



Rules of Origin

Rules of origin (ROO) are laws, regulations, and procedures used for ascertaining the country of origin of imported products. ROO are important for assessing tariffs, enforcing U.S. trade laws, establishing eligibility for trade preference programs and free trade agreements (FTAs), and more. ROO may be a policy tool to shape global supply chains, incentivize manufacturing in certain countries, and address issues such as tariff evasion. Historically, Congress has created ROO for specific products and trade preference programs as well as shaped ROO in FTAs through consultation with the executive branch and approved those ROOs through implementing legislation.

Background

Determining the country of origin of a product is relatively straightforward if all of a product’s raw materials and parts are manufactured and assembled in one country. Global supply chains, however, make determining origin a complex process because parts used in manufactured goods such as automobiles, computers, or clothing, often come from many countries. There are two uses of ROO: non-preferential and preferential (**Figure 1**).

Enforcement. In the United States, the U.S. Customs and Border Protection (CBP) interprets, administers, and enforces ROO, as well as country of origin labeling, tariff classification, customs valuation, and other laws relating to U.S. imports. U.S. importers are responsible for identifying country of origin; CBP verifies the accuracy of those declarations. Incorrect country of origin claims may result in delays, detention, or denial of entry of goods. Fraudulent claims may result in monetary penalties or criminal investigations.

International Commitments. The 1994 World Trade Organization (WTO) Agreement on Rules of Origin requires that WTO members not use ROO to disrupt trade; to apply ROO in a consistent, transparent, nondiscriminatory, and reasonable manner; and to notify other members about any rule changes. The WTO agreement also set up an ongoing program to harmonize non-preferential rules, with negotiations conducted by a WTO Rules of Origin committee and a technical committee under the World Customs Organization (WCO), which supports customs administrations worldwide on interpreting ROO and other technical issues.

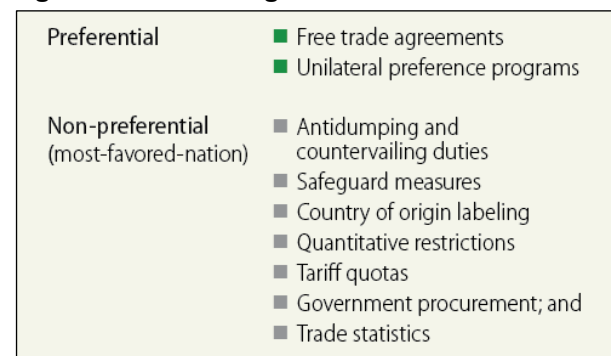
Non-preferential ROO

Non-preferential ROO apply to imports from all countries with which the importing country has most-favored nation (MFN) status. The United States extends MFN status to most WTO members. For non-preferential ROO, there is no specific U.S. law or legislative methodology that determines country of origin. CBP administers non-preferential rules based on regulations, prior agency

interpretations, and court decisions. Textile and apparel products are the only products subject to specific non-preferential ROO under 19 U.S.C. §3592, as amended. In most other cases, CBP determines origin on a case-by-case basis and generally confers country of origin to the country where a product was last “substantially transformed.” CBP considers a product to be substantially transformed when a new product with a different name, character, and use has been created.

When the country of origin is in doubt, an importer may apply to CBP for an advance ruling. CBP last attempted to standardize non-preferential ROO to provide transparency and predictability in 2008, but ultimately did not adopt proposed rules due to broad stakeholder concerns over potential increases in compliance costs.

Figure 1. Rules of Origin Uses



Source: World Customs Organization. Graphic by CRS.

Preferential ROO

U.S. imports from countries that have an FTA with the United States or receive other preferential trade treatment are generally subject to preferential ROO. Preferential ROO are applied in FTAs, such as the United States-Mexico-Canada Agreement (USMCA), and certain nonreciprocal trade preference programs, like the African Growth and Opportunity Act (AGOA). Preferential ROO ensure only eligible trading partners receive the tariff benefits of the special program or FTA. Some preferential ROO also may be crafted to limit the impact of these programs on import-sensitive industries. They are unique to each special trade program or FTA.

Historically, preferential ROO in FTAs are negotiated by the parties to the agreement and approved by Congress as part of FTA implementing legislation, some of which provide presidential authority to negotiate limited changes to ROO without congressional approval. ROO in U.S. trade preference programs like AGOA and GSP were drafted and approved by Congress.

Preferential ROO in FTAs and trade preference programs generally stipulate how an imported product is considered

to “originate” in a partner or beneficiary country. In order to receive preferential tariff treatment, imported products must satisfy one of three conditions. They must be: (1) wholly grown, harvested, or fished in the FTA region; (2) produced in the FTA region using only materials made in the FTA region; or (3) produced in the FTA region with non-FTA country components while meeting additional product-specific ROO requirements.

