation Act did not require the U.S. to replace the well-established *Gibson-Thomsen* substantial transformation test for an ultimate purchaser. *Id.* at 1102. The court held that Congress “did not intend to delegate the authority to do so to Customs.” *Id.*

72. *CPC Int’l*, No. 97-1, slip op. at 13. The Court noted that other provisions of the statute were specifically bifurcated for NAFTA and non-NAFTA goods. *Id.* Congress liberalized the standard of knowledge for an ultimate purchaser in the exception to the marking requirement by substituting a “reasonably know” standard for NAFTA goods versus the “necessarily know” standard for non-NAFTA goods under 19 U.S.C. § 1304(h)(1)(A)(1994). *Id.* at 13-14.

73. *CPC Int’l*, 933 F. Supp. at 1106. The Court concluded that the congressional intent under the NAFTA Implementation Act was not to overrule the *Gibson-Thomsen* test for NAFTA merchandise. *Id.* at 1098. U.S. Customs exceeded its delegated authority under 19 U.S.C. § 3314 because the interim regulations were contrary to the congressional intent and were unnecessary for the implementation of the Act. *Id.*

74. David Serko, *The CIT Rejects Customs NAFTA Country of Origin Marking Rules*, 59 WORLD WIDE SHIPPING, Oct.-Nov. 1996, at 10, 11.

75. *Id.*

76. E. Charles Routh, *A Few Pointers on Customs Law*, July 8, 1996, SB04 ALI-ABA 13, 24. Since the Customs Modernization Act was implemented, the burden of compliance has shifted from the Customs Service onto the importer. *Id.* Legal responsibility is now entirely on the importer and non-compliance carries with it substantial fines and penalties. *Id.* at 24-25.

77. *CPC Int’l*, 933 F. Supp. at 1105.

simple marking requirements.⁷⁸ Preferential trade agreements significantly alter the duty rates assessed upon a product based on its country of origin.⁷⁹ In addition, quantitative import restrictions in the form of quotas are designated by the country of origin of an imported product.⁸⁰ The recent GATT Agreement on Textiles and

78. Maxwell, *supra* note 7, at 669.

79. The U.S. Tariff Schedule divides duty rates into three separate categories. USITC Pub. 3001 (1997). Column 2 represents the rates enacted by the Smoot-Hawley Tariff Act of 1930 for all imported products and are the highest rates in the tariff. Tariff Act of 1930, ch. 497, 46 Stat. 590. Currently only countries that are not participating in any preferential trade agreements with the United States apply these rates, namely Afghanistan, Cuba, Laos, North Korea, and Vietnam. USITC Pub. 3001 (1997). On August 18, 1997, the Journal of Commerce reported that the U.S. had reached a bilateral trade agreement with Laos. *U.S. and Laos Reach Agreement on Trade*, J. OF COMM., Aug. 18, 1997, at 3A. For the commodities listed in note 52 *supra*, the Column 2 rates range from 35% of the imported value to 20.9¢ per kilogram of imported merchandise plus 40% of the imported value. See USITC Pub. 3001 (1997) (listing these duty rates).

Column 1 is divided into two sub-categories: General and Specific. USITC Pub. 3001 (1997). "General" rates of duty are for products originating from Most Favord Nation (MFN) countries — these are the generally applied rates of duty for our trading partners. 19 U.S.C. § 1202 General Headnote 3(d) (Supp. III 1985). For the commodities listed in note 52 *supra* the applicable "general" duty rates range from duty free to 15.8% of the imported value. See USITC Pub. 3001 (1997) (listing duty rates). "Specific" duty rates are based on bilateral and multilateral trade agreements, such as the Generalized System of Preferences (GSP), the Caribbean Basin Economic Recovery Act (CBERA), the Andean Trade Preference Act (ATPA), the United States-Israel Free Trade Area (US-IL), and others. *Id.* Our sample commodities range from duty-free to 10.5% of the imported value. *Id.*

80. John S. McPhee, *Agriculture and Textiles: The Fare and Fabric of Current GATT Negotiations*, 3 IND. INT'L & COMP. L. REV. 155, 161 (1992). Textile regulations developed in 1961 with the "Short-Term Arrangement" (STA) restricting the quantities of textiles imported from Japan. *Id.* The original purpose was to provide the textile industries in developed countries time to adapt to new competition from developing and underdeveloped countries. *Id.* at 162. In 1962, the STA was replaced by the "Long-Term Arrangements" (LTA) extending those restrictions for eleven more years. *Id.* The 1974 "Multi-Fiber Arrangement" (MFA) replaced the LTA allowing countries to develop bilateral agreements for the purpose of setting quotas on various types of textiles and textile products. *Id.* While the MFA gave lip service to expanding trade in textiles, in reality the restrictions were even greater than before. AVINASH K. DIXIT, *THE MAKING OF ECONOMIC POLICY: A TRANSACTION-COST POLITICS PERSPECTIVE* 138 (1996). The MFA remained in place until the adoption of the Uruguay Round Agreements. McPhee, *supra*, at 162. See also Maxwell, *supra* note 7, at 680 (discussing the use of quotas). The United States has increasingly used quota limits to ameliorate market disruptions in its economy. *Id.* at 680. Quotas limit the annual quantity of specific types of merchandise which is allowed to enter from any particular country. *Id.* at 680-681. See also Palmeter, *supra* note 7, at 3 (stating that a determination of a product's country of origin is actually a determination as to which country the importation is charged against, and ultimately, a determination if the product is allowed into the country at all).

