

The Impact of Preferential Rules of Origin on the Relationship of Free Trade Area and the Multilateral Trading System*

CHENG Xin-xuan¹

Abstract: The failure of Doha negotiation made regional integration organizations became the choice of development strategies in many member states. Thus, free trade rules of origin from the initial functions of determining whether goods were eligible for preferential treatment and preventing trade deflection added the characteristics of reflecting the interests of regional member countries as well as closely integrated with the production stage. The function changes led to preferential rules of origin in free trade area as the regional trade protection tools, increased regional trade diversion effect, reduced the level of global welfare, and had a definite conflict with the multilateral trading system. However, the preferential rules of origin promoted the openness within the region and increased freedom degree, was consistent with the multilateral trading system purpose, which had a coherent basis for the two. Member countries needed to adopt the principle of gradual, cumulative to achieve the principle of preferential rules of origin coordination in WTO level, in order to facilitate common development of free trade area and the multilateral trading system. China-ASEAN Free Trade Area rules of origin needed to be further adjusted, improved regional trade in services rules of origin, and adopted the principle of gradual and cumulative to eliminate the non-symmetry effects on Member States.

Key words: Preferential rules of origin; Free trade area; Multilateral trade system

On July 29, 2008, the failure of World Trade Organization (WTO) mini-ministerial declaration the end of the Doha Round. Multilateral trade system development ran into trouble, and regional integration organization became the first choice of development strategy of many member states. Rules of origin, as an important feature of free trade, affected regional member countries and the outside world more and more significantly. According to the applicable scope, FTA rules of origin can be classified into preferential rules of origin and non-preferential rules of origin.² In the Annex II of "Rules of Origin Agreement" formed in the Uruguay Round negotiations, preferential rules of origin, referred to any party according to the agreement provisions or trade groups, in determining whether the country or region enjoy preferential

* This paper gets the foundation from educational bureau programe: the studies on the effect of Origin rules impacting on trade and invest during regional integration. 10YJAGJW003.

區域一體化中原產地規則對貿易與投資轉移效應的實證研究。項目號: 10YJAGJW003

¹ Professor, Hebei University, China. E-mail: cheng_xinxuan@126.com.

² As the Free Trade Area of the non-preferential rules of origin were unified only in the European Union, other free trade areas make the non-preferential rules of origin based on national or regional units, so this article only discusses the relationship between preferential rules of origin and the multilateral trading system.

*Received 10 July 2010; accepted 18 September 2010

treatment to implement laws, regulations and generally applicable executive orders.³ The initial function of preferential rules of origin was to determine the nationality of imports, and whether it was entitled to preferential treatment and prevented trade deflection and so on. However, the development of regional economic organizations led to the functions expansion of preferential rules of origin, had a definite conflict with the multilateral trade system, meanwhile, they showed a degree of coordination in essence.

1. REPOSITION OF FREE TRADE PREFERENTIAL RULES OF ORIGIN FUNCTION

According to WTO reports, by the end of July 2007, the number of regional trade agreements notifying the WTO increased from 50 since the 1990's to 380, an increase of nearly 8 times. Of which, 205 agreements were being implemented. By 2010, the number reached at approximately 400. The trade volume of countries within the region at the end of 2007 accounted for about 50% of global trade.⁴ Different regional trade agreements with different rules of origin and showed the diversity (see Table 1). Their functions, on the original basis, added the characteristics of reflecting the interests of regional member countries and the close integration of the production stage.

Tbale 1: The products specific standards rules of origin applied in WTO regional economical cooperation organizations

Preferential regional trade arrangements	Tax Distribution List	Import content	Domestic or regional value-added content	Parts Content	Technical requirements content
Customs union(6)	6	2(60%-40%)	2(35-60%)		
Free Trade and Preferential Trade Arrangements(87)	83	68(60-30%)	7(25-65%)	67	74

Source: World Trade Organization(2002), <http://www.wto.org>

1.1 Free trade area preferential rules of origin reflected the economic interests of regional member countries.

Free trade area was “freedom inside and protection outside”. With the lower of the region's external barriers and the gradual elimination of non-tariff barriers, in order to protect the economic interests of regional member countries, the hidden trade protection tools were indispensable, and rules of origin can be used just as an important means of protected areas.

