ASSESSMENT OF RULES OF ORIGIN UNDER THE CARIBBEAN BASIN ECONOMIC RECOVERY ACT

Report to the President,
the Committee on Finance,
United States Senate, and
the Committee on Ways and Means,
House of Representatives,
on Investigation No. 332-298
Under Section 332 of the
Tariff Act of 1930

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UNITED STATES INTERNATIONAL TRADE COMMISSION

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PREFACE

The U.S. International Trade Commission (the Commission) instituted the present investigation, Assessment of Rules of Origin Under the Caribbean Basin Economic Recovery Act, investigation No. 332-298, on October 22, 1990, following enactment of the Customs and Trade Act of 1990.[1] (Sec. 223 is reproduced in app. A.) Section 223(a) of the act requires the Commission to undertake, pursuant to section 332(g) of the Tariff Act of 1930, an investigation for the purpose of assessing whether revised rules of origin for products of countries designated as beneficiary countries under the Caribbean Basin Economic Recovery Act (CBERA) are appropriate. Following enactment of section 223, the Commission received a joint letter, dated September 24, 1990, from the House Committee on Ways and Means and the Senate Committee on Finance (reproduced in app. B), asking the Commission, among other things, to assess the existing rules of origin with regard to their uniform and consistent application and to determine the extent, if any, to which the achievement of the goals of the act would be furthered by appropriate modifications.

Notice of the investigation was posted at the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and published in the Federal Register of October 31, 1990 (reproduced in app. C).[2] A public hearing on this investigation was held on January 16, 1991. The information contained in this report was obtained from research by the Commission's staff, from the Commission's files, from consultations with various Government agencies, from the submissions and statements of interested parties, and from other sources.

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[1] Pub. L. 101 382 (Aug. 20, 1990); 104 Stat. 629. Title II is also known as the Caribbean Basin Economic Recovery Expansion Act of 1990.

[2] 55 F.R. 45867.

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EXECUTIVE SUMMARY

Section 223(a) of the Customs and Trade Act of 1990 requires the Commission to assess whether revised rules of origin for products of countries designated as beneficiary countries under the Caribbean Basin Economic Recovery Act (CBERA) are appropriate. Section 223(a) further provides that if the Commission makes an affirmative assessment, it is to develop recommended revised rules of origin. The CBERA program provides for duty-free entry of eligible articles from designated Caribbean beneficiary countries.

In a joint letter, the House Committee on Ways and Means and the Senate Committee on Finance, requested that the Commission assess, among other matters, the existing rules of origin with regard to their uniform and consistent application and consider whether other U.S. rules of origin, such as a change of heading rule like that used in the United States-Canada Free-Trade Agreement (CFTA), could be adapted or incorporated into the CBERA rules.

The United States Trade Representative (USTR), the Department of the Treasury (Treasury), and the U.S. Customs Service (Customs) in separate comments to the Commission recommended that a change-of-tariff-classification rule be incorporated into the CBERA rules of origin. All expressed concern that the present rules are too subjective and unpredictable. They share the view that since a change-of-tariff-classification rule would be based on objective criteria, it would be less susceptible to subjective interpretation and application, thereby increasing uniformity and predictability. The USTR concluded that, because under a change-of-tariff-classification rule, exporters would have a higher degree of certainty as to the status of their goods under CBERA prior to exportation, the need for case-by-case review would be reduced.

Three interested persons recommended that the present CBERA rules of origin be retained without change. The Secretary of Commerce indicated that he did not see any structural problems with the CBI rules of origin and noted that the Department had received few complaints concerning those rules. The Department of Agriculture expressed an interest in the issue to the extent that it supported simplification of existing rules, but it made no other substantive comments.

One interested person proposed that the current rules be replaced with a rule based solely on a 50-percent value-added criterion. Two interested persons specifically opposed adoption of a 50-percent value-added criterion.

The CBI Embassy Group supported use of a change-of-tariff-classification rule, but also suggested that producers be given the option of using the current rule or any revised rule in order to avoid inadvertent adverse effects.

The Commission found no information which suggests that the current rule of origin for eligibility under the CBERA program significantly frustrates the effectiveness of the program. It appears that other factors are far more significant in decisions to source or produce products in the Caribbean Basin.

With respect to the alternative or modified rules proposed by some of the interested parties, it appears that on an overall basis no one would be more than marginally better than another, and that the relative potential benefits of any one are speculative.

Finally, with the potential adoption of a GATT agreement on rules of origin and the establishment of a set of origin rules under the proposed free trade agreement with Mexico, it may be reasonable to postpone revisions to the CBERA rule until the nature of any new rules of origin required by or derived from those sources can be considered. Such a delay would allow for a comprehensive and coordinated review of all U.S. rules of origin to accommodate any GATT obligations and also to take into account the administrative history of the CFTA rules.

Introduction

The United States has adopted several programs that permit eligible goods to be imported from beneficiary countries free of duty or at preferential rates of duty. These programs range from narrow, bilateral, reciprocal agreements, such as that with Canada under the Automotive Products Trade Act of 1965,[1] to broad, multilateral, nonreciprocal preference programs, such as that under the Caribbean Basin Economic Recovery Act (CBERA).[2] Each U.S. tariff preference program limits the number of participating countries and restricts to varying degrees the scope of the program by circumscribing the types of goods covered by the program and requiring that goods covered by the program originate in and in most cases be imported directly from, eligible countries.

In order to effect these restrictions and to provide for their uniform application, each program includes criteria (so-called "rules of origin"[3]) by which goods are determined to have originated in a beneficiary country or countries for purposes of duty-free treatment or other tariff preference.[4] Rules of origin attempt to ensure that the statutory preferences apply only to goods and articles grown, manufactured, or otherwise produced in a beneficiary country or countries. Rules of origin differ from program to program and, in certain cases, from product to product within a program.

The purpose of this report is to review the CBERA rules of origin with respect to their effectiveness and administrability, and to assess whether revision of the rules would be appropriate. This report also reviews the U.S. Customs Service (Customs) regulations used to interpret and apply the CBERA rules of origin. It compares the CBERA rules of origin with those applicable to imports from insular possessions, under the Generalized System of Preferences (GSP), under the United States-Israel Free-Trade Area (IFTA), from the freely associated states, and under the United States-Canada Free-Trade Agreement (CFTA), as well as to the principles put forth by the United States before the General Agreement on Tariffs and Trade (GATT) concerning international harmonization of rules of origin.[5]

[1] Pub. L. 89-283 (Oct. 21, 1965) as amended by Pub. L. 100-418; 19 U.S.C. 2001.

[2] Other preferences apply to imports from insular possessions, imports under the GSP, imports from Canada under the United States-Canada Free-Trade Agreement (CFTA), imports from Israel under the United States-Israel Free-Trade Area (IFTA), and imports under the GATT Agreement on Trade in Civil Aircraft.

[3] Also referred to by some as rules of preference.

[4] In addition, there are separate rules and regulations used to determine country of origin for other purposes, such as for implementation of textile quotas, for customs valuation, for marking of goods, or for prohibiting entry of goods.

[5] See "Communication From the United States," Sept. 27, 1990, and "Statement by the United States Delegation," Nov. 30, 1989, to the Negotiating Group on Non-Tariff Measures, Multilateral Trade Negotiations (Uruguay Round). Both documents were included in the post-hearing comments, dated Feb. 6, 1991, of Eugene L. Stewart and Jimmie V. Reyna.

For a general review of rules of origin, see two reports issued previously by the Commission: *The Impact of Rules of Origin on United States Imports and Exports* (investigation No. 332-192), USITC publication 1695, May 1985, and *Standardization of Rules of Origin* (investigation No. 332-239), USITC publication 1976, May 1987.

In reviewing the effectiveness and administrability of CBERA rules of origin, the Commission has given careful consideration to the views of interested persons and Government agencies. These views were given special attention because there is little statistical data or other quantifiable information regarding the impact of CBERA rules of origin on imports into the United States from beneficiary countries. General information and specific data on trade and economic activity under CBERA can be found in the Commission's annual report on the impact of CBERA on United States industries and consumers.[6]

The CBERA Program

Background

President Reagan, on February 24, 1982, in an address to the Organization of American States, outlined a major new program for economic cooperation and development for the Caribbean Basin.[7] This program became known as the Caribbean Basin Initiative (CBI).

As presented in the President's remarks, the CBI was designed to foster economic development primarily through stimulating of the private sector economically. To promote private-sector development, the proposal contained three basic mechanisms: a nonreciprocal free-trade arrangement, investment incentives, and expanded economic assistance. Under the proposed free-trade arrangement, designated beneficiary countries would receive duty-free treatment (with certain named products excepted) on their exports to the United States for 12 years. Investment incentives were to come from tax proposals and bilateral investment treaties. Expanded economic assistance to several of the Caribbean countries was proposed from supplemental Economic Support Funds and the Foreign Assistance Act.

The President first submitted this plan to Congress on March 17, 1982, as the Caribbean Basin Economic Recovery Act. On March 18, 1982, it was introduced in the House of Representatives as H.R. 5900. An amended version, H.R. 7397, was passed by the House of Representatives on December 17, 1982, but was not acted on by the Senate.

[6] *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers, First Report, 1984-85*, USITC publication 1897, September 1986; *Second CBERA Report*, 1986, USITC publication 2024, September 1987, *Third CBERA Report, 1987*, USITC publication 2122, September 1988, *Fourth CBERA Report*, 1988, USITC publication 2225, September 1989, and *Fifth CBERA Report*, 1989, USITC publication 2321, September 1990.

[7] "Remarks on the Caribbean Basin Initiative to the Permanent Council of the Organization of American States," Feb. 24, 1982, *Public Papers of the Presidents of the United States, Ronald Reagan*, 1982, book I, pp. 210-215.

The President resubmitted the House-passed version of his plan to Congress on February 23, 1983. On April 27, 1983, it was introduced as H.R. 2769[8] and, after further amendment, was enacted on August 5, 1983[9]. CBERA was implemented by Presidential Proclamation 5133, dated November 30, 1983.[10]

CBERA Rules of Origin and Implementing Regulations

The criteria by which an article of commerce is determined to be an eligible article for the purposes of CBERA are provided for in subsection 213(a) of CBERA (see general note 3(c)(v) to the Harmonized Tariff Schedule of the United States (HTS), reproduced at app. D) which provide in part that—

> the duty-free treatment provided under this title shall apply to any article which is the growth, product, or manufacture of a beneficiary country, if—
>
> (A) imported directly from a beneficiary country into the Customs territory of the United States; and
>
> (B) the sum of (i) the cost or value of the materials produced in a beneficiary country or two or more beneficiary countries plus (ii) the direct costs of processing operations performed in a beneficiary country or countries is not less than 35 percentum of the appraised value of such article at the time it is entered.[11]

Furthermore, it provides that—

> in order to be eligible for duty-free treatment, an article must be wholly the growth, product, or manufacture of a beneficiary country, or must be a new or different article of commerce which has been grown, produced, or manufactured in the beneficiary country; but no article or material of a beneficiary country shall be eligible for such treatment by virtue of having merely undergone—
>
> (A) simple combining or packaging operations, or
>
> (B) mere dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article.

Subsection 213(a) also authorizes the Secretary of the Treasury to prescribe any regulations needed to carry out that subsection. The regulations under which CBERA eligibility is determined are promulgated and administered by Customs.[12] These regulations reiterate the provisions of subsection 213, define the terms used in the subsection, and establish detailed procedures and criteria under which claims for duty-free entry under CBERA are to be reviewed.

To qualify for an exemption from duty, an article must be an eligible article.[13] An "eligible article" means any merchandise, other than excepted products, that is imported directly from a beneficiary country[14] and that meets the country-of-origin criteria set out in the regulations.

Products excepted from CBERA under section 213(b) include—

> (1) textile and apparel articles which are subject to textile agreements;
>
> (2) footwear not designated at the time of the effective date of this title as eligible articles for the purpose of the generalized system of preferences under title V of the Trade Act of 1974;
>
> (3) tuna, prepared or preserved in any manner, in airtight containers;
>
> (4) petroleum, or any product derived from petroleum, provided for in headings 2709 and 2710 of the Harmonized Tariff Schedule of the United States;
>
> (5) watches and watch parts (including cases, bracelets and straps), of whatever type including, but not limited to, mechanical, quartz digital or quartz analog, if such watches or watch parts contain any material which is the product of any country with respect to which HTS column 2 rates of duty apply; and

[8] For further background, see Caribbean Basin Economic Recovery Act, Report [to accompany H.R. 2769] from the Committee on Ways and Means, House of Representatives, report No. 98 266.

[9] Pub. L. 98-67, title II, (Aug. 5, 1983), as amended by Pub. L. 98-573, Pub. L. 99-514, Pub. L. 99-570, Pub. L. 100-418, Pub. L. 100-647, and Pub. L. 101-382; 97 Stat. 384; 19 U.S.C. 2701 et seq.

[10] 48 F.R. 54453, Dec. 5, 1983.

[11] The 35-percent requirement becomes relevant when an article is not wholly the growth, product, or manufacture of a beneficiary country. In the calculation of the direct processing costs, the law allows the cumulation of contributions from any combination of beneficiary countries. In this context, the term "beneficiary country" includes the Commonwealth of Puerto Rico and the U.S. Virgin Islands. If the cost or value of materials produced in the customs territory of the United States (other than Puerto Rico) is included, an amount not to exceed 15 percent of the appraised value attributable to the U.S. cost or value may be applied to the 35 percent minimum.

[12] 19 CFR 10.191-10.198. There have been relatively few published decisions regarding application of the CBERA rules of origin or related Customs regulations. In a recent decision (Customs Service Decision 90-88), Customs ruled on a set of facts surrounding obvious examples of substantial transformation and CBERA origin and consequently provided no particular insight into its interpretation of substantial transformation.

[13] The term "eligible articles" is defined at 19 CFR. 10.191(b)(2).