Clothing has adopted the NAFTA tariff-shift principles as a basis for country of origin determination and the *CPC International* decision may similarly jeopardize those agreements.⁸¹

B. The Impact of CPC International on the GATT Textile Agreement

Textile products occupy a unique position in U.S. trade policy based on thirty-six years of protectionist legislation.⁸² On July 1, 1996, the GATT Textile Agreement was implemented promulgating new country of origin determinations based on the tariff-shift principles.⁸³ Critics of the Agreement view the measure as another protectionist effort and contrary to the Uruguay Round Agreements Act.⁸⁴ However, if these new regulations are viewed in light of the CIT's recent decision in *CPC International*, they may be subject to revision.⁸⁵

On December 8, 1994, President Clinton signed the Uruguay Round Agreement Act that included an Agreement on Textiles and Clothing.⁸⁶ The Textile Agreement was designed to dismantle textile trade barriers by the year 2005.⁸⁷ Six months later, several members of Congress authored an amendment requiring changes to the rules of origin for textiles.⁸⁸ This amendment became a part of the implementing legislation for the Uruguay Round Agreements Act.⁸⁹ The sponsors of the amendment contend that the changes comply with the goal of "harmonization" of the rules of origin by bringing U.S. law into alignment with the European method of classification.⁹⁰ The critics argue that changing the

81. Serko, *supra* note 74, at 11.

82. Pamela A. Bannon, *Trade Relief: A Benefit or Burden for the Textile and Apparel Industries?*, 19 N.Y.U. J. INT'L L. & POL. 701, 704 (1987) (citing the Short-Term, Long-Term, and Multi-Fiber Arrangements).

83. Country of Origin Marking Exception for Textile Goods Assembled Abroad with Components Only Cut to Shape in the U.S., 61 Fed. Reg. 32924 (1996) [hereinafter *Origin Cut to Shape*].

84. Robert Mottley, *New Pattern for World Trade*, AM. SHIPPER, Jan. 1, 1996, at 31. See also Editorial, *Tussle Over Garments: America's New Textile Rules Pose a Daunting Test to Asian Importers*, ASIaweek, July 26, 1996, available in 1996 WL 11652745 (discussing the U.S. position regarding the revised origin rules for textiles versus the position the U.S. took in negotiating the GATT Uruguay Round Agreement).

85. Serko, *supra* note 74, at 11.

86. Uruguay Round, Pub. L. No. 103-465, § 101(d)(4), (10), 108 Stat. 4809 (1994).

87. JOHN KRAUS, THE GATT NEGOTIATIONS 19 (1994). The Agreement on Textiles and Clothing is intended to abolish all quantitative restrictions within ten years. *Id.*

88. Janice Wingo, Comment, *Rules of Origin for Textiles: Implementing Legislation for GATT*, 4 PAC. RIM L. & POL'Y J. 543, 588 (1995).

89. *Id.*

90. *Id.*

rules now, before the WTO has a chance to promulgate universal harmonized rules of origin, is really another protectionist trade barrier and in violation of the Uruguay Round Agreement.⁹¹

U.S. Customs has always used the "substantial transformation" criteria for determining the country of origin on textiles and clothing, but it has never defined the term relative to textile manufacturing.⁹² In 1984, U.S. Customs identified seven factors to be considered in determining whether a textile article is substantially transformed during manufacture.⁹³ The regulations clearly state that sewing fabric together is insufficient to render transformation.⁹⁴ The country of origin is, therefore, determined by where the fabric is cut to shape.⁹⁵ As an example, an article of clothing that is cut in Hong Kong from Chinese silk, then shipped to China for assembly and sewing, is considered to be of Hong Kong origin and Hong Kong's quota levels are charged.⁹⁶ The merchandise also carries a "Made-In Hong Kong" label.⁹⁷

The new GATT Textile Agreement abandoned this "substantial transformation" definition and adopted a tariff-shift approach by defining the country of origin as the country of assembly.⁹⁸ In the example above, the article of clothing is now considered of Chinese origin. Critics have argued that the change was the result of pressure on U.S. Customs brought by the Committee for the Implementation of Textile Agreements (CITA), an administrative agency created under the Kennedy Administration to provide trade protection for the textile industry.⁹⁹

In light of the CIT's decision in *CPC International*, a challenge to the new rules of origin may not withstand judicial scrutiny.¹⁰⁰ The GATT Textile Agreement, like the NAFTA Agreement, contained the qualifying "supremacy of current U.S. law" language by stating that "no provision of any of the Uruguay Round Agreements . . . that is inconsistent with any law of the United States shall have effect."¹⁰¹ The CIT in the *CPC International* case certainly found that Customs' use of the tariff-shift principles were

91. Mottley, *supra* note 84, at 31.

92. Wingo, *supra* note 88, at 558.

93. *Id.* at 559.