In order to protect the region's producers economic interests, different organizations used different origin criteria. For example, one fourth of EU rules of origin adopted value content criteria, and the free trade agreements with South Africa limited a minimum standard of 15% and not applied to textiles and clothing. NAFTA had also adopted the value content standards, but calculation methods were different from the European Union and other free trade areas, the minimum was lowered compared to the EU, and not applied to milk and edible animal products. Also the textiles had a minimum limit of 7%. In some trade agreement of Asia and Africa, there were no minimum content criteria.⁵ The different rules of origin, through the limitation of imported components content, value-added percentage and other conditions, effectively protected the intermediate input producers within the region, reflected the characteristics of different regional industry, and the protection level of different sectors, fully reflected the economic interests of member countries within the region.

³ World Trade Organization Secretariat, Suo Bicheng et al., “Introduction to the Uruguay Round Agreements”[M], Law Press, 2001,175.

⁴ WTO Report, 2007, www.wto.cn

⁵ Estevadeordal and Suominen(2004ab), Kati Suominen, Rules of origin in Global Commerce, p39, 2004.

1.2 The deepening mergence of rules of origin and the production stage

Multinational companies were the main body of international production, by global production, they exported the company's capital, technology and management experiences, established subsidiaries all over the world in order to closely associate the company's monopoly advantage with location advantage. As a result, multinational companies, by vertical and horizontal division of labor, made production network cover every corner of the world. One production procedure can be completed in many countries, sometimes within a region can complete only one working procedure. It made the rules of origin affect the selection of the manufacturer of a process and industry. In order to obtain the best interests of the region, the manufacturers needed to combine the production stage with the local rules of origin closely, and produced different effect.

Table 2: Effects of different types of rules of origin on different production stages

Basic rules	Research and development	Intermediate inputs	Final products	Sales and transportations
Substantive processing		When the final products need only a simple processing	Working usually when the final products non-simple assembly	
Specific manufacturing processes based on high-tech	The key program or major components related to research and development			
Rules of origin contain investment inputs	Machine contains the element of intellectual property and research and development			
Value-added criterion	Research and development contains a small percentage of the product final value	When calculate the value-added, the individual parts can play a key role	Most of the value are achieved at this stage, but does not consider the sale and transport	Sales and transportations can constitute most of the value-added

Source:Edwin Vermulst,Paul Water,and Jacques Bourgeois :Rules of Origin in International Trade:A Comparative Study,The University of Michigan Press,1997,pp25.

2. PREFERENTIAL RULES OF ORIGIN LEAD TO THE CONFLICT BETWEEN FREE TRADE AREA AND THE MULTILATERAL TRADING SYSTEM

Function changes of preferential rules of origin had an impact on the manufacturers production behavior, increased the protective effect of regional industry, and thus gave a negative effect on regional trade and welfare, conflicted with the objective of the multilateral trading system.

2.1 Increased trade diversion effect and reduced the level of global welfare

From an economic perspective, the theoretical foundation established by WTO was based on the comparative advantage of international division of labor. Countries should put resources on producing the comparative advantage products, gain interests of specialized division of labor, and promote the relocation of the production curve, expand the world production as well as improve the global welfare level. However, FTA rules of origin led countries to make the opposite choice, in order to enjoy preferential treatment, companies outside the region, needed to meet the regional rules of origin, the different manufacturers in different production chain locations adopted different measures to maximize their own economic interests (see Table 3). Finally, commodity producers will re-configure the raw materials and the source of