[14] The following countries and territories are designated beneficiary countries for the purposes of CBERA: Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, Saint Christopher and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Trinidad and Tobago, and British Virgin Islands. Suriname, the Cayman Islands, and the Turks and Caicos Islands are eligible for designation but have not sought such status.

(6) articles to which reduced rates of duty apply under subsection (h).[15] The regulations provide that claims for an exemption from duty must be supported by documentary evidence and that Customs can require production of such evidence when making an eligible article determination.

In addition section 213(c) limits duty-free treatment of sugars, sirups, molasses, beef, and veal products.

Under CBERA, the expression "imported directly" has several meanings. Such goods may be—

(1) shipped from a beneficiary country to the United States without passing through the territory of any non-beneficiary country;

(2) shipped through a non-beneficiary country, provided they do not enter the commerce of the non-beneficiary country while en route to the United States and the shipping documents indicate the United States as the final destination; or

(3) shipped through a non-beneficiary country, if

(a) the documents do not show the United States as the final destination,

(b) the article remains under the control of the customs authority of the intermediate country,

(c) the article does not enter the commerce of the intermediate country except for the purpose of sale other than at retail, and

(d) the article is not subjected to operations (other than loading or unloading) and other activities necessary to preserve it in good condition.[16]

To qualify for a tariff preference, articles "must be wholly the growth, product, or manufacture of a beneficiary country or must be a new or different article of commerce which has been grown, produced, or manufactured in a beneficiary country."[17] In the latter situation, duty-free entry may be accorded to an article only if the sum of the cost or value of the material produced in a beneficiary country or countries[18] plus the direct costs of processing operations[19] performed in a beneficiary country or countries is not less than 35 percent of the appraised value[20] of the article at the time it is entered.[21]

A unique provision of the CBERA rules of origin allows an importer to cumulate the cost or value of materials produced in and/or cost or value of processing or manufacture occurring in any beneficiary country or countries with those of any other beneficiary country when determining the 35-percent value-added minimum. This feature makes it easier to obtain eligibility for duty-free entry by permitting movement of goods or articles, particularly unfinished or incomplete products, among beneficiary countries without risk to their status as eligible articles.

[15] Subsection 213(h) applies to handbags, luggage, flat goods, work gloves, and leather wearing apparel that are the product of any beneficiary country and were not designated on Aug. 5, 1983, as eligible articles for purposes of the generalized system of preferences under title V of the Trade Act of 1974.

[16] 19 CFR 10.193.

[17] 19 CFR 10.191(b)(3). The expression "wholly the growth, product or manufacture of a beneficiary country" refers both (1) to any article which has been entirely grown, produced, or manufactured in a beneficiary country or two or more beneficiary countries and (2) to all materials incorporated in an article which have been entirely grown, produced, or manufactured in any beneficiary country or two or more beneficiary countries. That

17—Continued

expression does include articles or materials imported into a beneficiary country from a non beneficiary country even if such articles or materials were substantially transformed into new or different articles of commerce in the beneficiary country.

[18] 19 CFR 10.196(b). When the origin of a material is either not ascertainable or not satisfactorily demonstrated, the material is not considered to have been grown, produced, or manufactured in a beneficiary country. 19 CFR 10.196(c). The cost or value of materials produced in a beneficiary country includes the manufacturer's cost for the materials; the actual cost of waste or spoilage, less the value of recoverable scrap; and taxes and/or duties imposed on the materials by any beneficiary country, provided that they are not remitted on exportation. Alternatively, when a material is provided to a manufacturer without charge, or at less than fair market value, its cost or value is the sum of all expenses, production, or manufacture of the material, including general expenses; an amount for profit; and all other cost incurred in transporting the material to the manufacturer's plant.

[19] 19 CFR 10.197. "Direct cost of processing operations" includes those costs either directly incurred in or that can reasonably allocated to, the growth, production, manufacture, or assembly of the article. Such costs include actual labor costs; assists (e.g., dies, molds, tooling) that are allocable to the article; costs of research, development, design, engineering, and blueprints that are allocable to the article; and costs of inspecting and testing. Items that are not direct costs or costs of manufacturing include profit and general expenses of doing business, e.g., administrative salaries, insurance, commissions, and advertising.

[20] 19 CFR 10.195(b). For the purposes of determining the percentage of the sum of the cost or value of the material produced in a beneficiary country plus the direct costs of processing operations performed in a beneficiary country, the term "beneficiary country" includes the Commonwealth of Puerto Rico and the U.S. Virgin Islands. Any cost or value attributable to the U.S. Virgin Islands must be included in the article prior to its final exportation from a beneficiary country to the United States.

19 CFR 10.195(c). For purposes of meeting the 35-percent criterion, an amount not to exceed 15 percent of the appraised value at the time of entry may be attributed to the cost or value of materials produced in the customs territory of the United States (other than the Commonwealth of Puerto Rico).

[21] 19 CFR 10.195(a)(1) and 19 CFR 10.196. "Materials produced in a beneficiary country or countries" are those materials incorporated in an article that are either (1) wholly the growth, product, or manufacture of a beneficiary country or two or more beneficiary countries; or (2) (subject to the rules of origin criteria) substantially transformed in any beneficiary country or two or more beneficiary countries into a new or different article of commerce, which is then used in any beneficiary country in the production or manufacture of a new or different article which is imported directly into the United States.

No article or material is considered to have been grown, produced, or manufactured in a beneficiary country merely by virtue of having undergone simple combining or packaging operations or mere dilution with water or other substance that does not materially alter the characteristics of the article.[22] However, the fact that an article has undergone more than a simple combining or packaging operation or mere dilution is not necessarily dispositive of the question of whether that processing constitutes a substantial transformation for purposes of determining country of origin.[23]

Comparison of CBERA Rules of Origin with Other Selected U.S. Rules of Origin

U.S. rules of origin have evolved from a basic statutory requirement that most imported articles be clearly marked with the country of origin so that the ultimate purchaser is generally aware of the origin of the articles.[24] The requirement that imported goods be marked with the country of origin has been a longstanding feature of U.S. tariff laws and Customs regulations. Similarly, they have been the subject of historic judicial decisions. The fundamental principles of substantial transformation criteria have been developed through judicial review of cases involving country-of-origin markings.

Under the GATT's most-favored-nation (MFN) principle and subsequent reduction in duty rates on articles from MFN countries, the United States needed to determine country of origin for purposes other than the simple marking of goods. To qualify for MFN preferential rates of duty, the origin of the goods had to be established. Given the preexisting familiarity with substantial transformation criteria, it is not surprising that the principle of substantial transformation was used as a basis for MFN preference determination. As additional preference programs were enacted, origin criteria became essential elements of each program, usually based on the principle of substantial transformation.

Most, if not all, duty-rate preference programs require articles covered by the program to be a "product of" a beneficiary country. At present, the requisite finding of origin is generally based on the principle of substantial transformation.[25] In most instances, substantial transformation is determined by review of the individual changes and processes applied to an article during fabrication or manufacture. Because such reviews tend to be undertaken only upon request or for some particular regulatory necessity and to consider only the circumstances of the immediate situation, the conclusions reached often have little applicability to unrelated cases. Further, since the criteria used to determine substantial transformation have been developed primarily from administrative and adjudicatory decisions, their application to a new set of facts and circumstances may be uncertain.

In recognition of this situation, and in view of the international adoption of the Harmonized System, another means was devised to determine whether substantial transformation has occurred, the so-called "change-of-tariff-classification" rules. As discussed below, change-of-tariff-classification rules have been adopted as part of the CFTA.

Change-of-tariff-classification rules are a fixed set of criteria, which can be used to determine whether substantial transformation has occurred and thereby to establish the origin of the article. Since such rules are potentially more objective and consistent and can provide a high degree of detail and specificity, they should be able to be applied without resort to administrative review. Conversely, because of their specificity, such rules are relatively inflexible and complex and therefore may have unintended effects that would have to be mitigated, perhaps with additional criteria.

Products of Insular Possessions

Apart from MFN status, the preference program for products of insular possessions[26] is the least restrictive and the least complex U.S. preference program. Most goods are exempt from duty (see general note 3(a)(iv), HTS, reproduced in app. E) if they are—

(1) imported directly from insular possessions that are outside the customs territory of the United States;[27]

(2) the growth or product of any such possessions, or manufactured or produced in any such possession from materials which are the growth, product, or manufacture of any such possessions or of the customs territory of the United States, or of both; and

[22] 19 CFR 10.195(a)(2). The following are some of the processes considered to be simple combining or packaging operations and mere dilution: (1) addition of batteries to devices; (2) fitting together a small number of components by bolting, gluing, soldering, etc.; (3) blending foreign and beneficiary country tobacco; (4) addition of substances such as anticaking agents, preservatives, wetting agents, etc.; (4) repacking or packaging components together; (5) reconstituting orange juice by adding water to orange juice concentrate; and (6) diluting chemicals with inert ingredients to bring them to standard degrees of strength.

[23] 19 CFR 10.195(2)(ii)(D).

[24] See 19 U.S.C. 1304.

[25] The principle of substantial transformation has a long-standing relationship with country-of-origin determinations. A substantial transformation occurs when an article emerges from a process with a distinctive name, character or use, different from that possessed by the original material that was processed. For a discussion of substantial transformation, see U.S. International Trade Commission, *Standardization of Rules of Origin* (investigation 332-239), USITC publication 1976, May 1987, p. 13. Also see *Torrington Co. v. United States*, 764 F. 2d 1563, 1568 (1985) (citing *Texas Instruments, Inc. v. United States*, 681 F. 2d 778).

[26] The U.S. insular possessions include American Samoa, Guam, Johnston Island, Kingman Reef, Midway Islands, Commonwealth of Puerto Rico, U.S. Virgin Islands, and Wake Island. 19 U.S.C. 1401(h).

[27] All of the insular possessions are U.S. territory, but only Puerto Rico, is within the customs territory of the United States.

(3) do not contain foreign materials valued at more than 70 percent of the total value of the goods (or more than 50 percent of their total value with respect to goods described in section 213(b)[28] of CBERA).

In addition, goods from insular possessions that are not exempt from duty receive duty treatment no less favorable than that afforded beneficiary countries under GSP or CBERA.

The principal difference between the origin rules for goods imported from insular possessions and for goods imported under CBERA concerns the value of foreign or U.S. materials that may be incorporated into an article without changing its origin. Most goods that are the growth or product of an insular possession retain their duty-free status as long as (1) the value of foreign material content does not exceed 70 percent and (2) the remaining 30 percent of value is from U.S. materials or value added in the insular possession.[29] Under CBERA, in order for articles containing foreign or U.S. materials to be considered eligible articles, they must have had a minimum of 35 percent of their appraised value derived from the cost or value of materials produced in beneficiary countries or processing operations performed in beneficiary countries, except that up to 15 percent of the cost or value of U.S. materials may be included.

The less restrictive nature of the insular possessions duty exemption is also reflected in Customs regulations used to determine origin.[30] While the regulations used to determine eligibility under CBERA define terms and expressions, expand upon the basic law, analyze sample situations, and are otherwise comprehensive, those for products of insular possessions are brief and essentially restate the provisions of general note 3(a)(iv) of the HTS.

The GSP Program

To help developing countries expand their role in international trade, several industrialized nations working through the GATT have adopted tariff preference programs applicable to developing countries. The GSP program established by the United States grants duty-free entry to eligible articles from designated beneficiary developing countries.[31] The President, in accordance with statutory criteria, is authorized to designate beneficiary developing countries as well as eligible articles, and to review the program regularly to adjust these designations.

GSP and CBERA are specifically different with respect to the designation of eligible articles. GSP applies only to a positive list of designated articles, whereas CBERA includes all articles, other than named exceptions. Consequently, fewer products are covered under the GSP program than under the CBERA program. Duty-free treatment under GSP is prohibited on textile and apparel articles subject to textile agreements, certain watches and watch parts, import-sensitive electronic products, import-sensitive steel products, footwear, handbags, luggage, flat goods, work gloves, and certain leather wearing apparel.

In addition, continuation of GSP eligibility is reviewed annually in accordance with the competitive-need criterion and can be removed from a product for one or all beneficiary countries with relative ease through administrative processes and Presidential proclamation. By contrast, changes to product eligibility under CBERA generally occur as a result of legislation since CBERA strictly limits the occasions when Presidential action is appropriate. When compared with the GSP program, the CBERA program provides exporters with a more comprehensive range of eligible products, a greater permanence of eligibility, and generally a more stable regulatory environment.

Like the CBERA rules of origin, the GSP rules (see general note 3(c)(ii)(C), HTS, reproduced at app. F) grant duty-free entry to an eligible article that is the growth, product, or manufacture of a beneficiary country,[32] if the article is imported directly from a beneficiary country and the cost or value of the materials produced in such a country plus the direct costs of processing operations in a beneficiary is not less than 35 percent of the appraised value at the time of entry into the United States. However, the GSP rules do not permit either the cumulation of costs and value added in other beneficiary countries (except in the case of two or more members of the same association of countries that is treated as one country) or the inclusion of the value of U.S. materials, as is the case under CBERA.

The ability to cumulate costs of materials and processing incurred in CBERA beneficiary countries,

[28] Goods identified under section 213(b) (which exempts those goods from the CBERA program) include most textile and apparel articles subject to textile agreements, most footwear, tuna, petroleum and petroleum products, watches and watch parts, and certain other articles subject to reduced rates of duty.

[29] The product imported from an insular possession must have been produced or manufactured there. Simple handling or manipulation of foreign goods, even if constituting 30 percent or more of the appraised value, does not confer insular possession origin on the article.

[30] 19 C.F.R. 7.8.