94. 19 C.F.R. § 12.130(b)(1) (1984).

95. Wingo, *supra* note 88, at 559.

96. *Id.* at 560.

97. *Id.*

98. Serko, *supra* note 74, at 11.

99. Mottley, *supra* note 84, at 31.

100. On April 8, 1997, the U.S. Court of Appeals for the Federal Circuit upheld the new textile regulations in *Pac Fung Feather v. United States*, 111 F.3d 114, 117 (Fed. Cir. 1997). The court did not address the qualifying language provision but merely concurred with the U.S. Customs interpretation of the Uruguay Round Agreements Act. *Id.*

101. Uruguay Round, Pub. L. No. 103-465, § 102(a)(1), 108 Stat. 4809 (1994).

"inconsistent" with U.S. law.¹⁰² A challenge to the new origin regulations would force the court to address the underlying issue of long-term protectionism for U.S. textile manufacturers versus the cost of violating our international agreements under the Uruguay Round.

Beyond American shores, the revised U.S. rules have received widespread criticism as renegeing on the American commitments to the Uruguay Round.¹⁰³ The Agreement on Rules of Origin stated that there shall be "no retroactive application of changes in origin rules or in new rules of origin."¹⁰⁴ Senators from both parties recognized that the change in the textile origin rules might jeopardize other aspects of world trade.¹⁰⁵ The European Union (EU), on May 23, 1997, began proceedings before the WTO Dispute Resolution Panel challenging the U.S. changes as a violation of the Agreement on Textiles and Clothing, the Rules of Origin, and the Technical Barriers to Trade.¹⁰⁶ The Secretariat of the WTO still considers the action to be a pending consultation.¹⁰⁷ Whether the WTO's decision will have any impact on the U.S. Court of International Trade remains to be seen.

Beyond the current trade agreements, the WTO has promoted efforts to establish universal country of origin rules.¹⁰⁸ Disagree-

102. Serko, *supra* note 74, at 11.

103. Ben Wildavsky, *Singapore Slings*, NAT'L J. Sept. 21, 1996. See also Mottley, *supra* note 84, at 31 (stating that the new U.S. rules represent a setback for importers and a step away from harmonization); Editorial, ASIaweek, *supra* note 84 (indicating that Washington has unilaterally altered the quotas to which it committed); Editorial, *China Says 'Excessive Demands' Hamper Its WTO Accession*, ASIAN ECON. NEWS, Dec. 16, 1996, available in 1996 WL 11535345 (expressing the strong dissatisfaction of Long Yongtu, assistant foreign trade minister, regarding the U.S. changes in the rules of origin).

104. Wingo, *supra* note 88, at 565.

105. *Id.* Former Senator Bob Packwood expressed concern that the law implementing the change in the origin rules would jeopardize the impact of the Uruguay Round Agreement in other aspects of international trade. *Id.* Former Senator Bill Bradley also stated that the worst thing that Congress can do is to undo the GATT agreement by a textile origin amendment. *Id.*

106. Jim Ostroff, *EU Challenging U.S. Origin Regs. (European Union to Bring Suit With World Trade Organization Against Textile-and-Apparel Origin Rule Change)*, DAILY NEWS REC., Dec. 13, 1996, available in 1996 WL 8655674. This action would bring the decision to the WTO's Textiles Monitoring Body. *Id.* If the Monitoring Body finds for the Europeans, it could require the U.S. to either rescind the provision or pay compensation. *Id.* See also *WTO Dispute Settlement Overview*, (last modified Aug. 20, 1997) <<http://WTO.Org/WTO/Dispute/Bulletin.htm>> (stating that the changes in the U.S. rules of origin have resulted in EC products no longer being considered of EC origin in the U.S. market and in violation of numerous articles of the Uruguay Round Agreements and Article III of GATT 1994).

107. *WTO Dispute Settlement Overview*, *supra* note 106.