intermediate inputs, which may give up the cheap raw materials or intermediate inputs outside the region, shifted to the high cost raw materials and intermediate inputs within the region in place, resulting in adjustment of the production technology. The more complex of production techniques, the higher technical adjustment costs as a result of rules of origin constraints, the lower technical production efficiency, and the greater trade diversion effect. The reduction degree of products technical efficiency had a closely relation with the production function flexibility, the lower substitution degree of product inputs, the higher damage resulted from the rules of origin. If the free trade area rules of origin stringent degree raised, resource allocation would deviate from the direction of comparative advantage, leading to lower the global welfare level. Hufbauer and Schott(1993), Drysdale and Garnaut(1993) verified the NAFTA rules of origin economic effects. They considered that regional rules of origin served as a wedge in the NAFTA Member countries, increased the demands for intermediate inputs and will certainly raise the price of intermediate inputs, accordingly increased the cost of the final products. In the calculation of Cournot model, the trade volume of Canadian exports to the rest of the world from 34% down to 17%, exports to the U.S. from 47% up to 61%, the rules of origin led to the cost of intermediate inputs increased by 30%, welfare loss of 1.5% in Canada, 0.47% in the United States, and 3.0% in Mexico.⁶ Flatters and Kirt (2005) considered that the strict rules of origin made members lost the advantages of obtaining efficiency from non-members.⁷ European - Egypt Free Trade Agreement rules of origin contained about 100 pages, mainly impacting the textiles, clothing and leather industries, with higher standards rules of origin for hybrid cotton. As long as the raw materials of hybrid cotton from Egypt under 75%, the product will not be considered as originating in Egypt. As EU were not the main suppliers of raw materials of cotton, therefore, the EU - Egypt free trade area were prone to have trade diversion effect. Trade diversion effect arose because the number of Egyptian imports from the EU accounted for only 25% of Egypt's total imports, which belonged to tariff directory (5514.13) products imported from the EU were zero, the tariff directory 5514.39 products imported from the EU were 100%.⁸ Rules of origin for the leather industry mainly depended on tariff directory changes as a result of leather processing changes. During processing, the intermediate products tariff directories needed to change from HS41, HS42 to HS43. Products belonged to tariff directory HS41 applied tariff rates of 30%, not all such products were from the EU. Raw materials of processing from HS42 and HS43 were not all from the EU, so the strict rules of origin will lead to trade diversion effects.

2.2 Within the region it protected the industrial development, but outside was a discriminatory tool

Preferential rules of origin in free trade area amounted to a wedge between the free trade area and the multilateral trading system, which became internal protection and external discrimination. The degree of discrimination depended on two aspects: First, the coverage of regional trade agreements. Second, the difference degree between the free trade area and multilateral trade agreements. The more extensive coverage of regional trade agreements, the greater difference between the free trade agreements and multilateral trade agreements, the higher level of foreign discrimination due to the rules of origin. However, these factors were dynamic, with the increasing global trade liberalization, the degree of discrimination caused by rules of origin appeared to be inverse relationship with regional and multilateral liberalization. As Bonade. Haldeman and Michael. KeStecchi said : "The liberalization of free trade agreements depended on its rules of origin."

Some free trade area formulated a number of special rules for the purpose of protecting the regional industry, especially in the North American Free Trade Area. NAFTA rules of origin formulated a very detailed provision according to the product types, processing technology, added-value size and so on, although sometimes only aiming at a specific aspect of the rules of origin but it presented the protection of the entire production system.

⁶ Alex Jameson Appiah, Applied General Equilibrium Model of North American Integration with Rules of Origin, doctoral dissertation 1999.p30.

⁷ Flatters,F.,R.Kirk.2005.'Rules of Origin as Tools of Development: Lessons from SADC'.In the Origin of Goods:Rules of

⁸ Alex Jameson Appiah, Applied General Equilibrium Model of North American Integration with Rules of Origin, doctoral dissertation 1999.p30.