[31] Trade Act of 1974, title V, Pub. L. 93-618 (Jan. 3, 1975), as amended by Pub. L. 94-455 (Oct. 4, 1976), Pub. L. 96-39 (July 26, 1979), Pub. L. 98-573 (Oct. 30, 1984), and Pub. L. 101-382 (Aug. 20, 1990); 88 Stat. 1978; 19 U.S.C. 2461-2465. The GSP program was implemented on Jan. 1, 1976, under Executive Order 11888.

[32] Section 226 of the Customs and Trade Act of 1990, amended section 503(b) of the Trade Act of 1974 (19 U.S.C. 2463(b)) to revise the GSP rule of origin to limit duty-free treatment to any eligible article which is the growth, product, or manufacture of a beneficiary developing country. Previously, duty free treatment applied to any eligible article, regardless of its growth, production or manufacture, so long as the 35 percent beneficiary developing country content criteria were met. This amendment aligns the GSP rule of origin with the CBERA rule of origin and was intended to overturn the June 1988, decision of the U.S. Court of International Trade in *Madison Galleries, Ltd. v. United States*, 870 F. 2d 627 (1989). That decision invalidated a Customs regulation which required an eligible article imported under GSP to be a product of the exporting beneficiary country.

as well as an amount for costs of U.S. materials, allows manufacturers in CBERA beneficiary countries more flexibility and a greater variety of sources in their operations. This substantial benefit is not available under GSP.

The United States-Israel Free-Trade Area

The United States-Israel Free-Trade Area (IFTA) resulted from a bilateral reciprocal agreement[33] between the United States and Israel, which, among other things, provides for reduction or elimination of U.S. duties on products of Israel as well as nontariff barriers. A significant feature of the negotiating authority granted to the President was the requirement that the reduction or elimination apply only to articles that meet rules of origin (see general note 3(c)(vi), HTS, reproduced at app. G) essentially the same as those established under CBERA.[34] Included are the requirements of direct importation and the 35-percent added value; the ability to include up to 15 percent of the costs of U.S. materials; the exclusion of simple combining, packaging, or dilution operations; and the definition of the "direct costs of processing."

Articles Imported From the Freely Associated States

Under the Compact of Free Association Act of 1985, most articles imported from the Marshall Islands and the Federated States of Micronesia became eligible for duty-free treatment in accordance with specified rules of origin. The rules of origin applicable to articles from the freely associated states (see general note 3(c)(viii), HTS, reproduced at app. H) are again essentially the same as those used for CBERA and the IFTA.

The Andean Trade Initiative

On January 23, 1991, Senator Robert Dole, on behalf of the President, introduced legislation that would create a duty-free trade preference for products imported from Bolivia, Colombia, Ecuador, and Peru.[35] The rules of origin included in the bill are virtually identical to those used under CBERA. In fact, one of the purposes of the bill is to provide benefits comparable to those available to CBERA beneficiary countries.[36]

The CFTA

The CFTA is a comprehensive bilateral reciprocal agreement between the United States and Canada, which, among other things, provides for a 10-year phaseout of tariffs on all goods originating in the territory of Canada.[37] The phase-out is scheduled to be completed by 1998. The agreement includes rules of origin applicable to articles for which the tariff preference is claimed (see general note 3(c)(vii), HTS, reproduced at app. I). Of particular interest are those that apply to goods that are not wholly of Canadian or U.S. origin. The CFTA rules of origin are founded on the underlying principle of substantial transformation; however, the method used to determine whether substantial transformation has occurred differs significantly from that set out in CBERA and other U.S. tariff preference programs. The CFTA rules of origin also parallel those of CBERA by not permitting origin to be conferred by virtue of simple packaging or certain combining operations, or mere dilution with water or another substance that does not materially alter the characteristics of the goods; nor do they allow any process or work in which it is determined that the sole object was to circumvent the rules of origin.

In general under the CFTA, substantial transformation is determined by a showing that an enumerated change of tariff classification has occurred. Consequently, an article produced, processed, or manufactured in Canada, but not wholly of U.S. or Canadian origin, will be treated as having U.S. or Canadian origin if it has been sufficiently transformed so that the tariff classification applicable to the article at the time of entry, differs, in accordance with specified rules, from that applicable to the article or its precursor at the time it was initially imported into Canada or the United States.[38]

In certain cases, the CFTA origin rules also include a valued-added criterion that must be met, even though the requisite change of tariff classification has occurred. To satisfy that criterion there must be an

[33] Title IV of the Trade and Tariff Act of 1984 (Pub. L. 98-573, Oct. 30, 1984) amended sect. 102(b) of the Trade Act of 1974 (Pub. L. 93-618, Jan. 3, 1975, 19 U.S.C 2461-2465) to authorize the President to enter into a bilateral reciprocal trade agreement with Israel. The Agreement on the Establishment of a Free Trade Area Between the Government of the United States and the Government of Israel was signed on Apr. 22, 1985, and implemented by the United States-Israel Free Trade Area Implementation Act of 1985 (Pub. L. 99-47, June 11, 1985, 19 U.S.C. 2112).

[34] Sect. 402 of title IV of the Trade and Tariff Act of 1984 provides criteria for duty-free treatment that are virtually the same as those established by CBERA other than the ability to cumulate value added in other beneficiary countries. See general note 3(c)(vi), HTS, reproduced at app. G.

[35] Senate bill S.275, see C.R. S 1222, Jan. 29, 1991.

[36] Senator Robert Dole, in his statement introducing the bill (C.R. S 1222 Jan. 29,1991), stated—

> This legislation authorizes the President to offer legitimate trading opportunities, comparable to the trade preferences granted to our Caribbean Basin neighbors. . . [and] Under this initiative, direct imports from a beneficiary nation are eligible for duty-free treatment if at least 35 percent of their value was added in one or more of the beneficiary countries, including the CBI countries.

[37] Sect. 102(b) of the Trade Act of 1974, as amended by sect. 401 of the Trade and Tariff Act of 1984, authorized the President to enter into bilateral reciprocal trade agreements to eliminate or reduce tariffs on bilateral trade as well as non-tariff barriers after meeting specified procedural requirements. On Jan. 2, 1988, President Reagan and Prime Minister Mulroney signed the United States-Canada Free-Trade Agreement. The United States-Canada Free-Trade Agreement Implementation Act of 1988 (Pub. L. 100-449; 100 Stat. 418; 19 U.S.C. 2112 note) was signed into law on Sept. 28, 1988. The agreement entered into force on Jan. 1, 1989. See also 19 C.F.R. 10.301-10.311 for Customs implementing regulations.

[38] General note 3(c)(vii) of the HTS. See also Customs regulations at 19 C.F.R. 10.303.

additional determination that during substantial transformation sufficient value has been added in Canada or the United States before origin can be conferred.

In several cases individual administrative decisions are still necessary. For example, such situations can arise when there is no change-of-tariff classification even though substantial value has been added in Canada or the United States, when the choice of competing headings is not obvious, especially if the essential character of the third-country inputs is unclear, when the value-added criterion applies, or when fungible goods are commingled. These decisions may involve the production of extensive documentation in support of a claim of Canadian or U.S. origin, and in some cases the cost of compiling and maintaining that documentation is greater than the potential savings in duty.

The advantages or disadvantages of the CFTA rules of origin are somewhat difficult to assess. Because of the newness of the CFTA, the body of rulings, interpretations, or adjudicatory decisions is limited. In cases in which a change of tariff classification is readily apparent and when there is no value-added criterion, the rules appear to be relatively easy to apply and likely to provide a higher degree of predictability and uniformity than traditional case-by-case decisions regarding substantial transformation.

Proposed GATT Principles Regarding Rules of Origin

In the Uruguay Round of GATT negotiations, in response to a discussion concerning an agreement on rules of origin, the U.S. suggested four principles to govern the application of such rules:

(a) Rules of origin shall be based on a positive standard to the maximum extent possible, i.e., they should state what confers origin as opposed to what does not confer origin. Negative standards are permissible to clarify a positive standard.

(b) All origin systems maintained by a country shall ensure that the origin of products is determined in a consistent manner within each system.

(c) Rules of origin shall be readily understandable, published in easily understood language, and shall be uncomplicated and predictable in application.

(d) Any determination of origin shall be reviewable by an administrative or judicial authority of the relevant country other than the authority issuing the determination which has the authority to reverse or modify the determination.

Subsequent to the presentation of the U.S. views and those of other participating countries, a draft agreement was developed and is now being considered for adoption. The draft agreement adopts to a large extent the principles set out by the United States. However, the draft agreement, in a notable departure from the U.S. position, excludes preference programs from its requirements and disciplines, thereby limiting applicability primarily to situations involving MFN treatment or collection of statistical data. Should the proposed GATT agreement be adopted as drafted, and if the United States is a party to that agreement, then the United States would not be obligated to conform to that agreement any of its rules of origin applicable to its preference programs. The United States could, of course, unilaterally decide to align the preference program rules of origin with the GATT agreement in the interests of consistency and uniformity with non-preference rules.

Views of Interested Parties

United States Government Agencies

United States Trade Representative

In written comments (reproduced in app. J), the USTR said that it favors adoption of revised CBERA rules of origin and, in particular, supports use of change-of-tariff-classification rules like that in the CFTA. The USTR stated that new rules are necessary because existing rules are too subjective and that the substantial transformation criterion is too discretionary and unpredictable. The USTR also said that rules that provide explicit criteria would be easier for exporters to use and for Customs to administer. The comments from USTR did not address the value-added requirements of the CBERA or CFTA rules of origin.

Secretary of Commerce

In written comments (reproduced in app. K), Secretary of Commerce Robert A. Mosbacher stated that—

> The Department has received few complaints concerning CBI rules of origin. Business comments indicate that the CBI rules are responsive to the needs of the U.S. business community and the desire for economic development in the CBI-designated countries. The rules appear to maximize trade from the CBI countries while providing safeguards to assure that CBI countries are not used as points of transshipment for products from more developed countries.

In addition, Secretary Mosbacher does not see structural problems in the current CBERA rules of origin. He did, however, suggest that there is a need to obtain further information from those most directly affected by the rules.

Department of the Treasury

In written comments (reproduced in app. L), Treasury said that it recommends that the CFTA

rules,with suitable modifications, be considered as a basis for rules of origin under CBERA. Treasury believes that CBERA, because it lacks published rules of origin covering all products, prevents Caribbean exporters from being assured of the dutiable status without an explicit Customs ruling in advance of shipment. In addition, it believes that, because of the value-added requirement, Caribbean manufacturers are required to maintain detailed records that they might not ordinarily maintain.

The Treasury comment also includes the view that Caribbean manufacturers who claim CBERA preferences, often in good faith, may fail to achieve substantial transformation of third-country materials simply because there is no published standard against which they can judge whether their processing operations result in substantial transformation. One outcome of this situation is that preferential treatment may be granted in circumstances where the operation is relatively superficial and does not generate significant investment in the beneficiary country. Treasury points out that these conditions can continue for years, because Customs is unable to review adequately all claims for preference.

U.S. Customs Service

In its written comments (reproduced in app. M), Customs said that administration of rules of origin in general—CBERA rules in particular—is difficult both for the importers and Customs, particularly with respect to production and validation of documentary evidence necessary to satisfy origin claims under the preference programs. The Customs comments state in part that—

> The administration of the traditional case-by-case application of the substantial transformation test in determining whether articles are deemed to be "products of" BCs [beneficiary countries] also presents Customs and the importing community with certain problems. The principal difficulty relates to the subjective nature of the standard, which is due in large part to the absence of clearly defined rules in the statutes themselves for determining when a substantial transformation takes place. The absence of such rules, coupled with other factors such as the almost limitless variety of production processes and the continuous introduction of new products, necessarily requires that substantial transformation determinations be made by Customs on a case-by-case basis. Although a substantial body of administrative and judicial case law has developed over the years on this issue, only a limited degree of predictability has been achieved.

and that—

> The proliferation of different origin standards for various preference programs, especially in the last ten years, clearly has exacerbated the problem. Experience has shown that an increase in the diversity of origin criteria inevitably gives rise to more confusion and uncertainty on the part of the trade community, which in turn, results in increased administrative problems for customs authorities. The hybrid nature of the origin rules for U.S. preference programs also contributes to the overall problem. For the reasons explained earlier, the substantial transformation and 35% value-content requirements of the GSP, CBERA and U.S-Israel FTA are each inherently difficult to establish and verify. Having to satisfy both constitutes a significant obstacle to obtaining preferential treatment under those programs. The U.S.-Canada FTA also has hybrid rules of origin, but to a lesser extent than the other preference programs; a limited range [of] products from Canada are subject to both the change in classification and supplemental value-content requirements.

With respect to the CBERA rules of origin, Customs said that it favors the institution of a single origin methodology (in lieu of the present hybrid system) that is consistent with the direction of the draft GATT agreement, i.e., a rule based primarily on a change in tariff classification.

Department of Agriculture

The Department of Agriculture did not submit substantive comments, but did indicate its support for simplification of the CBERA rules of origin.

Other Interested Parties

Substantive comments were received from a group representing the diplomatic missions of CBERA beneficiary countries, from two firms that have operations in the Caribbean and utilize the CBERA preference, from two trade associations whose members may have Caribbean operations, from a U.S. citrus growers cooperative association, and from a law firm representing itself.

American Association of Exporters and Importers

The American Association of Exporters and Importers (AAEI) submitted a copy of its general position on rules of origin within the context of the draft GATT agreement and additionally indicated its opposition to adoption of a 50-percent local-content rule.

American Electronics Association

Written comments were received from the American Electronics Association (AEA). AEA represents companies whose products include computers, semiconductors, aerospace equipment, and telecommunications. AEA's comments essentially

present its views on the use of value-added criteria within rules of origin. In AEA's view, value-added criteria do not foster predictability, consistency, and ease of administration in the context of origin rules. AEA asserted that rules based on value-added criteria do not mesh with globalized manufacturing, purchasing, accounting, and distribution practices common to many of its members' operations, and that origin rules should not impose unreasonable expenses or business practices.