108. THE WORLD TRADE ORGANIZATION, MULTILATERAL FRAMEWORK FOR THE 21ST CENTURY AND U.S. IMPLEMENTING LEGISLATION (Terence P.

ment exists between countries as to whether the rules of origin are primarily an instrument of commercial policy, thereby intertwined with national economic policies, or technical, objective-neutral instruments.¹⁰⁹

C. *The Future for Universal Rules of Origin*

The Marrakech Agreement established the WTO with the dual objectives of substantially reducing tariffs and other trade barriers and eliminating discriminatory treatment in international trade relations.¹¹⁰ To that end, the WTO developed the Origin Agreement recognizing that international standards and conformity were important in facilitating trade.¹¹¹ The responsibility of developing those international standards became a priority for the WTO.¹¹² The theory behind harmonized rules of origin is to deflect trade barriers erected by preferential rules.¹¹³ Preferential rules allow countries to discriminate between similar products from different countries by allowing greater access and lower tariffs for products from preferential countries as opposed to the rest of the world.¹¹⁴ The Origin Agreement sought a single international set of origin rules to be used by signatory countries.¹¹⁵

The WTO proposed joining with the Customs Cooperation Council (CCC) of Brussels to form the Technical Committee on Rules of Origin.¹¹⁶ The CCC was formed in 1950 as a technical committee to assist the 111 members of GATT in dealing with Customs issues.¹¹⁷ The WTO Technical Committee will operate under the direction of the CCC in working toward a harmonization of the various rules of origin.¹¹⁸ The Agreement on Rules of Origin cite three criteria predominantly used by WTO member countries for defining the conditions where substantial transformation occurs.¹¹⁹

Stewart, ed., Am. Bar Assn. 1996). The participants of the Uruguay Round, recognizing the need for greater predictability and uniformity among trading nations, executed an Agreement on the Rules of Origin leading to harmonization of the non-preferential rules of origin. *Id.*

109. *Origin and Uruguay*, *supra* note 46, at 636-37.

110. THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (GATT Secretariat, 1994) at 138.

111. *Id.*

112. *Id.*

113. *Origin and Uruguay*, *supra* note 46, at 637.

114. *Id.* at 626 (stating that rules of origin are divided into two types: preferential and non-preferential).

115. *Id.* at 637.

116. *Law & Practice of the World Trade Organization*, Booklet B, 54 (Joseph F. Dennin, ed., Berman Press 6th ed. 1995) [hereinafter Booklet B].

117. David A. Pawlak, *Learning from Computers: The Future of the Free Trade Area of the Americas*, 27 U. MIAMI INTER-AM. L. REV. 107, 134 (1995).

118. Booklet B, *supra* note 116, at 54.

119. *Law & Practice of the World Trade Organization*, Booklet C, 14 (Joseph F. Dennin ed., Berman Press 6th ed. 1995) [hereinafter Booklet C].

Those three criteria are the following: (1) tariff-shift rules requiring a change in the tariff heading; (2) a "technical" rule or a list of manufacturing or processing operations which confer origin where those processes are carried out; and (3) an "economic" rule that defines origin based on where a specified percentage of the cost of the product is attributed.¹²⁰ The Agreement clearly expresses a preference for the tariff-shift approach because it is precise and objective.¹²¹

The Technical Committee viewed the United States' strong preference, for using the tariff-shift method as the sole basis for determining origin under the NAFTA Agreement, as indicative of the possibility of U.S. acceptance of an international country of origin rule based on this method.¹²² Clearly, the Court's decision in *CPC International*, requiring both tariff-shift and substantial transformation tests for marking designations, is contrary to the initial hard-line stance the U.S. took regarding the rules of origin.¹²³ While the *CPC International* court maintained that only the marking regulations were inconsistent with current trade law, other recent trade agreements may ultimately be affected by this decision, thereby jeopardizing our relationship with our trading partners.¹²⁴

III. PROPOSAL TO UNIFY COUNTRY OF ORIGIN RULES

Country of origin determinations have become increasingly complex with the proliferation of regional trading blocs (such as the EU and NAFTA), multilateral trade agreements, and multinational manufacturing corporations.¹²⁵ Firms must consider the origin of their products in making purchasing, manufacturing, and

120. *Id.* at 14-15. The Agreement on the Rules of Origin clearly does not favor the current U.S. *Gibson-Thomsen* test of "new name character, or use" as a basis for determining substantial transformation. *Id.* The EU's basic rule is that the country of origin is the country where a product received its last substantial process or operation that is "economically justified, having been carried out in an undertaking equipped for that purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture." *Id.* The basic criticism of both the U.S. and EU rules is that they are vague and provide little guidance, resulting in subjective decisions by the different customs administrators. *Id.*

121. *Id.* at 15-16.

122. *Id.* at 20. The NAFTA agreement is predominantly based on the tariff-shift approach with limited reference to any value-added or economic criteria. *Id.*

123. *Id.*

124. Serko, *supra* note 74, at 11. The CIT decision calls into question the validity of using the tariff-shift rules in the context of the WTO's efforts to draft global rules based on these principles. *Id.* Only time will judge how far-reaching the *CPC International* decision will be. *Id.*

125. Booklet C, *supra* note 119, at 1.

investment plans.¹²⁶ This Part proposes that the WTO adopt uniform country of origin rules for all purposes, both preferential and non-preferential applications.¹²⁷ The WTO is currently only considering unification of the non-preferential rules of origin.¹²⁸ This Part also proposes that the rules of origin be codified into a three-part test that encompasses both the tariff-shift provisions and elements of the *Gibson-Thomsen* substantial transformation test. This test will allow for greater objectivity and uniformity but will not be as administratively simplistic as the tariff-shift approach developed under NAFTA. Finally, this Part suggests that Congress adopt the new rules without relying on the qualifying language that has characterized other trade agreements.

