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EU FREE TRADE AGREEMENTS

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1. INTRODUCTION

Following the United Kingdom's (UK) departure from the European Union (EU), international trade and in particular free trade agreements have received much public attention. While barriers to trade between EU countries have been eliminated with the creation of the single market in the EU, trade barriers between EU countries and non-EU countries have been reduced and eliminated through free trade agreements. As a consequence of Brexit, the EU and the UK are now in the process of negotiating such a trade agreement to apply once the transition period ends on 31 December 2020.

The UK's transition from an EU Member State to a non-EU country is a good illustration of the barriers and restrictions to international trade and the various ways countries seek to reduce these and ease the import and export of goods and services. Once the transition period ends, EU and UK exporters will again be faced with the procedures and requirements that only apply to trade with non-EU countries. The UK will no longer benefit from the EU's trade agreements, which will affect not only UK exporters but also EU exporters of goods with UK input.

This paper provides an overview of the main customs and trade aspects of benefitting from trade agreements concluded between the EU and its trading partners, including the Rules on Origin, Proof of Origin, Registered Exporter and Approved Exporter. As such, the paper focuses on the main procedures and formalities for exporters, as well as specific elements of some of the main Free Trade Agreements concluded by the EU.

2. FREE TRADE AGREEMENTS

Free Trade Agreements (FTAs) are international agreements between one or more countries or regions that aim to reduce trade barriers. FTAs allow the movement of goods and services between the partner countries by eliminating or reducing trade barriers such as tariffs, duties and quotas.

The EU has various types of international agreements that include provisions on trade and investment¹. The European Economic Area (EEA) Agreement provides full access to the internal market for Iceland, Liechtenstein and Norway. These countries form part of the European Free Trade Association (EFTA) countries together with Switzerland². The EU has also concluded numerous association agreements with non-EU countries. These aim at closer economic and political cooperation, and also include provisions on trade, developing trade, political and security cooperation.

Aside from these, the EU has concluded several FTAs of which the most recent include those with Singapore, Canada (also referred to as CETA), Japan and Vietnam. All aforementioned agreements entered into force in the past three years. Trade agreements that are currently being negotiated include those with Australia, New Zealand and with regional groups such Mercosur (Argentina, Brazil, Paraguay and Uruguay) and the Association of Southeast Asian Nations (ASEAN).

Although each FTA sets out specific rules and procedures for obtaining preferential treatment, many aspects are governed by common rules and procedures.

¹ Please see the following link for a current state of play of the EU FTAs: <https://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/>

² Switzerland is not a party to the EEA, but has concluded a set of bilateral agreements with the EU on trade.

3. RULES OF ORIGIN

A core aspect of FTAs is that the preferential treatment only applies to goods originating in the trading partner countries. There are however certain exceptions, which allow goods to benefit even where they consist of non-originating materials.

These are all set out in the FTAs Rules of Origin (ROO). The ROO determine the criteria goods have to meet in order to be regarded as originating in a partner country and benefit from a lower or zero import duty rate of the FTA.

In order for goods to obtain a preferential duty treatment (i.e. a lower or zero import duty) two main conditions have to be met. First of all, the goods must either be wholly obtained in the partner country, meaning that the materials and products are sourced in one country and manufactured there. Secondly, the goods may also obtain preferential status after they have been sufficiently processed or worked in a partner country. Under this criterion, the materials may be sourced from other countries, but have to undergo sufficient working as determined by the specific FTA. Each FTA sets out the specific requirements for meeting these conditions. As an example, CETA provides that goods may benefit from preferential treatment if they are either wholly obtained in the EU or Canada, satisfy the change tariff classification requirement, do not exceed the value or weight limitation or have undergone specific working or processing.

3.1. Goods wholly obtained in a trade partner country

Where goods have been produced or manufactured exclusively from materials sourced in a partner country, the goods will fulfill the rules of origin of the FTA and obtain preferential treatment. An example hereof is the manufacture of EU origin cheese from milk wholly obtained from animals in the EU. As such, the final cheese product will be classified as EU originating cheese.