AEA said that origin rules should not contain value-added criteria, and that origin should be determined by either the country in which the goods were wholly produced or the country in which the materials or components last underwent a change in HTS tariff at the six-digit subheading level or underwent substantial transformation. AEA recommended that any revisions to the CBERA rules of origin should not make it more difficult to obtain the preference or create more administrative burdens.

Baxter Healthcare Corp.

Baxter Healthcare Corp. produces and distributes medical supplies and equipment. It assembles blood and transfusion collection products, catheters, and similar products in Costa Rica, Dominican Republic, and Puerto Rico. In its comments, Baxter indicated that it is satisfied with the present CBERA rules of origin and does not support adoption of a change-of-tariff-classification rule of origin. Baxter said that such a rule is more complex than necessary for CBI trade and will neither increase the predictability and ease of administration nor encourage more U.S. investment in the region. Under such a rule, their products would remain in a single subheading before and after CBERA operations.

Baxter noted that most CBERA-origin decisions by Customs have involved clear cases of substantial transformation and suggests that origin controversies are more likely to arise from local-content or added-value determinations. Baxter said that it favors retention of substantial transformation and specifically opposes adoption of a value-added rule based solely on a minimum 50-percent-local-content test, which it believes would be more restrictive than the present substantial-transformation test.

CBI Embassy Group

The CBI Embassy Group consists of the diplomatic missions of CBERA-beneficiary countries in the United States. In their comments, the CBI Group, indicated support for a change-of-tariff-classification like that used for the CFTA, but operating at the HS heading level and providing for exceptions in cases where transformation of certain products is insufficient to cause a change of tariff heading. In addition, the CBI Group recommended that producers be given the option to use the present rules or revised rules, in order to avoid inadvertent adverse effects. The CBI Group also proposed that revised rules provide for a temporary derogation of the applicability of rules of origin to infant industries in order to permit them to develop sufficient productive capacity for increased local input.

Florida Citrus Mutual

Florida Citrus Mutual is a cooperative association representing U.S. growers of citrus fruit for processing into juices and other products. Florida Citrus said that it is satisfied with the present CBERA rules of origin, in particular the rule regarding limits on dilution of juices with water.

Florida Citrus opposes adoption of a change-of-heading rule, and expressed concern about recent interpretations of the Harmonized System Nomenclature by the Customs Cooperation Council. Such interpretations might permit minor changes to the composition of fruit juices to cause a change of heading. Florida Citrus said that if a change-of-heading rule is recommended, then special exceptions for citrus and possibly other products would be needed to prevent simple pass-through operations that might otherwise comply with such a rule.

Stewart and Stewart

Stewart & Stewart (Stewart) is a law firm, that on its own behalf, provided testimony and written comments. Stewart proposed that the present CBERA rules of origin be replaced by a 50-percent-of-value rule as a first step in the harmonization of all U.S. rules of origin. Under this proposal, origin would be conferred on an article when 50 percent or more of the value of the article is of a particular national origin. If no one country accounts for 50 percent of the value of an article, then a country that accounts for 35 percent of the value should presumptively be the country of origin. In cases where no one country accounts for 35 percent of the value, then the country in which the highest proportion of the total value is added would be the country of origin.[39]

Stewart also said that the proposed 50-percent rule conforms with the criteria articulated by the United States in the negotiations regarding a GATT agreement on rules of origin. Specifically, Stewart asserted that the proposed rule would eliminate the use of the substantial transformation concept, thereby increasing predictability and consistency, and would reduce complexity and confusion in the determination of origin of products under the CBERA program.

Syntex Chemicals Inc.

Syntex Chemicals, Inc., is a manufacturer and importer of chemical products with facilities located in several countries. Syntex said that it generally supports retention of the present CBERA rules of origin but advocates liberalization of value-added requirements. Syntex said that certain costs, such as research and development costs and intellectual property costs, should be included in the value-added determination.

[39] See testimony of Jimmie V. Reyna during the Jan. 16, 1991, hearing (tr., 5)

Syntex opposes adoption of a CFTA-type rule but suggests that the CBERA origin rules be amended to permit a choice of alternative criteria rather than the single set of criteria provided for in the present rule. Alternative criteria could include substantial transformation, maximum percentage of foreign content, or change-of-heading in lieu of substantial transformation.

Assessment of Need for Revision

In assessing whether it is appropriate for the CBERA rules of origin to be revised, the Commission considered the points raised in the joint congressional letter, the reasons for section 223(a) of the act[40], and the comments of Government agencies and other interested persons. There are two basic questions that should be addressed. First, Do the present rules limit or impede full utilization of the CBERA program, and second, If they do, What alternatives are available to improve the situation? In making its assessment, the Commission has carefully considered the views of persons participating in this investigation.

Impact of the Origin Rules on the CBERA Program

There has been little interest in this investigation from firms operating in the Caribbean Basin under the CBERA regime.[41] None of those who made submissions to the Commission provided any quantifiable or even anecdotal evidence in support of the thesis that the CBERA rules of origin may be frustrating the effectiveness of the program. This apparent lack of concern about CBERA rules of origin was also reflected in Secretary Mosbacher's comments, which indicated that the Department of Commerce has received few complaints on the operation of these rules.

Furthermore, with the exception of the CBI Embassy Group, there were no comments in support of or recommending revision of the CBERA rules of origin from firms operating under the CBERA program.[42] At the same time, the comments from two firms having CBERA operations specifically favored retention of the existing rules.

This limited response may indicate how little the CBERA origin rules affect day-to-day operations under the program. The Commission has no information that suggests that the current rules of origin significantly limit the effectiveness of the program or that they are a serious concern in most decisions to participate or establish commercial operations in the Caribbean Basin.

Although firms often consider the impact of rules of origin during the definition phase of prospective CBERA operations, once program eligibility has been established, these rules are not likely to be of further concern. Companies planning to initiate enterprises under CBERA generally consult with Customs, in advance of startup, regarding the dutiable status of their eventual exports to the United States. Once that status has been determined, and unless the basis for that determination changes, the rules of origin rarely, if ever, come into play again during the life of the operation.

It appears that the most significant factors considered by a business contemplating new or additional operations in the Caribbean Basin are costs of transportation, costs of materials, costs and ease of construction of facilities, availability of a relatively low-cost, reliable, and trainable work force, stability of the economic and political environment, and general ability of the local infrastructure to support the needs of the business.

Although import statistics cannot measure lost opportunities, and not all situations can be envisioned, a review of the kinds of products likely to be exported from the Caribbean Basin reinforces the view that the rules of origin have marginal impact on decisions to utilize the CBERA preference. For example, a review of import statistics[43] for 1989, indicates that the vast

[40] The genesis of sect. 223(a) can be found in sect. 114 of H.R. 1233, Caribbean Basin Economic Recovery and Expansion Act of 1989, reported on July 12, 1989. The provisions of sect. 114, which were not included in the Customs and Trade Act of 1990, reflected an administration proposal to authorize the President to proclaim new rules for determining whether articles originate in beneficiary countries. In its report (H. Rep. 101-136) on the bill, the House Committee on Ways and Means stated in part that—

The primary reason for authorizing new rules for determining CBI origin is to provide a basis for the Administration to develop a system applicable to Caribbean Basin exports to the United States that would give greater transparency and predictability than the present system involving subjective determinations with respect to substantial transformation.

The Committee understands that existing rules of origin for implementing the U.S. Canada Free Trade Agreement would be used as a point of departure in developing rules for administering the CBI. New rules of origin could be of significant benefit to Caribbean exporters by providing greater certainty as to their customs treatment in the U.S. market. The Committee is concerned, however, that any new rules continue to require meaningful local content of benefit to the Caribbean and to preclude mere pass through operations and transshipments from third countries.

[41] During the Commission's hearing on Jan. 16, 1991, Commissioner Rohr took note of this apparent lack of interest and asked Commission staff to do all it could to obtain the views of the private sector (tr.,28). This experience was similar to that the House Subcommittee on Trade of the Committee on Ways and Means during consideration of H.R. 1233, the original proposed CBERA II legislation. Of the 98 written comments reprinted by the Committee, only 7 referenced or commented on rules of origin, and of those 7 only 3 provided substantive comments or suggestions (see "Written Comments on H.R. 1233, the Caribbean Basin Economic Recovery Expansion Act of 1989", Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, Committee Print WMCP:101-6, April 4, 1989).

[42] Subsequent to the Jan.16, 1991 hearing, Commission staff contacted several organizations and groups with a potential interest in the issues before the Commission and suggested that they submit comments. As a consequence additional submissions were received from AAEI, AEA, and the CBI Embassy Group.

[43] USITC staff estimated in the *Fifth CBERA Report, 1989*, that U.S. imports from designated CBERA countries in 1989, totaled $6.6 billion, of which about $906 million (13.7 percent) was entered under CBERA, and of that figure, $331 million (5 percent) received duty-free treatment exclusively because of CBERA provisions.

majority of imports, in terms of value, from CBERA-designated beneficiary countries in that year comprised (1) goods excluded from the program, e.g., petroleum products, textiles, and apparel; (2) goods that are free of duty on an MFN basis, e.g., coffee, aluminum ore, and ammonia; and (3) eligible articles that are unlikely to require an origin determination, e.g., fresh vegetables and other agricultural or horticultural products, usually wholly produced in CBERA beneficiary countries.

During 1989, products that were eligible for duty-free entry under GSP but for which CBERA treatment was claimed included raw cane sugar, baseballs and softballs, medical instruments, certain electrical apparatus, fresh cantaloupes and other melons, articles of jewelry, methanol, certain articles of apparel, footwear uppers, and certain frozen vegetables. Together, this group accounted for almost $300 million, or almost one-third of imports entered under the CBERA preference. Although the GSP rules of origin applicable in 1989 differed somewhat from those of CBERA, recent amendments to the GSP rules make them essentially the same as the CBERA rules, especially with regard to substantial transformation requirements. Today the choice of preference is less likely to be based on country-of-origin considerations.

As can be seen from table 1, the majority of goods imported into the United States for which the CBERA preference was claimed, both in terms of c.i.f. value and variety, are agricultural or related products. For most of these products, a question of origin under CBERA rules is unlikely to occur because they are perishable and unlikely to be transshipped into the Caribbean Basin for final processing.

The Commission received several substantive comments from Federal agencies with a direct interest in administration of the CBERA rules of origin. Those agencies, with one limited exception,[1] support adoption of change of tariff classification as the basis for substantial transformation determinations. Although not stated explicitly, it appears these agencies support, to the extent possible, simplification or elimination of value-added rules.

[44] The Secretary of Commerce supported simplification of the rules but did not endorse any particular revision.

Table 1[1]
C.i.f value of leading U.S. imports which were ineligible under GSP, but benefited from CBERA duty-free treatment in 1989
(1,000 dollars)

HTS Subheading No.	*Description*	*CBERA beneficiary imports*
0202.30.60	Frozen boneless beef, except processed	76,005
0201.30.60	Fresh or chilled boneless beef, except processed	51,345
0804.30.40	Pineapples, in crates or other packages	38,559
2207.10.60	Undenatured ethyl alcohol	22,093
8533.40.00	Electrical variable resistors	18,509
8532.24.00	Ceramic dielectric fixed capacitors	12,288
2402.10.80	Cigars, cheroots and cigarillos valued ≥ 23¢[2]	11,680
0710.80.95	Frozen orange juice, concentrated	10,115
2401.20.80	Tobacco, partly or wholly stemmed	10,033
0710.80.95	Frozen vegetables, n.e.s.i.	9,634
0202.30.20	Frozen, boneless, processed, high-quality beef	9,543
2401.10.60	Cigarette leaf tobacco, not stemmed	9,385
2208.40.00	Rum and tafia	8,263
8533.21.00	Electrical fixed resistors	6,912
7213.31.30	Irregularly wound coils of hot-rolled steel rod	5,791
7214.40.00	Hot-rolled bars and rods of steel <0.25% carbon	3,961
2009.20.40	Grapefruit juice, concentrated	3,708
0802.90.90	Nuts, n.e.s.i.	3.580
0202.30.40	Frozen, boneless, processed beef, except high qual.	3,113
0714.10.00	Cassava (manoic), fresh or dried	3,036
0804.30.20	Pineapples, bulk.	2,908
0810.10.40	Fresh strawberries, if entered from Sept 16-June 14	2,887
2402.10.60	Cigars, cheroots, and cigarillos valued >15¢ & <23¢	2,768
0603.10.60	Roses, fresh cut	2,375
9507.90.70	Artificial baits and flies	2,296
2004.90.90	Other prepared vegetables, frozen	2,181
0805.10.00	Oranges, fresh or dried	2,103
2207.20.00	Ethyl alcohol and other spirits, denatured	1,945
7214.20.00	Concrete reinforcing bars of iron or steel	1,670
0714.90.40	Fresh arrowroot, salep, and Jerusalem artichokes	1,655

[1] Adapted from table 3-3, U.S. International Trade Commission *Fifth CBERA Report, 1989,* USITC Publicaton 2321, September 1990.

[2] Cigars that benefited from CBERA duty-free treatment are from the Dominican Republic, which lost its GSP eligibility for cigars in July 1989. Figure given represents imports from July 1, 1989, through Dec. 31, 1989.

Source: U.S. Department of Commerce.

From their comments, these agencies appear to seek a regulatory environment and structure that is more easily managed and requires fewer resources to implement. It also appears that their support for change comes not from any specific defect in the current rules of origin, but rather from an interest in gaining consistency and predictability while reducing the administrative burden generated by those rules.

The Alternatives

Having a lack of substantive information that the origin rule is frustrating the CBERA program, a question is raised as to whether the adoption of the alternatives suggested during the course of this investigation would further encourage the economic development of the beneficiary countries.