A. Rules of Origin Unification: Rationale

Currently the WTO is charged with the responsibility of drafting uniform rules of origin. The goal of the WTO is the development of universal origin requirements for non-preferential purposes accepted by all trading partners.¹²⁹ However, it may not be possible to find a one-size-fits-all rule to the complex nature of this problem. Noticeably absent from the WTO's three-year plan are the rules of origin for preferential treatment.¹³⁰ This omission is significant to the trade community for it is only by unifying the origin rules for all applications that the benefits of uniformity and objectivity will be achieved.¹³¹

126. *Origin and Uruguay*, *supra* note 46, at 628.

127. Sheppard & Leo, *supra* note 52, at 24. Under current provisions it is possible for one item to have one country of origin for marking purposes, another for duty assessment, and yet a third country for special applications of quota limitations, imposition of antidumping or countervailing duties, or for the prohibited merchandise exclusions. *Id.*

128. Booklet C, *supra* note 119, at 4.

129. International Harmonization of Customs Rules of Origin, 61 Fed. Reg. 68295 (1996). The Uruguay Round Agreement on Rules of Origin bears the primary responsibility for the harmonization of origin rules for the purpose of providing certainty in the conduct of international trade. *Id.* To that end, the WTO initiated a three year program beginning in July of 1995 to (1) develop harmonized definitions of goods and minimal processes deemed not to confer origin, (2) consider the tariff-shift principles as a means of reflecting transformation, and (3) develop supplementary criteria based on other standards for those products that tariff-shift principles do not reflect transformation. *Id.*

130. Booklet C, *supra* note 119, at 4-5. The Rules Agreement is intended to cover MFN tariffs, antidumping and countervailing duties, safeguard measures, country-of-origin marking rules, tariff quotas and other quantitative restrictions, government procurement, and collection of trade statistics. *Id.* Not included in this Agreement are the rules of preference for trade agreements. *Id.* This exclusion is significant given the number of trade agreements entered into by the signatory parties. *Id.* The United States intended the Harmonized Rules of Origin cover preferential trade, however, the EU opposed extending the Rules of Agreement that far. *Id.* at 5 n.19.

131. John S. Rode, *Proceedings of the Seventh Annual Judicial Conference of*

The rules of origin need to be unified for all purposes. Segregation of the rules of origin for preferential treatment versus other purposes leaves the trade community struggling with multiple systems of origin determination for the same product, and in the U.S., segregation leaves the importer liable for erroneous representations.¹³² Segregation also allows countries to manipulate the rules for discriminatory treatment as a means of protectionism.¹³³

The International Trade Council (ITC) Customs Cooperation Committee has proposed that there are four critical elements to achieving acceptance of universal rules of origin: uniformity, simplicity, predictability, and administratability.¹³⁴ Additionally, the rules should be transparent and not used as political instruments for shifting trade policy.¹³⁵ The ITC has also stated that they should be based on positive criterion.¹³⁶ For example, the rules should state what does confer origin as opposed to what does not.¹³⁷ Adoption of the tariff-shift principles is a step toward this unification, but the tariff-shift method requires supplementation. Exceptions based on valuation and processing are necessary to determine when a sufficient transformation has occurred despite the lack of change in the tariff classification.¹³⁸

B. Rules of Origin Unification: A Proposal

Rules of origin should be based on a three-part test. The basis for part one is on the tariff-shift provisions as exemplified under the NAFTA agreement.¹³⁹ The problem with a simple tariff-shift approach is two-fold. First, the Harmonized Tariff Schedules were never developed for the determination of origin.¹⁴⁰ The Schedules were developed simply as a universal codification system of com-

the United States Court of International Trade, 137 F.R.D. 509, 589. (Oct, 15, 1990).

132. See Routh, *supra* note 76, at 24-25.

133. *Origin and Uruguay*, *supra* note 46, at 625.

134. KRAUS, *supra* note 87, at 31. See also Edward C. Galfand, *Heeding the Call for a Predictable Rule of Origin*, 11 U. PA. J. INT'L BUS. L. 469, 488 (1989) (stating that consistency and ease of application are primary concerns).

135. KRAUS, *supra* note 87, at 31. See also Booklet C, *supra* note 119, at 6-7. The Rules Agreement has as one of its disciplines to "ensure that origin rules are not used as instruments to pursue trade objectives, either directly or indirectly." Booklet C, *supra* note 119, at 6-7.