3.2. Goods sufficiently transformed in a trade partner country

In many cases the final product consists of materials sourced in different countries. If materials are sourced from countries that are not party to the particular FTA, it is still possible to benefit from the preferential treatment, provided that the product undergoes sufficient work. The FTA sets out the procedures that are regarded as sufficient.

3.2.1. The value added rule

Goods manufactured in one partner country which incorporate materials sourced in non-partner countries may still obtain preferential status if the value of the non-originating materials does not exceed a certain percentage of the price of the final product. For example, the rule for plastic jugs in the PEM Convention requires that the value of all non-originating materials does not exceed 50% of the Ex Works price of the final product³. In this case, plastic jugs with an Ex Works price of € 6 that are manufactured using non-originating plastic granules (€ 2) and plastic lids (€ 0,50), may still be exported as EU origin. This is because the value of the non-originating materials does not exceed 50% of the price of the final plastic jugs.

³ The Regional Convention on pan-Euro-Mediterranean preferential rules of origin (PEM Convention) establishes common rules on preferential origin and applies amongst others to the EU, EFTA, Egypt, Morocco, Israel, Turkey and Serbia.

While FTAs commonly use the Ex Works price, the EU-Japan FTA also allows the use of the FOB price (Free On Board) instead of the Ex Works price of the final product. Each FTA provides the specific value limitations for the different goods and materials. The application of the value added rule is very precise and can be challenging for companies. Nevertheless, as many products are produced with non-originating materials, it is crucial for companies to assess whether the value added rule can be applied to obtain origin status and thereby gain preferential treatment.

3.2.2. Change of tariff classification

Goods may be considered sufficiently worked or processed when the final product is classified in a chapter, heading or sub-heading of the Harmonized System different from the classification of the non-originating materials used in the manufacture. For example in CETA, linseed oil is classified under HS sub-heading 1516 20. The linseed itself is classified under heading 1204. As the rule for vegetable fats and oils requires a change from any other chapter, linseed oil manufactured by linseed imported for example from Turkey will obtain EU preferential origin when exported to Canada.

3.2.3. Specific working or processing

It is not all work that will be considered sufficient under the FTAs. Each FTA provides specific operations that set out the minimal work required in order to obtain preferential status. For example, in the PEM Convention the rule for marble requires cutting by sawing or otherwise of marble of a thickness of 25 cm. If non-originating marble with a thickness of 40 cm is imported to a partner country and cut into a thickness of 20 cm, the final marble product will be considered sufficiently worked and will obtain preferential origin status.

In addition to the rules on sufficient working and processing, FTAs may also list operations which are considered insufficient. Regardless of whether other requirements have been fulfilled, these minimal operations will not be able to confer origin status when only non-originating products have been used. For example, assembly of packages, washing/cleaning, ironing of textiles and peeling or stoning of fruits are operations which have expressly been classified as insufficient to confer origin status on wholly non-origin materials. The list of insufficient operations varies, so each FTA contains an exhaustive list of operations that have been deemed insufficient.

3.2.4. Combination of list rules

There may be instances where more rules are required to be fulfilled. For example, in the EU-Chile Agreement the rules for citrus juice combine the “wholly obtained” rule as well as the value added rule. Under this rule, citrus fruits must be wholly obtained in the partner country and the value of any materials of chapter 17 must not exceed 30% of the Ex Works price of the final product. In this case, citrus juice manufactured in Chile from citrus fruits harvested there may obtain preferential origin status, even where non-origin sugar, for example from Brazil, has been used. In this case the value of the non-originating sugar must not exceed the value limitation of 30%.

3.3. Cumulation

Oftentimes the manufacturing of products involve materials from two or more countries. In such cases, rules allowing for cumulation make it easier to fulfil the rules of origin. Under the concept of cumulation working or processing carried out in one or more countries other than the exporting country may be taken into account when determining the origin.

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For example, olive oil produced from olives originating in the EU and a partner country may be regarded as originating in the EU when exported to that partner country. In this case, the processing operations carried out in the partner country do not need to fulfill the requirements listed in those rules for the particular product. Instead these operations only need to go beyond the listed insufficient processing or working.