Suggested revisions fall into three categories: (1) adoption of a change-of-tariff-classification rule to determine whether substantial transformation has occurred, (2) deletion of the substantial transformation test with reliance entirely on a 50 percent-value-added criterion to determine origin, and (3) variations on or combinations of (1) and (2). It is noted that in its report on Standardization of Rules of Origin, the Commission commented on the administrative advantages and disadvantages of the substantial transformation, value-added, and change of tariff classification criteria. Each is currently in use and each has strengths and weaknesses.

From the standpoint of which alternative would be the most suitable for carrying out the purposes of the CBERA program, it is probable that on an overall basis no one would be more than marginally better than any other. It has to be recognized that the opportunity for encouraging economic development in the Caribbean Basin through a special tariff preference program is undoubtedly limited, owing to the generally low MFN-tariff rates already in effect for eligible goods and the availability for duty-free entry for a wide variety of goods under the GSP program. Thus, the potential value of any benefits to beneficiary countries, to operations within those countries, or to exporters and importers making use of CBERA, which might accrue from adoption of one or more of the alternative rules proposed to the Commission, is speculative.

In the past, the Congress has felt it important to consider the interrelationships and in some cases the interdependency of the various U.S. preference programs. Consequently, any substantive restructuring of the CBERA rules may necessitate concomitant or parallel changes in other preference programs. Recently, in the Caribbean Basin Economic Recovery Expansion Act of 1990, Congress specifically included an amendment that carefully aligns the GSP rules of origin with the CBERA rules of origin. Revision of the CBERA rules at this time would place the CBERA preference on a separate footing and would create a new set of origin rules having a single application.

In the same vein, with the potential adoption of a GATT agreement on rules of origin in the near term and the establishment of a set of origin rules under the proposed free-trade agreement with Mexico, it may be reasonable to postpone revisions to the CBERA rule until the nature of any new rules of origin required by or derived from those sources can be considered. Such a delay would allow for a comprehensive and coordinated review of all U.S. rules of origin to accommodate any new GATT obligations and also to take into account the administrative history of the CFTA rules.

A piecemeal approach, that is, amendment of the CBERA rules as suggested in many of the comments submitted to the Commission, without regard to similar rules in other preference programs or future programs, may result in further revisions in the near future and may cause additional uncertainty and administrative changes. The Commission is not aware of any circumstances or sense of urgency that would justify such a course of action.

Finally, the opportunity to develop a common root for U.S. rules of origin may present itself in the near future, since there is a strong likelihood that if the pending GATT negotiations covering rules of origin for non-preference programs come to fruition, then application of the principles set out in that agreement will require fundamental changes to basic U.S. rules of origin. It is reasonable to expect that such rules of origin could be adapted or extended to individual preference programs.

APPENDIX A
SECTION 223 OF THE TRADE AND CUSTOMS ACT OF 1990

"(A) assembled or processed in whole of fabricated components that are a product of the United States, or

"(B) processed in whole of ingredients (other than water) that are a product of the United States,

in a beneficiary country; and

"(ii) neither the fabricated components, materials or ingredients, after exportation from the United States, nor the article itself, before importation into the United States, enters the commerce of any foreign country other than a beneficiary country.

As used in this paragraph, the term 'beneficiary country' means a country listed in general note 3(c)(v)(A).".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) applies with respect to goods assembled or processed abroad that are entered on or after October 1, 1990.

SEC. 223. RULES OF ORIGIN FOR PRODUCTS OF BENEFICIARY COUNTRIES.

(a) ITC INVESTIGATION.—

(1) The United States International Trade Commission shall immediately undertake, pursuant to section 332(g) of the Tariff Act of 1930, an investigation for the purpose of assessing whether revised rules of origin for products of countries designated as beneficiary countries under the Caribbean Basin Economic Recovery Act are appropriate. If the Commission makes an affirmative assessment, it shall develop recommended revised rules of origin.

(2) The Commission shall submit a report on the results of the investigation under paragraph (1), together with the text of recommended rules, if any, to the President and the Congress no later than 9 months after the date of the enactment of this Act. Reports.

(b) LEGISLATIVE RECOMMENDATIONS.—If the President considers that the implementation of revised rules of origin for products of beneficiary countries would be appropriate, the President shall transmit to the Congress suggested legislation containing such rules of origin. In formulating such suggested legislation, the President shall— President of U.S.

(1) take into account the report and recommended rules submitted under subsection (a); and

(2) obtain the advice of—

(A) the appropriate advisory committees established under section 135 of the Trade Act of 1974,

(B) the governments of the beneficiary countries,

(C) the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate, and

(D) other interested parties.

SEC. 224. CUMULATION INVOLVING BENEFICIARY COUNTRY PRODUCTS UNDER THE COUNTERVAILING AND ANTIDUMPING DUTY LAWS.

(a) MATERIAL INJURY.—Section 771(7)(C)(iv) of the Tariff Act of 1930 (19 U.S.C. 1677(7)(C)(iv)) is amended to read as follows:

"(iv) CUMULATION.—

"(I) IN GENERAL.—For purposes of clauses (i) and (ii) and subject to subclause (II), the Commission shall cumulatively assess the volume and effect of

APPENDIX B
LETTER FROM HOUSE COMMITTEE ON WAYS AND MEANS AND SENATE COMMITTEE ON FINANCE

Congress of the United States
House of Representatives
Washington, DC 20515

September 24, 1990

The Honorable Anne Brunsdale
Acting Chairman
U.S. International Trade Commission
500 E Street, S.W.
Washington, D.C. 20436

Dear Madam Chairman:

As you know, section 223(a) of the Customs and Trade Act of 1990 requires the Commission to undertake an investigation pursuant to section 332(g) of the Tariff Act of 1930, for the purpose of assessing whether the rules of origin for products of countries designated as beneficiary countries under the Caribbean Basin Economic Recovery Act (CBERA, or the Act) are appropriate, and if not, to recommend revised rules of origin. During consideration of this legislation each of the Committees was concerned that achievement of the benefits of the Act may be frustrated by origin rules which lacked predictability of result or consistency of application. Therefore, in carrying out this mandate we encourage the Commission to:

Assess the existing rules of origin with regard to their uniform and consistent application and to determine the extent, if any, to which the achievement of the goals of the Act would be furthered by appropriate improvements.

Consider modifications to the rules of origin that would improve their predictability of result, as well as their uniform and consistent administration. In this regard, the Commission may wish to consider the extent to which they conform with the rules of origin proposed by the United States in the Uruguay Round for adoption by the General Agreements on Tariffs and Trade (GATT) and whether other United States' rules of origin (e.g., a change of heading rule such as that used under the U.S.-Canada Free Trade Agreement) could be adapted to or incorporated in whole or in part into the CBERA rules, in order to enhance the utilization of the Caribbean Basin program.

The Commission should seek the views of the private sector, particularly firms which import goods from beneficiary countries, governments of beneficiary countries, and U.S. Government agencies. The Commission should also consider holding a public hearing in Washington to facilitate the receipt of views.

We look forward to receiving your report and any recommendations you may make regarding revision of the Caribbean Basin rules of origin.

Sincerely yours,

Lloyd Bentsen
Chairman
Committee on Finance
United States Senate

Dan Rostenkowski
Chairman
Committee on Ways and Means
U.S. House of Representatives

APPENDIX C
NOTICE OF INSTITUTION OF INVESTIGATION NO. 332–298

INTERNATIONAL TRADE COMMISSION

[332-298]

Assessment of Rules of Origin Under the Caribbean Basin Economic Recovery Act

AGENCY: United States International Trade Commission.

ACTION: Institute of investigation and scheduling of hearing.

EFFECTIVE DATE: October 22, 1990.

FOR FURTHER INFORMATION CONTACT: Lawrence A. DiRicco, Office of Tariff Affairs and Trade Agreements, U.S. International Trade Commission, Washington, DC 20436 (telephone 202-252-1592 through November 30, 1990, thereafter 202-205-2606).

BACKGROUND AND SCOPE OF INVESTIGATION: The Commission instituted investigation No. 332-298, Assessment of Rules of Origin Under the Caribbean Basin Economic Recovery Act, under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)), as required by section 223 of the Customs and Trade Act of 1990 (the Act) which was enacted on August 20, 1990. Section 223(a)(1) of the Act requires the Commission to conduct an investigation for the purpose of assessing whether revised rules of origin for products of countries designated as beneficiary countries under the Caribbean Basin Economic Recovery Act (CBERA) are appropriate, and states that if the Commission makes an affirmative assessment, it is to develop recommended revised rules of origin. Section 223(a)(2) of the Act directs the Commission to submit a report on the results of its investigation, together with the text of recommended rules, if any, to the President and the Congress no later than 9 months after the date of the enactment of the Act.

The Commission has received a joint letter from Congressman Dan Rostenkowski, Chairman of the House Committee on Ways and Means, and from Senator Lloyd Bentsen, Chairman of the Senate Committee on Finance, which describes in greater detail the information that the Committees would like included in the report. More specifically, the Committee chairmen asked that the Commission assess the existing rules of origin with regard to their uniform and consistent application and determine the extent, if any, to which the achievement of the goals of CBERA would be furthered by appropriate improvements, and to consider modifications that would improve their predictability of result, as well as their uniform and consistent administration. The Committee chairmen also stated that the Commission should seek the views of the private sector, particularly firms which import goods from beneficiary countries, and U.S. Government agencies as well as consider holding a public hearing in Washington, DC, to facilitate the receipt of views.

The Commission will review the present rules of origin under CBERA with respect to administerability, particularly with regard to complexity of implementation, uniformity of application and consistency of determination.

The Commission will also consider whether the rules should be revised, and whether such revision should take into account other means of determining origin adopted or proposed by the United States since the enactment of CBERA. In this regard the Commission may consider whether other United States rules of origin (e.g., a change of heading rule such as that used under the U.S.-Canada Free Trade Agreement) could be adapted to or incorporated in whole or in part into the CBERA rules of origin. If the Commission determines that revised rules are necessary, it will provide recommended revised rules. The report will be submitted to President and the Congress by May 20, 1991.

PUBLIC HEARING: A public hearing in connection with this investigation will be held in the Hearing Room of the U.S. International Trade Commission, 500 E Street, SW, Washington, DC., on January 16, 1991, at 9:30 a.m. All persons shall have the right to appear by counsel or in person, to present information and to be heard. Requests to appear at the public hearing should be filed with the Secretary, U.S. International Trade Commission, 500 E Street, SW., Washington, DC., 20436, not later than noon, December 18, 1990. Written prehearing comments (original and 14 copies) should be filed not later than noon, December 19, 1990. Post-hearing comments must be submitted by no later than January 30, 1991.

WRITTEN SUBMISSIONS: Interested parties (including other Federal agencies) are invited to submit written statements concerning the subject of the report. Such statements must be submitted by no later than December 19, 1990, in order to be considered by the Commission. Commercial or financial information that a party desires the Commission to treat as confidential must be submitted on separate sheets of paper, each clearly marked "Confidential Business Information" at the top. All submissions requesting confidential treatment must conform with the requirements of § 201.6 of the Commission's Rules of Practice and Procedure (19 CFR 201.6). All written submissions, except for confidential business information, will be made available for inspection by interested persons. All submissions should be addressed to the Secretary, United States International Trade Commission, 500 E Street SW., Washington, DC 20436.

Hearing-impaired individuals are advised that information on this matter can be obtained by contacting our TDD terminal on 202-252-1809.

Issued October 24, 1990.

By order of the Commission.

Kenneth R. Mason,

Secretary.

[FR Doc. 90-25724 Filed 10-30-90; 8:45 am]

BILLING CODE 7020-02-M

APPENDIX D
GENERAL NOTE 3(c)(v) TO THE HTS

General Note 3(c) (con.):

(v) Products of Countries Designated as Beneficiary Countries for Purposes of the Caribbean Basin Economic Recovery Act (CBERA).

(A) The following countries and territories or successor political entities are designated beneficiary countries for the purposes of the CBERA, pursuant to section 212 of that Act (19 U.S.C. 2702):

Antigua and Barbuda	El Salvador	Netherlands Antilles
Aruba	Grenada	Panama
Bahamas	Guatemala	Saint Christopher and Nevis
Barbados	Guyana	Saint Lucia
Belize	Haiti	Saint Vincent and the Grenadines
Costa Rica	Honduras	Trinidad and Tobago
Dominica	Jamaica	Virgin Islands, British
Dominican Republic	Montserrat	

(B) (1) Unless otherwise excluded from eligibility by the provisions of subdivisions (c)(v)(D) or (c)(v)(E) of this note, any article which is the growth, product, or manufacture of a beneficiary country shall be eligible for duty-free treatment if that article is provided for in a subheading for which a rate of duty of "Free" appears in the "Special" subcolumn followed by the symbol "E" or "E*" in parentheses, and if--

(I) that article is imported directly from a beneficiary country into the customs territory of the United States; and

(II) the sum of (A) the cost or value of the materials produced in a beneficiary country or two or more beneficiary countries, plus (B) the direct costs of processing operations performed in a beneficiary country or countries is not less than 35 per centum of the appraised value of such article at the time it is entered. For purposes of determining the percentage referred to in (II)(B) above, the term "beneficiary country" includes the Commonwealth of Puerto Rico and the United States Virgin Islands. If the cost or value of materials produced in the customs territory of the United States (other than the Commonwealth of Puerto Rico) is included with respect to an article to which subdivision (c)(v) of this note applies, an amount not to exceed 15 per centum of the appraised value of the article at the time it is entered that is attributed to such United States cost or value may be applied toward determining the percentage referred to in (II)(B) above.

(2) Pursuant to subsection 213(a)(2) of the CBERA, the Secretary of the Treasury shall prescribe such regulation as may be necessary to carry out subdivision (c)(v) of this note including, but not limited to, regulations providing that, in order to be eligible for duty-free treatment under CBERA, an article must be wholly the growth, product, or manufacture of a beneficiary country, or must be a new or different article of commerce which has been grown, produced, or manufactured in the beneficiary country, and must be stated as such in a declaration by the appropriate party; but no article or material of a beneficiary country shall be eligible for such treatment by virtue of having merely undergone--

(I) simple combining or packaging operations, or

(II) mere dilution with water or mere dilution with another substance that does not materially alter the characteristics of the article.