Table 3: Measures adopted by different interest groups at different production stages

The company's position in the production chain	Import competitive department	Export competitive department
Intermediate inputs	Interest groups protected the intermediate inputs and final products by rules of origin and locked the market	Do not have much incentive to intermediate inputs and final products
Final products	Interest groups implemented contingent protection aiming at rules of origin	Interest groups do not encourage the use of restrictive rules of origin, if the supply chain mainly fixed in countries outside the region, interest groups will against the restrictive rules of origin.

Source: Kati Suominen, Rules of origin in Global Commerce, Ph.D. dissertation. P111, 2004.

The special rules of North American Free Trade Area applied to specific sectors, mainly in textiles, electronics and automotive manufacturing sectors. The raw materials constitution standards used in textiles and clothing rules of origin adopted the principle of “Yarn Forward” or “Fiber Forward”. For example, the shirts produced in the United States. If the cotton raw material came from Australia, the shirt production can not enjoy preferential treatment in the region. In addition, there was a “Weaving forward” rule meant that the product benefited from the fabric must be produced in North America. Only a very small number of products using this standard, such as cotton and man-made fiber bag, handbag, coated fabric. For electrical equipments (mainly communication equipments, color TV, copiers and computers), in accordance with the provisions of NAFTA, in order to be eligible for the North American Free Trade Area of origin, the main components of office switching equipment-printed circuit board assemblies must be assembled in North America, the rules allowed for one printed circuit board in every 10 pieces can be assembled outside North America. By the impact of telecommunications equipment rules of origin, American Telephone and Telegraph Company had transferred production to Mexico from Asia, and increased production investment in the United States. For copiers, copier rules of origin required all major assemblies and printed circuit board assemblies were produced in North America. The rule was the equivalent of 80% of the value of local content in North America. For color television rules of origin, in accordance with the NAFTA, as long as its main components-the TV picture tubes originating in North America, color television sets were eligible to obtain North America origin. There were more stringent rules of origin for cars, about 200 pages. Car manufacturing standards in NAFTA set the North American local value content of 62.5% (January 1, 2002 start). In order to accurately calculate the regional value content standards, NAFTA has also adopted a new tracking rule to require manufacturers to track each piece of non-originating in the regional parts of the value, so the value in the calculation of the final product was very clear. Meanwhile, it required the auto parts manufacturer keep each certificate origin.⁹ NAFTA existed single value-added rules of origin on all the products. Some economists performed empirical analysis of NAFTA rules of origin, because of the use of high local cost of intermediate inputs, leading to economy distortions effect which was equivalent to 4.3% tariff.¹⁰ The inherent inconsistency of FTA rules of origin had increased the regional protection for particular industry or sector. Preferential rules of origin usually differed from the preferential trading arrangements, this arrangement provided special treatments to countries with special connection which related to history, geography and political factors. In this sense, the implementation of a country's preferential rules of origin according to its wishes offered different degree of preferential benefit. Therefore, the United States had six different sets of preferential rules of origin, the EU had fourteen sets, Australia had five sets, Canada had six sets. Japan was an exception because it was almost no preferential agreements.¹¹ The United States established different value-added percentage in a variety of different preferential rules of origin so as to require a lower value-added percentage from the countries had closer ties with the U.S. The Free Trade Area established outside the United States and America did not adopt “NAFTA” model, the free trade area of United States and Jordan as well as United States and Israel used only value content standards. In addition, for the same product different regions used different standards of origin. For

⁹ Xu Jinliang, 《Rules of origin - production, use and reform》, University of International Business and Economics, Dissertation, p. 64, 1998

¹⁰ Global Economic Prospects 2005, World Bank Report, P70.

¹¹ Edwin Vermulst, Paul Water, and Jacques Bourgeois : Rules of Origin in International Trade: A Comparative Study, The University of Michigan Press, 1997, pp25.

example, in the European Union / European Free Trade Agreement, the car had a specific percentage rule of origin, all non-material value can not exceed 40% of the final price. However, in NAFTA, the car rules of origin contained the requirements of change of tariff directory and increased value, the input value within the region was no less than 50% of the total value. In the European Union and Eastern Europe free trade agreements, the car's specific rules of origin about non-origin material value were not exceeding 40% of prices. Inconsistent of rules of origin had increased the protection for a particular industry or sector within region, thus the coordination between Member States became more difficult, the ordination rules of origin based on WTO level become difficult too.