There are three types of cumulation; bilateral cumulation, diagonal cumulation and full cumulation, of which bilateral cumulation is the most common in FTAs.

Bilateral cumulation

Under bilateral cumulation, producers and manufacturers may use materials originating in the other partner country, provided the operations exceed the listed insufficient operations. For example, under the EU-Chile Agreement, cleaning cloths manufactured in the EU using fabric originating in Chile (45% of Ex Works price) and non-originating sewing thread from China (10% Ex Works price) fulfill the rules of origin, even though the value limitation for non-originating materials is 40%. This is because the fabrics from Chile will benefit from the rules on cumulation and be regarded as EU origin material.

Diagonal cumulation

Diagonal cumulation is in fact an extension of bilateral cumulation to multiple countries. It involves two or more countries which are all partners to the same preferential trade agreement, which allows for such cumulation.

Regional cumulation

Regional cumulation is a form of diagonal cumulation, which exists between a group of beneficiary countries, such as the ASEAN countries. Under the EU – Singapore FTA, materials from ASEAN countries that have preferential agreements with the EU may be considered as originating in Singapore or the EU when further processing or incorporation takes place respectively in Singapore or the EU.

Full cumulation

Bilateral and diagonal cumulation only apply to originating materials. Full cumulation on the other hand takes account of all operations carried out in the partner country. For example, instead of only taking into account the origin of the materials also operations subsequently carried out in a partner country are taken into account. To illustrate, under the PEM convention the rules of origin for fabrics require manufacture from fibre (double transformation). Non-origin yarn imported to partner country A and manufactured into fabrics there will not benefit from preferential status when exported to other partner countries since the double transformation requirement is not fulfilled. However, if the fabrics are exported to partner country B without preferential treatment and further manufactured into garments in that partner country, the final product will have undergone double transformation, thus fulfilling the rule of origin. In this case, the rules on full cumulation allow the processing done in both countries to be taken into account. The final garments will be regarded as originating in partner country B and will benefit from preferential treatment when exported to partner country C.

Proof of origin

When seeking to benefit from preferential treatment, exporters need to certify that the rules of origin have been satisfied. The specific rules for certifying the origin status of goods is provided in the different trade agreements. In general such a claim for preferential treatment needs to be supported by a document on origin, which has to be presented to the customs authorities of the country of import.

Each trade agreement provides which documents on origin must be submitted. These documents can be divided into government certificates issued by the exporting country, self-certification by the exporter and importer's knowledge. Aside from the importer's knowledge, these documents have a certain validity period as determined in the trade agreement.

The origin documents are furthermore only valid for one single shipment under most preferential trade agreements. However, under some agreements, such as the EU-Japan FTA, an exporter can make out a document on origin valid for multiple shipments of identical products within a period not exceeding 12 months.

4.1. Certificate issued by customs administration or public authority of exporting partner country

There are two types of government certificates; the EUR.1 and the EUR-MED certificates.

A movement certificate EUR.1 is issued by the exporting country's competent authority and may be used in preferential trade between the EU and most partner countries with which the EU has signed FTAs.

Like the EUR.1, the EUR-MED certificate is also issued by the competent authorities, but is solely used for the purpose of trade under the PEM Convention. The EUR-MED certificate identifies all the countries involved in cumulation within the production processes. The use of the EUR-MED instead of the EUR.1 depends on whether Mediterranean countries are involved, whether diagonal or full cumulation is applied and duty drawback is granted.

4.2. Self-certification issued by the exporter in the partner country of export

Self-certification by the exporter is a declaration on a commercial document, such as an invoice or a packing list. This results in a statement on origin, origin declarations or an invoice declaration. Depending on the trade agreement and value of the exported goods, EU exporters are usually required to be either registered in the Registered Exporter System (REX) or authorized by the customs authorities, also known as the Authorized Exporter Status (AES) in order to self-certify. These statuses provide for an efficient way to use FTAs.

4.2.1. Statement on origin – registered exporters

A statement on origin is a declaration made out by the exporter on the origin status of products on a commercial document (invoice, packing list, etc.). It can be used as a document on origin in trade under for example CETA and the EU – Japan EPA.