Specific Rules of Origin. Each U.S. FTA has a chapter containing general ROO provisions, combined with an annex that lists ROO for individual products. These product-specific ROO generally take one of three forms:

- **Change of Tariff Classification** or “tariff-shift” rules require that a product be “substantially transformed” as illustrated by a change in its Harmonized Tariff Schedule (HTS) tariff classification. The level of change required varies from product to product. One example of a tariff-shift rule is the so-called “yarn-forward” rule for textiles and apparel. Yarn-forward means that all yarn and fabric used to make a textile or apparel product must be formed in the FTA region.
- **Regional Value Content (RVC)** rules require that a minimum percentage of the product by value be produced in the FTA region. Value can be calculated in various ways and take into account costs such as parts, labor, insurance, packing, and transportation, duties, taxes, customs brokerage fees, and waste/spoilage of production material. Three common methods found in U.S. FTAs are the **build-up method** (calculations add together the costs *originating in the FTA region*), **build-down method** (calculations subtract the *non-originating* costs from the adjusted value of the finished product), and **net cost method** (calculations capture the direct manufacturing costs per unit, such as factory labor, materials, and direct overhead).
- **Technical** rules require that some kind of manufacturing or processing operation be conducted in the FTA region for the product to originate. For example, specific chemical reactions or defined changes in particle size confer origin of certain chemicals and related products.

Cumulation allows producers in FTA countries to manufacture goods from parts originating in more than one country in the FTA region to qualify for duty-free FTA status. For example, in USMCA, a product can be produced “in the territory of one or more of the Parties,” as long as the product meets the agreement’s ROO.

Preferential ROO for Certain Sectors. ROO in FTAs are negotiated by industry. Import-sensitive industries or products generally have stricter ROO to protect domestic industries and prevent non-FTA countries from taking advantage of tariff reductions available to FTA partners. For example, textile and apparel ROO in U.S. FTAs typically follow the yarn-forward rule, which require everything except for the fiber to be sourced from within the FTA region. Automotive ROO in FTAs generally use RVC rules. USMCA, which has the strictest automotive ROO among U.S. FTAs, has an RVC requirement of 75%. It also includes a unique labor value content (LVC)

requirement stipulating that 40-45% of a vehicle’s content be made by workers earning more than \$16 per hour.

Considerations for Congress

ROO are central to the international trade system and trade negotiations. Congress may consider the following:

Modifying ROO. ROO may be a policy tool used to support U.S. policy goals, such as strengthening regional supply chains. In theory, preferential ROO with a higher RVC could incentivize manufacturing in countries that are parties to the FTA or beneficiaries of the preference program. Auto ROO under USMCA were tightened from the North American Free Trade Agreement to encourage North American manufacturers to source more materials from the region. Congress may consider directing the executive branch to assess and renegotiate existing ROO in U.S. FTAs to meet U.S. policy goals. Given presidential authority to negotiate limited changes to an agreement’s ROO, Congress may consider whether such changes require congressional approval. Recent trade agreements negotiated under the Trump Administration have raised questions over whether the executive branch has the authority to create ROO outside of congressionally approved FTAs, given Congress’s authority to regulate foreign trade. Congress may also consider amending ROO in trade preference programs, which are relatively flexible, to strengthen regional supply chains and encourage program utilization.

Proliferation of Preferential ROO. Due to the growing number of preferential trade agreements, each with its own ROO provisions, businesses may choose to forego meeting preferential ROO if compliance costs outweigh the benefits provided by a U.S. FTA or trade preference program. As a result, businesses may source most cost-effective inputs from non-preferential countries. Some policymakers support stronger preferential ROO to address supply chain security. Congress may assess the impact of complex preferential ROO on business decisions and consider whether there is a need to balance policy priorities, such as supply chain security, with efficiency.

Country of Origin and Tariff Enforcement. Stakeholders and some Members of Congress have expressed concerns that certain entities are circumventing higher U.S. tariffs using transshipment. In such circumstances, a manufacturer may perform limited or minimal manufacturing processes on a product in a second country facing lower U.S. tariffs and declare the country of origin in that country before exporting to the United States. Such practices could be considered unlawful if CBP determined substantial transformation had not occurred. Congress may conduct oversight into CBP implementation of country-of-origin determinations and tariff enforcement, including the agency’s capacity to effectively monitor false or incorrect country of origin declarations. Congress also may assess whether non-preferential ROO could be clarified to address concerns of tariff evasion. For example, some Members have introduced legislation to require the executive branch to consider specific criteria, such as the value-add of the manufacturing process and affiliation with entities subject to higher tariffs, when determining country of origin for imports subject to certain tariff actions (e.g., 118th Cong. H.R. 3882, S. 1856, S. 5110; 119th Cong. S. 172).

Liana Wong, Analyst in International Trade and Finance

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