3. PREFERENTIAL RULES OF ORIGIN MADE A COORDINATION BASIS FOR FREE TRADE AREA AND THE MULTILATERAL TRADING SYSTEM

The "internal freedom and external protection" principle of FTA preferential rules of origin had some negative effects on the development of the WTO. However, due to rules of origin, the free trade area changes provided development spaces for the multilateral trading systems.

3.1 Increased openness within the region was conducive to the development of WTO

FTA rules of origin improved the internal protection level, but also deepen the economic ties between member countries within the region, and enhanced mutual openness. South - North Free Trade Agreement rules of origin were stricter than the South - South Free Trade Agreement, leading to the South - North Free Trade Agreement with relatively higher internal openness. North American Free Trade Agreement was a typical representative of North-South free trade agreements, of which the rules of origin were very strict and complicated. Because of its complexity, the regional manufacturers used more production factors within the region and improved the efficiency and flexibility, promoted adequate exchange of internal human and capital. The resulting series of related agreements such as the intellectual property, competition policy, government procurement agreement contained in the North American Free Trade Area which were more perfect than other free trade agreements and agreements contained in the WTO. Multilateral trade agreements completed the agreements in accordance with the North American Free Trade Agreement order. Thus, the strict rules of origin can lead to increased openness between member countries within the region and raised internal integration level.

But the South-South free trade agreements ran the opposite results. South -South free trade agreements adopted non-restrictive rules of origin, the degrees of rigor were far below the North-South free trade agreements and the implementation of the results were far from ideal. Such as the Caribbean Community as well as Eastern and Southern Africa Common Market effects were not obvious, with no strictly rules of origin protection within the member states, manufacturers adopted the principle of profit-maximizing to choose the lowest cost of raw materials, which could not intentionally support the internal related industries. Thus, the regional economic ties between member states became loose and internal integration was not improved, with mutual openness was limited too.

Strict rules of origin promoted the openness and freedom of the free trade area, which was consistent with the purpose of the WTO and was a prelude for the multilateral trading system further development.

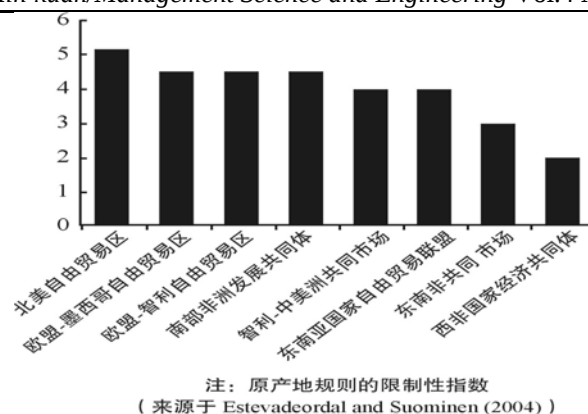


Fig 1: The stringent degree of South - North Trade Agreement rules of origin relative to the South - South trade agreements

North American Free Trade Area
 EU - Mexico Free Trade Area
 EU - Chile Free Trade Area
 Southern African Development Community
 Chile - Central American Common Market
 Southeast Asia Free Trade Association
 Common Market for Eastern and Southern Africa (COMESA)
 Economic Community of West African States

3.2 Investment instead of trade was conducive to the development of WTO investment agreement

The short-term effect of FTA rules of origin can influence intra-regional trade flows, in the long term, rules of origin will affect the flow of investment.¹² As the price was equal to the cost in the long term, differences due to factor endowments may not affect trade flow, on the contrary, capital flow will bring benefits to the manufacturers, so the investment will replace the trade flow.