General Note 3(c)(v)(B) (con.):

(3) As used in subdivision (c)(v)(B) of this note, the phrase "direct costs of processing operations" includes, but is not limited to--

(I) all actual labor costs involved in the growth, production, manufacture, or assembly of the specific merchandise, including fringe benefits, on-the-job training and the cost of engineering, supervisory, quality control, and similar personnel; and

(II) dies, molds, tooling, and depreciation on machinery and equipment which are allocable to the specific merchandise.

Such phrase does not include costs which are not directly attributable to the merchandise concerned or are not costs of manufacturing the product, such as (I) profit, and (II) general expenses of doing business which are either not allocable to the specific merchandise or are not related to the growth, production, manufacture, or assembly of the merchandise, such as administrative salaries, casualty and liability insurance, advertising, and salesmen's salaries, commissions or expenses.

(4) Notwithstanding section 311 of the Tariff Act of 1930 (19 U.S.C. 1311), the products of a beneficiary country which are imported directly from such country into Puerto Rico may be entered under bond for processing or manufacturing in Puerto Rico. No duty shall be imposed on the withdrawal from warehouse of the product of such processing or manufacturing if, at the time of such withdrawal, such product meets the requirements of subdivision (c)(v)(B)(1)(II) above.

(C) Articles provided for in a provision for which a rate of duty of "Free" appears in the "Special" subcolumn followed by the symbols "E" or "E*" in parentheses are eligible articles for purposes of the CBERA pursuant to section 213 of that Act. The symbol "E" indicates that all articles provided for in the designated provision are eligible for preferential treatment except those described in subdivision (c)(v)(E). The symbol "E*" indicates that some articles provided for in the designated provision are not eligible for preferential treatment, as further described in subdivision (c)(v)(D) of this note. Whenever an eligible article is imported into the customs territory of the United States in accordance with the provisions of subdivision (c)(v)(B) of this note from a country or territory listed in subdivision (c)(v)(A) of this note, it shall be eligible for duty-free treatment as set forth in the "Special" subcolumn, unless excluded from such treatment by subdivisions (c)(v)(D) or (c)(v)(E) of this note.

(D) Articles provided for in a provision for which a rate of duty of "Free" appears in the "Special" subcolumn followed by the symbol "E*" in parentheses shall be eligible for the duty-free treatment provided for in subdivision (c)(v) of this note, except--

(1) articles of beef or veal, however provided for in chapter 2 or chapter 16 and heading 2301, and sugars, sirups and molasses, provided for in heading 1701 and subheadings 1702.90.31, 1806.10.41, 1806.10.42, and 2106.90.11, if a product of the following countries, pursuant to section 213(c) of the CBERA:

Antigua and Barbuda
Montserrat
Netherlands Antilles
Saint Lucia
Saint Vincent and the Grenadines

(2) sugars, sirups and molasses, provided for in heading 1701 and subheadings 1702.90.31, 1806.10.41, 1806.10.42, and 2106.90.11, to the extent that importation and duty-free treatment of such articles are limited by additional U.S. note 4 of chapter 17, pursuant to section 213(d) of the CBERA; or

General Note 3(c)(v)(D) (con.):

(3) textile and apparel articles--

(I) of cotton, wool or fine animal hair, man-made fibers, or blends thereof in which those fibers, in the aggregate, exceed in weight each other single component fiber thereof; or

(II) in which either the cotton content or the man-made fiber content equals or exceeds 50 percent by weight of all component fibers thereof; or

(III) in which the wool or fine animal hair content exceeds 17 percent by weight of all component fibers thereof; or

(IV) containing blends of cotton, wool or fine animal hair, or man-made fibers, which fibers, in the aggregate, amount to 50 percent or more by weight of all component fibers thereof;

provided, that beneficiary country exports of handloom fabrics of the cottage industry, or handmade cottage industry products made of such handloom fabrics, or traditional folklore handicraft textile products, if such products are properly certified under an arrangement established between the United States and such beneficiary country, are eligible for the duty-free treatment provided for in subdivision (c)(v) of this note.

(E) The duty-free treatment provided under the CBERA shall not apply to watches and watch parts (including cases, bracelets and straps), of whatever type including, but not limited to, mechanical, quartz digital or quartz analog, if such watches or watch parts contain any material which is the product of any country with respect to which column 2 rates of duty apply.

APPENDIX E
GENERAL NOTE 3(a)(iv) TO THE HTS

GENERAL NOTES

1. Tariff Treatment of Imported Goods. All goods provided for in this schedule and imported into the customs territory of the United States from outside thereof are subject to duty or exempt therefrom as prescribed in general notes 3 and 4.

2. Customs Territory of the United States. The term "customs territory of the United States", as used in the tariff schedule, includes only the States, the District of Columbia and Puerto Rico.

3. Rates of Duty. The rates of duty in the "Rates of Duty" columns designated 1 ("General" and "Special") and 2 of the tariff schedule apply to goods imported into the customs territory of the United States as hereinafter provided in this note:

   (a) Rate of Duty Column 1.

      (i) Except as provided in subparagraph (iv) of this paragraph, the rates of duty in column 1 are rates which are applicable to all products other than those of countries enumerated in paragraph (b) of this note. Column 1 is divided into two subcolumns, "General" and "Special", which are applicable as provided below.

      (ii) The "General" subcolumn sets forth the general most-favored-nation (MFN) rates which are applicable to products of those countries described in subparagraph (i) above which are not entitled to special tariff treatment as set forth below.

      (iii) The "Special" subcolumn reflects rates of duty under one or more special tariff treatment programs described in paragraph (c) of this note and identified in parentheses immediately following the duty rate specified in such subcolumn. These rates apply to those products which are properly classified under a provision for which a special rate is indicated and for which all of the legal requirements for eligibility for such program or programs have been met. Where a product is eligible for special treatment under more than one program, the lowest rate of duty provided for any applicable program shall be imposed. Where no special rate of duty is provided for a provision, or where the country from which a product otherwise eligible for special treatment was imported is not designated as a beneficiary country under a program appearing with the appropriate provision, the rates of duty in the "General" subcolumn of column 1 shall apply.

      (iv) Products of Insular Possessions.

         (A) Except as provided in additional U.S. note 5 of chapter 91 and except as provided in additional U.S. note 2 of chapter 96, and except as provided in section 423 of the Tax Reform Act of 1986, goods imported from insular possessions of the United States which are outside the customs territory of the United States are subject to the rates of duty set forth in column 1 of the tariff schedule, except that all such goods the growth or product of any such possession, or manufactured or produced in any such possession from materials the growth, product or manufacture of any such possession or of the customs territory of the United States, or of both, which do not contain foreign materials to the value of more than 70 percent of their total value (or more than 50 percent of their total value with respect to goods described in section 213(b) of the Caribbean Basin Economic Recovery Act), coming to the customs territory of the United States directly from any such possession, and all goods previously imported into the customs territory of the United States with payment of all applicable duties and taxes imposed upon or by reason of importation which were shipped from the United States, without remission, refund or drawback of such duties or taxes, directly to the possession from which they are being returned by direct shipment, are exempt from duty.

         (B) In determining whether goods produced or manufactured in any such insular possession contain foreign materials to the value of more than 70 percent, no material shall be considered foreign which either--

            (1) at the time such goods are entered, or

            (2) at the time such material is imported into the insular possession,

            may be imported into the customs territory from a foreign country, and entered free of duty; except that no goods containing material to which (2) of this subparagraph applies shall be exempt from duty under subparagraph (A) unless adequate documentation is supplied to show that the material has been incorporated into such goods during the 18-month period after the date on which such material is imported into the insular possession.

General Note 3(a)(iv) (con.):

(C) Subject to the limitations imposed under sections 503(b) and 504(c) of the Trade Act of 1974, goods designated as eligible under section 503 of such Act which are imported from an insular possession of the United States shall receive duty treatment no less favorable than the treatment afforded such goods imported from a beneficiary developing country under title V of such Act.

(D) Subject to the provisions in section 213 of the Caribbean Basin Economic Recovery Act, goods which are imported from insular possessions of the United States shall receive duty treatment no less favorable than the treatment afforded such goods when they are imported from a beneficiary country under such Act.

APPENDIX F
GENERAL NOTE 3(c)(ii)(C) TO THE HTS

General Note 3(c)(ii) (con.):

(C) Articles provided for in a provision for which a rate of duty of "Free" appears in the "Special" subcolumn followed by the symbols "A" or "A*" in parentheses are those designated by the President to be eligible articles for purposes of the GSP pursuant to section 503 of the Trade Act of 1974. The symbol "A" indicates that all beneficiary developing countries are eligible for preferential treatment with respect to all articles provided for in the designated provision. The symbol "A*" indicates that certain beneficiary developing countries, specifically enumerated in subdivision (c)(ii)(D) of this note, are not eligible for such preferential treatment with regard to any article provided for in the designated provision. Whenever an eligible article is imported into the customs territory of the United States directly from a country or territory listed in subdivision (c)(ii)(A) of this note, it shall be eligible for duty-free treatment as set forth in the "Special" subcolumn, unless excluded from such treatment by subdivision (c)(ii)(D) of this note; provided that, in accordance with regulations promulgated by the Secretary of the Treasury the sum of (1) the cost or value of the materials produced in the beneficiary developing country or any 2 or more countries which are members of the same association of countries which is treated as one country under section 502(a)(3) of the Trade Act of 1974, plus (2) the direct costs of processing operations performed in such beneficiary developing country or such member countries is not less than 35 percent of the appraised value of such article at the time of its entry into the customs territory of the United States.

APPENDIX G
GENERAL NOTE 3(vi) TO THE HTS

General Note 3(c) (con.):

(vi) United States-Israel Free Trade Area Implementation Act of 1985.

(A) The products of Israel described in Annex 1 of the Agreement on the Establishment of a Free Trade Area between the Government of the United States of America and the Government of Israel, entered into on April 22, 1985, are subject to duty as provided herein. Products of Israel, as defined in subdivision (c)(vi)(B) of this note, imported into the customs territory of the United States and entered under a provision for which a rate of duty appears in the "Special" subcolumn followed by the symbol "IL" in parentheses are eligible for the tariff treatment set forth in the "Special" subcolumn, in accordance with section 4(a) of the United States-Israel Free Trade Area Implementation Act of 1985 (99 Stat. 82).

(B) For purposes of subdivision (c)(vi) of this note, goods imported into the customs territory of the United States are eligible for treatment as "products of Israel" only if--

(1) each article is the growth, product or manufacture of Israel or is a new or different article of commerce that has been grown, produced or manufactured in Israel;

(2) each article is imported directly from Israel into the customs territory of the United States; and

(3) the sum of--

(I) the cost or value of the materials produced in Israel plus

(II) the direct costs of processing operations performed in Israel, is not less than 35 percent of the appraised value of each article at the time it is entered.

If the cost or value of materials produced in the customs territory of the United States is included with respect to an article to which subdivision (c)(vi) of this note applies, an amount not to exceed 15 percent of the appraised value of the article at the time it is entered that is attributable to such United States cost or value may be applied toward determining the percentage referred to in subdivision (c)(vi)(B)(3) of this note.

(C) No goods may be considered to meet the requirements of subdivision (c)(vi)(B)(1) of this note by virtue of having merely undergone--

(1) simple combining or packaging operations; or

(2) mere dilution with water or mere dilution with another substance that does not materially alter the characteristics of the goods.

(D) As used in subdivision (c)(vi) of this note, the phrase "direct costs of processing operations" includes, but is not limited to--

(1) all actual labor costs involved in the growth, production, manufacture or assembly of the specific merchandise, including fringe benefits, on-the-job training and the cost of engineering, supervisory, quality control and similar personnel; and

(2) dies, molds, tooling and depreciation on machinery and equipment which are allocable to the specific merchandise.

Such phrase does not include costs which are not directly attributable to the merchandise concerned, or are not costs of manufacturing the product, such as (I) profit, and (II) general expenses of doing business which are either not allocable to the specific merchandise or are not related to the growth, production, manufacture or assembly of the merchandise, such as administrative salaries, casualty and liability insurance, advertising and salesmen's salaries, commissions or expenses.

(E) The Secretary of the Treasury, after consultation with the United States Trade Representative, shall prescribe such regulations as may be necessary to carry out subdivision (c)(vi) of this note.

APPENDIX H
GENERAL NOTE 3(viii) TO THE HTS

General note 3(c) (con.):

(viii) Articles Imported from the Freely Associated States.

(A) Pursuant to sections 101 and 401 of the Compact of Free Association Act of 1985 (99 Stat. 1773 and 1838), the following countries shall be eligible for treatment as freely associated states:

Marshall Islands
Micronesia, Federated States of

(B) Except as provided in subparagraphs (D) and (E) of this paragraph, any article imported from a freely associated state shall enter the customs territory of the United States free of duty if--

(1) such article is imported directly from the freely associated state, and

(2) the sum of (I) the cost or value of the materials produced in the freely associated state, plus (II) the direct costs of processing operations performed in the freely associated state is not less than 35 percent of the appraised value of such article at the time of its entry into the customs territory of the United States.

If the cost or value of materials produced in the customs territory of the United States is included with respect to an article the product of a freely associated state and not described in subparagraph (D) of this paragraph, an amount not to exceed 15 percent of the appraised value of such article at the time it is entered that is attributed to such United States cost or value may be applied toward determining the percentage referred to in subparagraph (B)(2)(II) above.