136. KRAUS, *supra* note 87, at 31. See also Booklet C, *supra* note 119, at 10 (stating that the rules should be developed based on positive standards, although it may be necessary to use negative standards to clarify the positive standards).

137. KRAUS, *supra* note 87, at 31.

138. Galfand, *supra* note 134, at 491.

139. NAFTA, Pub. L. No. 103-182, § 3332 (a)(1)(B), 107 Stat. 2057 (1993).

140. David Palmeter, *The Seventh Annual Judicial Conference of the United States Court of Appeals for the Federal Circuit*, 128 F.R.D. 409, 502 (May 24, 1989). See also Galfand, *supra* note 134, at 491 (citing the *Standardization of Rules of Origin*, USITC Pub. 1976, Inv. No. 332-239 (May, 1987)).

modities.¹⁴¹ Second, simple assembly operations would grant new origin benefits resulting in the push to establish simple assembly plants in countries with favorable duty rates.¹⁴² For example, if parts from a number of countries are shipped to an assembly plant in Mexico, under the NAFTA tariff-shift approach, the new product meets the criteria for duty free treatment. However, the product contains no material of Mexican origin. The product contains only the added low-level labor costs of the assembly operation. It is this second component that requires the next two steps in the evaluation.

Part two of the test is an analysis of the manufacturing process the commodity underwent in the exporting country to determine if the origin has changed. Over the years, Customs has identified simple assembly, packaging, painting, and other processes that do not change the origin of a product.¹⁴³ These processes have been well documented through *stare decisis*.¹⁴⁴ Additionally, the Customs Cooperation Council under the 1973 Kyoto Convention of GATT provided detailed listings of minimal operations that will never be sufficient to confer origin.¹⁴⁵ The EU has also devel-

141. Galfand, *supra* note 134, at 490. See also Booklet C, *supra* note 119, at 17. An additional problem with this approach is that Customs classifications are not necessarily uniform at this time for all products in trade. Booklet C, *supra* note 119, at 17.

142. *Origin and Uruguay*, *supra* note 46, at 627. Preferential rules or origin are designed to minimize trade deflection which occurs when a country undertakes minimal processing in a country receiving preferential treatment simply to take advantage of that preference. *Id.* See also Sheppard & Leo, *supra* note 52, at 26 (summarizing the U.S. International Trade Commission report that the faults of the tariff-change approach include its failure to deal with assembly operations and its reliance on nomenclature not drafted with origin determinations in mind).

143. *Origin and Uruguay*, *supra* note 46, at 633 n.35. In determining substantial transformation the United States currently uses specified process tests, sometimes in combination with value-added tests. *Id.* See also EDMOND MCGOVERN, INTERNATIONAL TRADE REGULATIONS, GATT, THE UNITED STATES, AND THE EUROPEAN COMMUNITY 117 (1986). Regulations have determined that assembly operations may include any method that joins or fits together solid components, such as welding, soldering, riveting, force fitting, gluing, laminating, sewing or the use of fasteners, and may also include incidental operations either before or after the assembly. *Id.*

144. See, e.g., *Uniroyal Inc. v. United States*, 542 F. Supp. 1026, 1029-30 (Ct. Int'l Trade 1982) (holding that the attachment of the out-sole to the upper is a minor manufacturing operation leaving the identity of the upper intact); *Murray v. United States*, 621 F.2d 1163, 1169 (1st Cir. 1980) (holding that screening glue for impurities was only a minor operation and did not result in a change in the origin of the glue from China to Holland); *Texas Instruments v. United States*, 681 F.2d 778, 785 (C.C.P.A. 1982) (finding that the processing of photodiodes and integrated circuits, basically an assembly operation, did result in a substantial transformation and subsequent change of origin).

145. Booklet C, *supra* note 119, at 12 n.46. The minimal operations insufficient to confer origin are as follows:

oped a list of simple manufacturing processes that do not confer origin.¹⁴⁶ Generally, processed-based rules of origin should be clear, precise, and easily verified by customs authorities.¹⁴⁷ Additionally, process-based determinations are more readily understood by producers and manufacturers as they are based on the language of the trade as opposed to customs technical classifications.¹⁴⁸

The last analysis for conferring origin status is based on value-added criteria. The value added to the commodity during the process of manufacture in the exporting country should meet a specific threshold.¹⁴⁹ Currently, the United States has different thresholds depending on the trade agreement: 35% with the GSP countries,¹⁵⁰ 35% with the Caribbean Basin Initiative (CBI) countries,¹⁵¹ 35% with Israel,¹⁵² and 50% or 60% under the NAFTA

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- a) operations necessary for the preservation of goods during transportation or storage;
 - b) operations to improve the packaging or marketable quality of the goods or to prepare them for shipment, such as breaking bulk, grouping of packages, sorting and grading, repacking;
 - c) simple assembly operations;
 - d) mixing of goods of different origin, provided that the characteristics of the resulting products are not essentially different from the characteristics of the goods which have been mixed.