The EU was the world's most sophisticated integration organizations, which made full use of rules of origin induced large numbers of foreign investments to the EU. For example, in 1989, the European Commission established Integrated Circuit(IC) rules of origin, which provided that "diffusion" procedure required a high degree of accuracy and a lot of research and development, the "diffusion" process should be the origin of integrated circuits. With the introduction of this rule, the European circuit, with no advantage in the world, had attracted a lot of investment. It was reported that in 1987 there were 102 IC manufacturers in Europe, by 1990, more than 20 foreign companies had moved to Europe, made the European manufacturers of integrated circuits increased to 124 with an increase of 20%.¹³ The U.S. companies set up about 40 integrated circuit manufacturing factories in Europe. Before the introduction of integrated circuits rules of origin in the EU, the U.S. integrated power production plants in the Native American ran "spread" production process.

Through the strict North American Free Trade Area rules of origin, the United States reached the effect of introduction of foreign investment. For example, NAFTA rules of origin formulated that the main components of telecommunications switching equipment-printed circuit board assemblies must be produced in North America. To meet the requirement, American Telephone and Telegraph Company had transferred their manufacturing operations from Asia to Mexico and increased investment in the United States. Photocopiers rules of origin also led Japan's Canon invested 100 million dollars in Virginia of the United States built a copier manufacturer. After the establishing of the North American Free Trade Area, in

¹² Kala Krishna, Understanding Rules of Origin, The Origin of Goods Rules of Origin in Regional Trade Agreements, Edited by Olivier Cadot Antoni Estevadeordal Akiko Suwa-Eisenmann and Thierry Verdier, Oxford University Press, 2006, p23.

¹³ Zhang Xiang, Understanding and application of rules of origin—a issue is crucial to our economic development and interests

order to get qualified North American origin, Hitachi, Mitsubishi, Sony and other Japanese companies had established five color TV factories in North America. In addition, NAFTA also provided the criteria for enjoying preferential tariff treatment within region, the imported cars must meet the standards of value content of 62.5% in North America. Such rules of origin forced Japan to set up plants in Mexico and increased the procurement of share auto parts in the North American. Moran (1998) showed that as the complexity of NAFTA rules of origin, a large number of foreign investors were attracted to North America. He cited the ATT, Fujitsu, Zenith, Sony, Samsung and other companies successfully introduced investment to NAFTA from Asia.¹⁴ FTA rules of origin led to increasing direct investment in the region from countries outside the region, thus increased the number and size of international direct investment. However, many problems must be faced in the investment process, and a protocol needed to be formulated. Investment agreement in WTO will inevitably cause the concern of member countries, and subsequently improved.

3.3 Increased administrative costs resulting from rules of origin promoted the producers choice of GSP

Management rules of origin had a relation with the certificates of origin, and different FTA adopted different certificates of origin management approaches (see Table3). EU rules of origin required the use of active certificates can be called two stages certificates. That was the exporter or exporting agency applied for certificates from the exporting country, or by the customs authorities of the exporting country issue the invoice. For the North American Free Trade Area and other free trade areas established in the United States, using the self-certification ---- the exporters signed a certificate in line with origin provisions. Southern common market and the Andean Community required a certificate issued by the Government department or government authorized private sector. In several managements rules of origin, self-certification was the lowest cost way, and the government reduced management costs, but it may lead to certificates of origin were not rigorous.

Table 4: Management methods of certificate of origin in some free trade area

Free trade area	Proof
Eurozone	Two-stage certification, Restrictive self-certification
EU - South Africa	Two-stage certification, Restrictive self-certification
EU - Mexico	Two-stage certification, Restrictive self-certification
EU - Chile	Two-stage certification, Restrictive self-certification
North American Free Trade Area	Self-certification
United States - Chile	Self-certification
Mexico - Bolivia	Self-certification
Canada - Chile	Self-certification
South Common Market	Public department or the government-authorized private department
South Common Market-Chile	Public department or the government-authorized private department
South Common Market- Bolivia	Public department or the government-authorized private department
Andean Community	Public department or the government-authorized private department
Japan-Singapore	Public department or the government-authorized private department
United States - Singapore	Self-certification
Chile - Korea	Self-certification
United States - Jordan	Self-certification