(C) Tuna of subheading 1604.14.20 in an aggregate quantity entered in any calendar year from the freely associated states not to exceed 10 percent of United States consumption of canned tuna during the immediately preceding calendar year, as reported by the National Marine Fisheries Service, may enter the customs territory free of duty, provided that such imports shall be counted against the aggregate quantity of tuna that is dutiable under the general subcolumn of rate of duty column 1 for subheading 1604.14.20 for that calendar year.

(D) The duty-free treatment provided under subparagraph (B) of this paragraph shall not apply to--

(1) tuna of subheading 1604.14.20 (except tuna in an aggregate quantity entered in any calendar year from the freely associated states not to exceed 10 percent of United States consumption of canned tuna during the immediately preceding calendar year, as reported by the National Marine Fisheries Service);

(2) textile and apparel articles which are subject to textile agreements;

(3) footwear, handbags, luggage, flat goods, work gloves and leather wearing apparel, the foregoing which were not eligible articles for purposes of the Generalized System of Preferences on April 1, 1984;

(4) watches, clocks and timing apparatus of chapter 91 (except such articles incorporating an optoelectronic display and no other type of display); and

(5) buttons of subheading 9606.21.40 or 9606.29.20.

(E) (1) Whenever a freely associated state--

(I) has exported (directly or indirectly) to the United States during a calendar year a quantity of such article having an appraised value in excess of an amount which bears the same ratio to $25,000,000 as the gross national product of the United States for the preceding calendar year (as determined by the Department of Commerce) bears to the gross national product of the United States for calendar year 1974 (as determined for purposes of section 504(c)(1)(A) of the Trade Act of 1974 (19 U.S.C. 2464(c)(1)(A)); or

(II) has exported (either directly or indirectly) to the United States during a calendar year a quantity of such article equal to or exceeding 50 percent of the appraised value of the total imports of such article into the United States during that calendar year;

APPENDIX I
GENERAL NOTE 3(vii) TO THE HTS

General Note 3(c) (con.):

(vii) United States-Canada Free-Trade Agreement Implementation Act of 1988.

(A) Goods originating in the territory of Canada that are described in Annex 401.2(B) of the United States-Canada Free-Trade Agreement, entered into on January 2, 1988, are subject to duty as provided herein. Goods originating in the territory of Canada, as defined in subdivision (c)(vii)(B) of this note, that are imported into the customs territory of the United States and that are entered under a provision for which a rate of duty appears in the "Special" subcolumn followed by the symbol "CA" in parentheses are eligible for the tariff treatment set forth in the "Special" subcolumn, in accordance with section 201 of the United States-Canada Free-Trade Agreement Implementation Act of 1988.

(B) For the purposes of subdivision (c)(vii) of this note, goods imported into the customs territory of the United States are eligible for treatment as "goods originating in the territory of Canada" only if--

(1) they are goods wholly obtained or produced in the territory of Canada and/or the United States, or

(2) they have been transformed in the territory of Canada and/or the United States, so as to be subject--

(I) to a change in tariff classification as described in the rules of subdivision (c)(vii)(R) of this note, or

(II) to such other requirements subdivision (c)(vii)(R) of this note may provide when no change in tariff classification occurs, and they meet the other conditions set out in subdivisions (c)(vii)(F), (G), (H), (I), (J) and (R) of this note.

(C) Goods shall not be considered to originate in the territory of Canada pursuant to subdivision (c)(vii)(B)(2) merely by virtue of having undergone--

(1) simple packaging or, except as expressly provided by the rules of subdivision (c)(vii)(R) of this note, combining operations,

(2) mere dilution with water or another substance that does not materially alter the characteristics of the goods, or

(3) any process or work in respect of which it is established, or in respect of which the facts as ascertained clearly justify the presumption, that the sole object was to circumvent the provisions of subdivision (c)(vii) of this note.

(D) Accessories, spare parts, or tools delivered with any piece of equipment, machinery, apparatus, or vehicle that form part of its standard equipment shall be treated as having the same origin as that equipment, machinery, apparatus, or vehicle if the quantities and values of such accessories, spare parts, or tools are customary for the equipment, machinery, apparatus, or vehicle.

(E) Goods exported from the territory of Canada originate in the territory of Canada only if the goods meet the applicable requirements of subdivisions (c)(vii)(B), (C) and (D) of this note and are shipped to the territory of the United States without having entered the commerce of any third country and the goods, if shipped through the territory of a third country, do not undergo any operations other than unloading, reloading, or any operation necessary to transport them to the territory of the United States or to preserve them in good condition, and the documents related to the exportation and shipment of the goods from the territory of Canada show the territory of the United States as their final destination.

(F) Whenever the processing or assembly of goods in the territory of Canada and/or the United States results in one of the changes in tariff classification in Canada described by the rules set forth in subdivision (c)(vii)(R) of this note, such goods shall be considered to have been transformed in the territory of Canada and shall be treated as goods originating in the territory of Canada, provided that such processing or assembly occurs entirely within the territory of Canada and/or the United States and that such goods have not subsequently undergone any processing or assembly outside of Canada or the United States that improves the goods in condition or advances them in value.

General Note 3(c)(vii) (con.):

(G) Whenever the assembly of goods in the territory of Canada fails to result in a change of tariff classification because--

(1) the goods were imported into the territory of Canada in an unassembled or a disassembled form and were classified as unassembled or disassembled goods pursuant to General Rule of Interpretation 2(a), or

(2) the tariff provision for the goods provides for both the goods themselves and their parts,

such goods shall not be treated as goods originating in the territory of Canada.

(H) Notwithstanding subdivision (c)(vii)(G), goods described in that paragraph shall be considered to have been transformed in the territory of Canada and be treated as goods originating in the territory of Canada if--

(1) the value of materials originating in the territory of Canada and/or the United States that are used or consumed in the production of the goods plus the direct cost of assembling the goods in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States, and

(2) the goods have not subsequent to assembly undergone processing or further assembly in a third country and they meet the requirements of subdivision (c)(vii)(E) of this note.

(I) The provisions of subdivision (c)(vii)(H) of this note shall not apply to goods of chapters 61 through 63.

(J) In making the determination required by subdivision (c)(vii)(H)(1) of this note and in making the same or a similar determination when required by the rules of subdivision (c)(vii)(R) of this note, where materials originating in the territory of Canada and/or the United States and materials obtained or produced in a third country are used or consumed together in the production of goods in the territory of Canada, the value of materials originating in the territory of Canada and/or the United States shall be treated as such only to the extent that it is directly attributable to the goods under consideration.

(K) In applying the rules set forth in subdivision (c)(vii) of this note, a specific rule shall take precedence over a more general rule.

(L) As used in subdivision (c)(vii)(B) of this note, the phrase "goods wholly obtained or produced in the territory of Canada and/or the United States" means--

(1) mineral goods extracted in the territory of Canada and/or the United States,

(2) goods harvested in the territory of Canada and/or the United States,

(3) live animals born and raised in the territory of Canada and/or the United States,

(4) fish, shellfish and other marine life taken from the sea by vessels registered or recorded with Canada and flying its flag,

(5) goods produced on board factory ships from the marine life referred to in subparagraph (4) provided such factory ships are registered or recorded with Canada and fly its flag,

(6) goods taken by Canada or a Canadian national or enterprise from the seabed or beneath the seabed outside territorial waters, provided that Canada has rights to exploit such seabed,

(7) goods taken from space provided they are obtained by Canada or a Canadian national or enterprise and not processed in a third country,

(8) waste and scrap derived from manufacturing operations and used goods, provided they were collected in the territory of Canada and/or the United States, and are fit only for the recovery of raw materials, and

General Note 3(c)(vii)(L) (con.):

(9) goods produced in the territory of Canada and/or the United States exclusively from goods referred to in subparagraphs (1) to (8), inclusive, or from their derivatives, at any stage of production.

(M) As used in subdivisions (c)(vii)(H) and (R) of this note, the phrase "value of materials originating in the territory of Canada and/or the United States" means the aggregate of:

(1) the price paid by the producer of exported goods for materials originating in the territory of Canada and/or the United States or for materials imported from a third country used or consumed in the production of such originating materials, and

(2) when not included in that price, the following costs related thereto--

(I) freight, insurance, packing and all other costs incurred in transporting any of the materials referred to in subparagraph (1) to the location of the producer,

(II) duties, taxes and brokerage fees on such materials paid in the territory of Canada and/or the United States,

(III) the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or byproduct, and

(IV) the value of goods and services relating to such materials determined in accordance with subparagraph 1(b) of article 8 of the Agreement on Implementation of article VII of the General Agreement on Tariffs and Trade.

(N) As used in subdivision (c)(vii)(H) and (R) of this note, the phrase "value of the goods when exported to the territory of the United States" means the aggregate of--

(1) the price paid by the producer for all materials, whether or not the materials originate in Canada and/or the United States, and, when not included in the price paid for the materials, the following costs related thereto--

(I) freight, insurance, packing and all other costs incurred in transporting all materials to the location of the producer,

(II) duties, taxes and brokerage fees on all materials paid in the territory of Canada and/or the United States,

(III) the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or byproduct, and

(IV) the value of goods and services relating to all materials determined in accordance with subparagraph 1(b) of article 8 of the Agreement on Implementation of article VII of the General Agreement on Tariffs and Trade, and

(2) the direct cost of processing or the direct cost of assembling the goods.

(O) As used in subdivisions (c)(vii)(H), (N) and (R) of this note, the phrase "direct cost of processing or direct cost of assembling" means the costs directly incurred in, or that can reasonably be allocated to, the production of goods, including--

(1) the cost of all labor, including benefits and on-the-job training, labor provided in connection with supervision, quality control, shipping, receiving, storage, packaging, management at the location of the process or assembly, and other like labor, whether provided by employees or independent contractors,

(2) the cost of inspecting and testing the goods,

(3) the cost of energy, fuel, dies, molds, tooling, and the depreciation and maintenance of machinery and equipment, without regard to whether they originate within the territory of Canada and/or the United States,

General Note 3(c)(vii)(O) (con.):

(4) development, design, and engineering costs,

(5) rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used in the production of the goods, and

(6) royalty, licensing, or other like payments for the right to the goods, but not including--

(I) costs relating to the general expense of doing business, such as the cost of providing executive, financial, sales, advertising, marketing, accounting and legal services and insurance,

(II) brokerage charges relating to the importation and exportation of goods,

(III) costs for telephone, mail and other means of communication,

(IV) packing costs for exporting the goods,

(V) royalty payments related to a licensing agreement to distribute or sell the goods,

(VI) rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used by personnel charged with administrative functions, or

(VII) profit on the goods.

(P) For the purposes of subdivision (c)(vii) of this note, the term "materials" means goods, other than those included as part of the direct cost of processing or assembling, used or consumed in the production of other goods.

(Q) For the purposes of subdivision (c)(vii) of this note, the term "territory" means--

(1) with respect to Canada, the territory to which its customs laws apply, including any areas beyond the territorial seas of Canada within which, in accordance with international law and its domestic laws, Canada may exercise rights with respect to the seabed and subsoil and their natural resources, and

(2) with respect to the United States,

(I) the customs territory of the United States,

(II) the foreign trade zones located in the United States and the Commonwealth of Puerto Rico, and

(III) any area beyond the territorial seas of the United States within which, in accordance with international law and its domestic laws, the United States may exercise rights with respect to the seabed and subsoil and their natural resources.

(R) Change in Tariff Classification Rules.

(1) Section I: Chapters 1 through 5.

A change from one chapter to another; no changes within chapters.

(2) Section II: Chapters 6 through 14.

(aa) A change from one chapter to another; no changes within chapters except that agricultural and horticultural goods grown in the territory of Canada shall be treated as originating in the territory of Canada even if grown from seed or bulbs imported from a third country.

(bb) A change to subheadings 0901.12 through 0901.40 from any other subheadings, including another subheading within that group.

General Note 3(c)(vii)(R)(6)(bb) (con.):

materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(cc) A change to a heading of chapter 30 from any other heading, including other headings within that chapter, except a change to heading 3004 from heading 3003.

(dd) A change to chapter 31 from any other chapter.

(ee) A change to headings 3208 through 3215 from any other heading outside that group.

(ff) A change to chapter 33 from any other chapter.

(gg) A change to heading 3304 through 3307 from any heading outside that group.

(hh) A change to a heading of chapter 34 from any other heading, including another heading within that chapter.

(ii) A change to subheadings 3402.20 through 3402.90 from any other subheading outside that group.

(jj) A change to a heading of chapter 35 from any other heading, including another heading within that chapter.

(kk) A change to a heading of chapter 36 from any other heading, including another heading within that chapter.

(ll) A change to chapter 37 from any other chapter.

(mm) A change to heading 3704 from any other heading.

(nn) A change to headings 3705 through 3706 from any other heading outside that group

(oo) A change to heading 3808 from any other heading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States, or, in the case of goods which contain more than one active ingredient, not less than 70 percent of the value of the goods when exported to the territory of the United States. Any materials that are eligible for duty-free treatment in both Canada and the United States on a most-favored-nation basis, or any materials imported into the territory of either Canada or the United States which, if imported into the territory of the United States, would be free of duty under a trade agreement that is not subject to a competitive need limitation, shall be treated as materials originating in the territory of Canada and/or the United States.

(7) Section VII: Chapters 39 through 40.

(aa) A change to any heading of chapter 39 from any other heading, including another heading within that chapter; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(bb) A change to chapter 40 from any other chapter.

(cc) A change to any heading of chapter 40 from any other heading within that chapter; provided, except for the rules listed below in this section, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of

General Note 3(c)(vii)(R) (con.):

(3) Section III: Chapter 15.

(aa) A change to chapter 15 from any other chapter.

(bb) A change to any of the following subheadings from any other subheading: 1507.90, 1508.90, 1511.90, 1512.19, 1512.29, 1513.19, 1513.29, 1514.90, 1515.19, 1515.29.

(cc) A change to heading 1516 from any other heading.

(dd) A change to heading 1517 from any other heading.

(ee) A change to headings 1519 through 1520 from any other heading outside that group.