Id.

146. *Origin and Uruguay*, *supra* note 46, at 633 n.35. The EU also uses specified process tests to determine product-specific origin requirements. *Id.* For example, diffusion of an integrated circuit does confer origin whereas incorporation of an optical system in a photocopier does not. *Id.* at 634. See also James Taylor, Jr., *The Seventh Annual Judicial Conference of the United States Court of Appeals for the Federal Circuit*, 128 F.R.D. 409, 511 (May 24, 1989) (stating that the general rule in the EU is that mere assembly operations, while they may effect a change in the tariff classification, are insufficient to confer origin).

147. Booklet C, *supra* note 119, at 18.

148. *Id.*

149. *Id.*

150. Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978 (codified as 19 U.S.C. § 2463(b)) [hereinafter GSP Act]. The sum of the cost or value of the materials produced in the beneficiary developing country (BDC) plus the direct costs of the processing operations performed in the BDC may not be less than 35% of the appraised value of the imported merchandise. *Id.* See also Maxwell, *supra* note 7, at 685 (noting that also included in the GSP Act agreement is the requirement that in addition to the 35% value-added criteria, the commodity must also be the "growth, product, or manufacture" of the BDC — thus returning to the substantial transformation basis for determination).

151. Caribbean Basin Economic Recovery Act Pub. L. No. 98-67, 97 Stat. 384 (1983) [hereinafter CBERA]. The value-added criteria of 35% is the same as for the GSP Act system. *Id.* See also Maxwell, *supra* note 7, at 688 (stating the CBERA agreement also includes the substantial transformation test in addition to the 35% value-added determination for origin purposes). See also Sheppard & Leo, *supra* note 52, at 25 (stating the CBERA also allows up to 15% of the 35% value-added to be of U.S. origin).

agreement.¹⁵³ Additionally, the factors included in calculating that value-added percentage need to be uniform.¹⁵⁴ Currently the trade agreements are inconsistent as to what costs may be factored into this value-added percentage, such as labor costs, depreciation, real estate, and so forth.¹⁵⁵ In order to achieve the goal of universal origin, the value-added percentage and the factors used to achieve that percentage must also be uniform for all trade agreements and origin purposes.¹⁵⁶

C. Rules of Origin 3-Step Test: Its Roots in International Trade

A three-step process in developing uniform rules of origin is not new to international trade. The WTO has identified these three methods individually as the primary systems currently used by the major trading countries to identify origin.¹⁵⁷ The WTO has provided the Technical Committee with a three-year work schedule to develop harmonized rules of origin based on these three methods.¹⁵⁸ The difficulty is in achieving universal origin rules based on the application of only one of the three above methods in order to achieve an administratively user-friendly approach. Each of the methods alone has inherent flaws.¹⁵⁹ Only by the combina-

152. United States-Israel Free Trade Area Implementation Act, Pub. L. No. 99-47, 99 Stat. 82 (codified as 19 U.S.C. § 2112) [hereinafter US-IL]. This agreement requires direct importation and 35% value added. *Id.* See also Maxwell, *supra* note 7, at 692 (stating that the language of the US-IL requires that the article must be the "growth, product, or manufacture", thereby necessitating the use of the substantial transformation test for determining the product's origin as well). See also Sheppard & Leo, *supra* note 52, at 25 (stating that the US-IL, like the CBERA, allows 15% of the 35% value-added to be of U.S. origin).

153. NAFTA, Pub. L. No. 103-182, § 3332(a)(2)(B), 107 Stat. 2057 (1993). The regional value content must not be less than 60% where the transaction value method is used, or is not less than 50% where the net cost method is used. *Id.*

154. Booklet C, *supra* note 119, at 19. The determination of origin based on the value that was added during processing may change depending on whether such items as interest on capital equipment and real property, depreciation, marketing and sales expenses are included. *Id.* Additionally, currency fluctuations may impact costs for raw materials and labor costs. *Id.*

155. Maxwell, *supra* note 7, at 688-89. The CBERA definition of "direct costs" was expanded from the GSP Act definition to allow for all actual labor costs, including engineering, quality control, and the production of molds or tooling. *Id.* These elements may not be considered under the GSP Act program. *Id.*

156. Sheppard & Leo, *supra* note 52, at 26 (citing the principal flaw with a value-added rule of origin is that it must be applied on a case-by-case basis and application can be affected by exchange rates and assessment of appropriate costs).

157. Booklet C, *supra* note 119, at 14.

158. *Id.* 11.

159. For example, under the tariff-shift approach, milk from Canada (classified under heading 0401.) that is processed into cheese (classified under

tion of all three methods can it be determined when a manufactured product has achieved a new country of origin.