Source: Estevadeordal and Suominen(2004ab)

It is estimated that the European Free Trade Agreement and free trade agreement reached by the European Union, due to complexity of the rules of origin, the administrative and technical work in line with the terms of the agreement increased amount to at least 5% of production costs. As the cost was too high, making at least 1/4 exporters abandoned preferential treatments to pay the Most-favoured-nation rate of

¹⁴ Alex Jameson Appiah, Applied General Equilibrium Model of North American Integration with Rules of Origin, doctoral dissertation 1999.p25.

duty, which meant that there were 3/4 of the exporters bore the higher costs, reduced the trade creation effect.¹⁵

4. THE COORDINATION DIRECTION OF THE PREFERENTIAL RULES OF ORIGIN AT WTO LEVEL

With the strengthening of economic globalization, and economies increasingly interlinked between countries as well as the international economic interdependence strengthening. The production of one product may in many countries, the specialization degree continued to improve and the whole world formed a tight production network. At the moment, to judge a product's country of origin was particularly important. At the same time, the globalization of trade and capital raised more requirements for the rules of origin content enrichment, but also made the coordination of rules of origin became more urgent.

Although in the Uruguay Round, the United States and other countries suggested extend the coordination range to all the rules of origin including preferential rules of origin, other countries represented by the European Union hoped coordination range limited to the non-preferential rules of origin, which will exclude all the rules of origin included in free trade agreements and the GSP rules of origin from the scope of coordination. 《Agreement on Rules of Origin》 of WTO specified that the rules of origin had no relation with tariff preferences provided by contractual and regional autonomy trade system which in excess of the MFN clause in GATT. The agreement without engagement on the regional integration organizations such as EU, NAFTA, Australia-New Zealand Alliance, Association of Southeast Asian Nations and so on. But the WTO rules of origin was only a matter of principle, its main principle was “control the use of rules of origin”.¹⁶ Seldom related to specific contents. Although an annex in the agreement, “joint declaration”, involved discriminatory tariff arrangements of origin issues, it gave no real guidance, thus to leave the gray area for implementation of differential treatment and became a protection sword of regional group.

4.1 Coordination with progressive principle

Preferential rules of origin was characteristic of the world's preferential trade arrangements which affected almost 50% of world trade. European Union and the North American Free Trade Area of the preferential rules of origin were the most influential in the world, called “Pan-European model” and “NAFTA model”. If the coordinating with different free trade area rules of origin at the level of WTO was too difficult to done in one action. Then needed to adopt a progressive manner, first, developed to two models --- Pan-European model and the NAFTA model.

After enlargement of EU, it became a region of 27 members. The original rules of origin adopted by EU extended to new members. Rules of origin for the new member states had not changed, only the minimum content standards adjusted to 10%. In addition, the EU and developing countries had also established a number of free trade areas, formulated rules of origin adopted the European Union mode. In accordance with this development trend, many countries may adopt the EU rules of origin model.

Western Hemisphere will adopt the rules of origin of NAFTA model. North American Free Trade Area was America's major region, their rules of origin were relatively mature. With the establishment of the United States and Chile Free Trade Area as well as the Central American countries, NAFTA rules of origin will be used in the America free trade areas. Meanwhile, Chile and South Korea free-trade area adopted the NAFTA mode rules of origin, the United States and South Korea free trade also used NAFTA rules of

¹⁵ Kala Krishna, Understanding Rules of Origin, The Origin of Goods Rules of Origin in Regional Trade Agreements, Edited by Olivier Cadot Antoni Estevadeordal Akiko Suwa-Eisenmann and Thierry Verdier, Oxford University Press, 2006, p22.