In order to make out a statement on origin the exporter must be registered in REX. The REX system is a database of registered exporters and is based on a principle of self-certification by the exporters making out the preferential origin documents (statement on origin or origin declaration). In order to be entitled to do so, the exporter has to be registered in the database by the competent authority. Once registered, the exporter obtains the status of an “Registered Exporter”. For unregistered exporters a statement on origin may however be made out if the value of the consignment does not exceed EUR 6.000.

In practice, the use of REX is partial. Under the EU – Vietnam FTA for example, the REX system must be used for exports from the EU, unless the value of the consignment does not exceed EUR 6.000. However, as for imports from Vietnam, REX is not (yet) applied: the EUR.1 certificate should be used as well as an approved exporter license. The exception for consignments under EUR 6.000 also applies in this case.

4.2.2. Origin declaration and invoice declaration – approved exporters

An origin declaration or an invoice declaration is a statement on the origin of the goods made out by an exporter on a commercial document. These may be used instead of government certificates.

In order to make an origin declaration or invoice declaration the exporter must obtain an authorization from the competent customs authorities and be granted AES. An exporter may obtain AES when certain criteria set by the customs authorities have been met. Once the status obtained, the export formalities are simplified as the exporter is authorized to self-certify the preferential origin of goods by including a specific declaration on invoices or other commercial documents.

The AES authorization is valid for all exports of the covered originating goods during the period of authorization. As an exception, it is possible for an unauthorized but registered exporter to make out an origin declaration under the CETA. Aside from this case, exporters without AES may make out origin declarations or invoice declarations for consignments having a value not exceeding EUR 6.000.

4.3. Supplier's declaration

Documents evidencing the preferential origin of goods can be made on the basis of information and documents, such as supplier's declarations. An example is the Long Term Supplier Declaration (LTSD). A supplier's declaration provides information on the originating status of goods. By making out such a declaration, the supplier informs his customer (the exporter or importer), who needs this information to certify the origin status of the goods. Although a supplier's declaration may not be used as a document of origin for claiming preferential treatment, it is used for applications for movement certificates, such as EUR.1 and EUR-MED and invoice/origin declarations or statements of origin.

Benefitting from the FTAs – in practice

It is crucial for companies involved in import or export of goods to assess whether an FTA applies to their trade and, if so, how the preferential treatment can be obtained. In order to benefit from a preferential tariff the basic conditions must be fulfilled. In case of non-compliance import duties can be reclaimed by the customs authorities.

Firstly, the relevant products must fulfil the rules of origin. This is the case for products wholly obtained in the EU or partner country. In this regard, the rules on cumulation may assist in fulfilling this requirement. For products that also consist of non-originating materials, it is still possible to fulfil the preferential origin requirement. This can be done through sufficient working or processing of the product and complying with the product specific rules of origin (change in tariff classification, value added rule, etc.).

Secondly, the preferential treatment has to be claimed by submitting the correct documents on origin. This is done upon importation, although, in some cases it is also possible to claim the preferential treatment retroactively. Depending on the FTA, the preferential treatment may be claimed through government certificates, such as the EUR.1 and EUR-MED or based on self-certification by the exporter. Self-certification may either be done through the REX system, where a statement on origin is to be submitted, or through the AES system, where an origin or invoice declaration is to be submitted. In these cases the origin may further be declared on commercial documents, including delivery notes, invoices and packing lists. The exporter is responsible for the accuracy of the documents and must prove the declared origin upon request.

Concluding remarks

FTAs have received much attention in the last years, particularly as a result of Brexit and the UK's departure from the single market. Whereas trade with the UK was previously frictionless, after Brexit trade with the UK will be subject to procedures and formalities that only apply to non-EU countries. This brings attention to the various FTAs the EU has concluded and the ways companies may benefit from the preferential treatment.

It is crucial for companies involved in international trade to examine if and how they can benefit from the many FTAs. This way companies can reduce costs and improve their competitiveness. When claiming the preferential treatment companies must however ensure that all the requirements are complied with in order to avoid the risks of non-compliance, including import duties being reclaimed.