The objective of the WTO's Technical Committee is to identify which processes of manufacture do and which do not confer origin and to establish exactly which costs should be included in the value-added criteria. The NAFTA agreement has identified much of the tariff-shift criteria that may serve as a starting point for a universal tariff-shift approach. Given the experience of time and usage, the tariff-shifts now itemized under the NAFTA agreement may be adjusted and adapted. Once member countries develop and adopt the guidelines for each of the three steps, the majority of products and processes may be evaluated under clear and precise rules. Only exceptions such as new methods of process not currently reviewed or additional costs not considered before would require additional interpretation. In essence, the *Gibson-Thomsen* substantial transformation test of new name, character, or use would not disappear but would be defined on the basis of three new criteria: specific tariff-shifts, process-determinations, and value-added costs.

In *CPC International*, U.S. Customs attempted to restrict the *Gibson-Thomsen* test by using only the tariff-shift determination for NAFTA products.¹⁶⁰ As the court indicated, the congressional intent was always clear; U.S. Customs simply erred in their zeal to move toward the administratively simpler tariff-shift approach.¹⁶¹

heading 0406.) in the United States does not result in the necessary tariff-shift in the headings to result in cheese of U.S. origin. USITC Pub. 3001, at GN12(t)/4. The requirements for tariff-shift under the NAFTA agreement for heading 0401 through 0410 require a shift from another chapter. *Id.* Yet, most people would concur that cheese and milk, while both a part of the dairy family, are sufficiently different.

As an example of the confusion arising from the use of a process-based system of determining origin are two cases where the end result differed. In *Ferrostaal Metals Corp. v. United States*, the court held that annealing and galvanizing of steel did result in a new country of origin. 644 F. Supp. 535, 537 (Ct. Int'l Trade 1987). However, in *Superior Wire v. United States*, steel rod drawn into wire did not result in a new country of origin, despite the fact that the court considered almost the same factors in the two cases. 669 F. Supp. 472 (Ct. Int'l Trade 1987), *aff'd*, 867 F.2d (Fed. Cir. 1989).

The value-added method of determination of origin may also give rise to some problems. Consider a simple assembly operation in a high-wage country versus a low-wage country. If an unassembled bicycle is assembled in the United States the value added in labor costs alone might be sufficient to confer new origin even though the manufacture of all of the parts of the bicycle took place outside the United States. However, that same assembly process in a low-wage country might be insignificant in comparison to the value of the bicycle itself, thus not conferring a new country of origin.

160. *CPC Int'l Inc. v. United States*, 933 F. Supp. 1093, 1097 (Ct. Int'l Trade 1996).

161. John Simpson, *Proceedings of the Seventh Annual Judicial Conference of the United States Court of International Trade*, 137 F.R.D. 509, 583 (Oct. 15, 1990). In speaking on behalf of Customs in 1990, Mr. Simpson predicted

The Court of International Trade's recent decision in *CPC International* may be seen as a stumbling block in the smooth progression to the harmonization of the rules of origin. While the decision may seem limited in scope, the court actually laid the groundwork for expansion of the origin criteria for marking purposes under the NAFTA agreement. However, this determination should not be limited to marking or to simply the NAFTA agreement.

D. Congressional Endorsement

Significantly important to the goals of free trade is the contradictory nature of the United States' approach to these trade agreements. While actively negotiating for freer and more transparent trade policies, Congress has limited full U.S. endorsement by attaching qualifying language to trade agreements, smacking of protectionism. The United States, as a signatory party, consented to abide by the terms and definitions of those trade agreements. Alterations by one signatory country may well result in others picking and choosing areas of conformance. Congress needs to recognize that it cannot straddle the free trade fence by adopting trade agreements and then enacting legislation that includes disclaimers allowing current law to apply as it did in both the NAFTA Regulations and the GATT Textile Revised Regulations.¹⁶²

CONCLUSION

The United States has consistently led the world in moving toward more liberalized trade agreements. It has long recognized the need to promote the goals that the WTO is presently codifying. The WTO must embody the additional elements of process-determination and value-added criteria to the tariff-shift principles in order to create a new definition of "substantial transformation" and a universal system of defining preferential and non-preferential country of origin rules.

Once those elements have been defined, Congress needs to whole-heartedly endorse the origin requirements and not fall back on language that maintains current law and evaluations.

that the United States will change its own rules. *Id.* at 584. He suggested that the U.S. cannot go on making case-by-case determinations of origin, and the change will almost certainly be a rule of origin based primarily on a change in tariff classification. *Id.* at 584. In 1994, the U.S. Customs interim regulations for the NAFTA agreement did precisely what Mr. Simpson predicted. 19 C.F.R. §§ 12, 20, 134 (1994).

162. NAFTA, Pub. L. No. 103-182, § 3312(a)(1), 107 Stat. 2057 (1993). See also Uruguay Round, Agreements, Pub. L. No. 103-465, § 102 (a)(1), 108 Stat. 4809 (1994).

One of the goals of the WTO in developing harmonized rules of origin is to eliminate their use as instruments of trade policy. The United States' support is essential in achieving that goal.