¹⁶ OECD, “Regional and the Multilateral Trade System”, Organization for Economic Co-operation and Development, 2002, p 160.

origin. The FTA rules of origin will affect some countries in Asia formed free trade area choice of rules of origin, tend to NAFTA rules of origin model.

From the development of global regional economic organizations perspective, free trade area rules of origin will mainly develop to the Pan-European mode and the NAFTA mode. With the strengthening of economic globalization, increasing liberalization of international trade, the Pan-European mode and the North American Free Trade Area mode will also gradually integrated to form harmonious rules of origin.

4.2 Coordination with cumulative principle

Cumulation was a preferential trade arrangement that allowed members to use the non-originating materials processing products from the other members of party without loss of the final product preferential treatment. Application of cumulation of the EU since 1997, they adopted three types of cumulative methods: a. Bilateral cumulation, that was two PTA members allowed both the other members to use their own PTA raw materials processing products while can still gain the origin. b, Diagonal cumulation, it meant the mutual preferential rules of origin member countries can use any materials and intermediate products from the member countries processing their products and gain origin. Pan-European model was the most extensive area using diagonal cumulation. The system applied to the European Union and 16 trading partners in the World and more than 40 free trade areas. C, Full cumulation, it meant using the products had relation with the “preferential rules of origin” countries and processing them to final products still be eligible for the origin. For example, the European Union and South Africa free trade area adopted the full cumulation, the South African products can contain any raw materials from South African Customs Union can still be identified as originating in South Africa.

As can be seen from the cumulation, the free trade area preferential rules of origin aimed at not only for the region itself, the relevant nations or regions will become beneficiaries. Obviously, this approach reduced the protection degree brought by overlap free trade area, thus extended the preferential to a broader relevant region. Therefore, if advocating the cumulation of free trade area, will facilitate the coordination of the global rules of origin and was conducive to the development of WTO.

5. CONCLUSION

The fast development of regional economical organizations enlarged the preferential rules of origin function, added the characteristics of reflecting interests of regional member countries as well as closely integrated with the production stage. All these features led to preferential rules of origin in free trade area as the regional trade protection tools, increased regional trade diversion effect, and reduced global welfare level.

These effects brought by preferential rules of origin had a conflict with the objectives of the WTO. At the same time, preferential rules of origin increased the degree of openness and freedom within the region, producers adopted investment instead of trade practices also promoted the development of WTO investment agreement. The huge costs of administrative rules of origin also promoted the members choice of GSP. These impacts set a coordination foundation between the free trade area and the multilateral trading system, by the use of progressive and cumulative principles may achieve the coordination between the multilateral trading systems.

REFERENCES

- Alex Jameson Appiah.(1999). *Applied General Equilibrium Model of North American Integration with Rules of Origin*. Doctoral dissertation, 25.
- Alex Jameson Appiah. (1999). *Applied General Equilibrium Model of North American Integration with Rules of Origin*. Doctoral dissertation, 30.

- Edwin Vermulst, Paul Water, and Jacques Bourgeois. (1997). *Rules of Origin in International Trade: A Comparative Study*. Michigan: The University of Michigan Press, 25.
- Kala Krishna. (2006). Understanding Rules of Origin. *The Origin of Goods Rules of Origin in Regional Trade Agreements*. Edited by Olivier Cadot Antoni Estevadeordal Akiko Suwa-Eisenmann and Thierry Verdier. Oxford University Press, 22-23.
- Kati Suominen . (2004ab). Estevadeordal and Suominen. *Rules of Origin in Global Commerce*, 39.
- Organization for Economic Co-operation and Development. (2002). *Regional and the Multilateral Trade System*, 160.
- World Bank Report. (2005). *Global Economic Prospects*, 70.
- World Trade Organization Secretariat, Suo Bicheng et al..(2001). *Introduction to the Uruguay Round Agreements*. Law Press, 175.
- XU Jinliang. (1998). *Rules of Origin - Production, Use and Reform*. Dissertation, 64. University of International Business and Economics.