(ff) A change to subheading 1519.19 from any other subheading.

(gg) A change to subheading 1519.20 from any other subheading.

(hh) A change to subheading 1520.90 from any other subheading.

(4) Section IV: Chapters 16 through 24.

(aa) A change from one chapter to another, except for goods of chapter 20 subject to rule (ee).

(bb) A change to heading 1704 from any other heading.

(cc) A change to heading 1806 from any other heading.

(dd) A change to subheading 1806.31 or 1806.90 from any other subheading.

(ee) Fruit, nut, and vegetable preparations of chapter 20 that have been prepared or preserved merely by freezing, by packing (including canning) in water, brine, or in natural juices, or by roasting, either dry or in oil (including processing incidental to freezing, packing, or roasting), shall be treated as a good of the country in which the fresh good was produced.

(ff) A change to subheading 2009.90 from any other subheading; provided, that neither a single juice ingredient, nor juice ingredients from a single third country, constitutes in single-strength form more than 60 percent by volume of the product.

(gg) A change to headings 2203 through 2209 from any other heading outside that group.

(hh) A change to heading 2309 from any other heading.

(ii) A change to headings 2402 through 2403 (except subheading 2403.91) from any other heading outside that group.

(5) Section V: Chapters 25 through 27.

(aa) A change from one chapter to another.

(bb) A change to headings 2710 through 2715 from any other heading outside that group.

(cc) A change to heading 2716 from any other heading.

(6) Section VI: Chapters 28 through 38.

(aa) A change to chapters 28 through 38 from any chapter outside that group.

(bb) A change to any subheading of chapters 28 through 38 from any other subheading within those chapters; provided, except for the other rules in this section, that the value of

General Note 3(c)(vii)(R)(7)(cc) (con.):

processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(dd) A change to headings 4007 through 4008 from any other heading outside that group.

(ee) A change to headings 4009 through 4017 from any other heading outside that group.

(ff) A change to subheading 4012.10 from any other subheading.

(8) Section VIII: Chapters 41 through 43.

(aa) A change from one chapter to another.

(bb) A change to headings 4104 through 4111 from any other heading outside that group.

(cc) A change to heading 4302 from any other heading.

(dd) A change to headings 4303 through 4304 from any other heading outside that group.

(9) Section IX: Chapters 44 through 46.

(aa) A change from one chapter to another.

(bb) A change between headings in chapter 44.

(cc) A change to any of the following subheadings from any other subheading: 4412.11.50, 4412.12.50, 4412.19.50, 4412.29.50, or 4412.99.90.

(dd) A change to headings 4503 through 4504 from any other heading outside that group.

(ee) A change to heading 4602 from any other heading.

(10) Section X: Chapters 47 through 49.

(aa) A change from one chapter to another.

(bb) A change to heading 4808 through 4809 from any other heading outside that group.

(dd) A change to headings 4814 through 4823 from any other heading outside that group except a change from heading 4809 to heading 4816.

(11) Section XI: Chapters 50 through 63.

(aa) A change to headings 5004 through 5006 from any heading outside that group.

(bb) A change to heading 5007 from any other heading.

(cc) A change to headings 5106 through 5113 from any heading outside that group.

(dd) A change to headings 5204 through 5212 from any heading outside that group.

(ee) A change to headings 5306 through 5311 from any heading outside that group.

(ff) A change to any heading of chapter 54 from any other chapter.

(gg) A change to headings 5501 through 5507 from any other chapter.

(hh) A change to headings 5508 through 5516 from any heading outside that group.

General Note 3(c)(vii)(R)(11) (con.):

(ii) A change to any heading of chapter 56 from any heading outside that chapter other than headings 5106 through 5113, 5204 through 5212, 5306 through 5311, or headings of chapters 54 and 55.

(jj) A change to any heading of chapter 57 from any heading outside that chapter other than headings 5106 through 5113, 5204 through 5212, 5306 through 5309, 5311, any heading of chapter 54, or 5508 through 5516.

(kk) A change to any heading of chapter 58 from any heading outside that chapter other than headings 5106 through 5113, 5204 through 5212, 5306 through 5311, or headings of chapters 54 and 55.

(ll) A change to any heading of chapter 59 from any heading outside that chapter other than headings 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407, 5408, or 5512 through 5516.

(mm) A change to any heading of chapter 60 from any heading outside that chapter other than headings 5106 through 5113, 5204 through 5212, 5309 through 5311, or headings of chapters 54 and 55.

(nn) A change to any heading of chapter 61 from any heading outside that chapter other than headings 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407, 5408, 5512 through 5516, or 6001 through 6002; provided, that goods are both cut (or knit to shape) and sewn or otherwise assembled in the territory of Canada and/or the United States.

(oo) A change to any heading of chapter 62 from any heading outside that chapter other than headings 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407, 5408, 5512 through 5516, or 6001 through 6002; provided, that goods are both cut and sewn in the territory of Canada and/or the United States.

(pp) A change to any heading of chapter 63 from any heading outside that chapter other than headings 5106 through 5113, 5204 through 5212, 5306 through 5311, or headings of Chapters 54 and 55; provided, that goods are both cut and sewn in the territory of Canada and/or the United States.

(qq) Notwithstanding rules (nn) and (oo), apparel goods provided for in chapters 61 and 62 that are both cut and sewn in the territory of Canada and/or the United States from fabric produced or obtained in a third country, and that meet other applicable conditions for preferred tariff treatment under subdivision (c)(vii) of this note, shall be subject to the rate of duty provided in the "Special" subcolumn for goods that originate in Canada, in the annual quantities set forth below, and shall, above those quantities for the remainder of the annual period, be subject to duty at the rates provided for in the "General" subcolumn of column 1:

Non-wool apparel	41,806,500 square meters
Wool apparel	5,016,780 square meters

(rr) Notwithstanding rules (dd), (ee), (ff), (hh), (kk), (mm) and (pp), non-wool fabric and non-wool made-up textile articles provided for in chapters 52 through 55, 58, 60 and 63 that are woven or knitted in Canada from yarn produced or obtained in a third country, and that meet other applicable conditions for preferred tariff treatment under subdivision (c)(vii) of this note, shall be subject to the rate of duty provided in the "Special" subcolumn for goods that originate in Canada, in the annual quantity of 25,083,900 square meters for the period commencing on January 1, 1989, and ending on December 31, 1992, and shall, above this quantity for the remainder of the annual period, be subject to duty at the rates provided for in the "General" subcolumn of column 1.

General Note 3(c)(vii)(R) (con.):

(12) Section XII: Chapters 64 through 67.

(aa) A change from one chapter to another.

(bb) A change to subheadings 6401.10 through 6406.10 from any other subheading outside that group; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(cc) A change to headings 6503 through 6507 from any other heading outside that group.

(dd) A change to headings 6601 through 6602 from any other heading outside that group; provided that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(ee) Within heading 6701, goods fabricated from feathers (such as fans, feather dusters, and feather apparel) in which feathers are the material or component that gives the fabricated goods their essential character shall be treated as good of the country in which fabrication occurred.

(ff) A change to heading 6702 from any other heading.

(gg) A change to heading 6704 from any other heading.

(13) Section XIII: Chapters 68 through 70.

(aa) A change from one chapter to another.

(bb) A change to subheading 6812.20 from any other subheading.

(cc) A change to subheading 6812.30 through 6812.40 from any other subheading outside that group.

(dd) A change to subheading 6812.50 from any other subheading.

(ee) A change to subheadings 6812.60 through 6812.90 from any other subheading outside that group.

(ff) A change to heading 6813 from any other heading.

(gg) A change to headings 7003 through 7006 from any other heading outside that group.

(hh) A change to headings 7007 through 7020 from any other heading outside that group.

(ii) A change to subheading 7019.20 from any other heading.

(14) Section XIV: Chapter 71.

(aa) A change from one chapter to another.

(bb) A change to headings 7113 through 7118 from any other heading outside that group, except that pearls, temporarily or permanently strung but without the addition of clasps or other ornamental features of precious metals or stones, shall be treated as a good of the country in which the pearls were obtained.

(15) Section XV: Chapters 72 through 83.

(aa) A change from one chapter to another; provided, that goods subject to rules (ii) or (vv) meet the conditions set forth therein.

General Note 3(c)(vii)(R)(15) (con.):

(bb) A change to headings 7206 through 7207 from any other heading outside that group.

(cc) A change to headings 7208 through 7216 from any other heading outside that group.

(dd) A change to heading 7217 from any other heading except headings 7213 through 7215.

(ee) A change to headings 7218 through 7222 from any other heading outside that group.

(ff) A change to heading 7223 from any other heading except headings 7221 and 7222.

(gg) A change to headings 7224 through 7228 from any other heading outside that group.

(hh) A change to heading 7229 from any other heading except headings 7227 and 7228.

(ii) A change to heading 7308 from any other heading, except for changes resulting from the following processes performed on angles, shapes, or sections of heading 7216--

drilling, punching, notching, cutting, cambering, or sweeping, whether performed individually or in combination,

adding attachments or weldments for composite construction,

adding of attachments for handling purposes,

adding weldments, connectors, or attachments to H-sections or I-sections; provided, that the maximum cross-sectional dimension of the weldments, connectors, or attachments is not greater than the dimension between the inner surfaces of the flanges of the H-section or I-sections,

painting, galvanizing, or otherwise coating, or

adding a simple base plate without stiffening elements, individually or in combination with drilling, punching, notching, or cutting, to create an article suitable as a column.

(jj) A change to headings 7309 through 7326 from any other heading outside that group.

(kk) A change to headings 7403 through 7408 from any other heading of chapter 74 outside that group; provided, with the exception of a change to subheading 7408.19, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(ll) A change to heading 7409 from any other heading.

(mm) A change to headings 7410 through 7419 from any other heading outside that group; provided, that with respect to a change to heading 7413, the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of goods when exported to the territory of the United States.

(nn) A change to heading 7505 from any other heading.

(oo) A change to heading 7506 from any other heading.

(pp) A change to subheading 7506.20.50 from any other subheading.

(qq) A change to headings 7507 through 7508 from any other heading outside that group.

(rr) A change to headings 7604 through 7606 from any other heading outside that group.

General Note 3(c)(vii)(R)(15) (con.):

(ss) A change to heading 7607 from any other heading.

(tt) A change to headings 7608 through 7609 from any other heading outside that group.

(uu) A change to headings 7610 through 7616 from any other heading outside that group.

(vv) A change to headings 7801 or 7901 from headings of other chapters; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(ww) A change to headings 7803 through 7806 from any other heading, including another heading within that group; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(xx) A change to headings 7904 through 7907 from any other heading, including another heading within that group; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(yy) A change to headings 8003 through 8004 from any other heading outside that group.

(zz) A change to headings 8005 through 8007 from any other heading outside that group.

(ab) A change to any of the following subheadings from any other subheading: 8101.92, 8101.99, 8102.92, 8102.99, 8103.90, 8104.90, 8105.90, 8108.90, 8109.90.

(cd) A change to subheading 8107.90 from any other subheading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(ef) A change to subheading 8111.00.60 from any other subheading.

(16) Section XVI: Chapters 84 through 85.

(aa) A change from one chapter to another, other than a change to heading 8544.

(bb) A change from one heading (other than a parts heading) to another heading, other than heading 8528 or 8529.

(cc) A change to heading 8407 from any other heading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(dd) A change to heading 8528 or 8529 from any other heading, a change from a parts heading to a heading other than a parts heading, or a change from a parts subheading to a subheading other than a parts subheading; provided, with the exception of a change to subheading 8471.92, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(ee) A change to subheadings 8471.20 through 8471.91 from any subheadings outside that group.

General Note 3(c)(vii)(R)(16) (con.):

(ff) A change to subheadings 8516.10 through 8516.79 from subheading 8516.80.

(gg) A change to heading 8524 from any other heading.

(hh) A change to heading 8544 from any other heading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(17) Section XVII: Chapters 86 through 89.

(aa) A change from one chapter to another.

(bb) A change to any heading of this section (other than a heading within the groups 8701 through 8705 or 8901 through 8905) from another heading other than a parts heading.

(cc) A change to any heading of this section from a parts heading; or within any heading, a change to any subheading from a parts subheading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(dd) A change to headings 8701 through 8705 from any other heading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(ee) A change to headings 8901 through 8905 from any other headings; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(18) Section XVIII: Chapters 90 through 92.

(aa) A change from one chapter to another.

(bb) A change to any heading of this section from a parts heading, or to any subheading from a parts subheading; provided, with the exception of a change to heading 9009, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(cc) A change to any heading within the group 9005 through 9032 from any other heading (including another heading within that group), except that a change from a parts heading shall be subject to rule (bb) of this section.

(dd) Notwithstanding rule (bb), goods subject to classification within headings 9101 through 9107 shall be treated as goods of the country in which the movement subject to classification under headings 9108 through 9110 was produced.

(ee) A change to headings 9108 through 9113 from any other heading, including another heading within that group; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

General Note 3(c)(vii)(R) (con.):

(19) Section XIX: Chapter 93.

(aa) A change to this chapter from any other chapter.

(bb) A change to any heading of this section from a parts heading, or to any subheading from a parts subheading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(20) Section XX: Chapters 94 through 96.

(aa) A change from one chapter to another, except a change to subheading 9404.90 from headings 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408, and 5512 through 5516.

(bb) A change to any heading of this section from a parts heading, or to any subheading from a parts subheading; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(cc) A change to a subheading within the group 9608.10 through 9608.39 from a subheading within the group 9608.91 through 9608.99; provided, that the value of materials originating in the territory of Canada and/or the United States plus the direct cost of processing performed in the territory of Canada and/or the United States constitute not less than 50 percent of the value of the goods when exported to the territory of the United States.

(dd) A change to subheading 9614.20 from subheading 9614.10.

(21) Section XXI: Chapter 97.

A change to this chapter from any other chapter.

APPENDIX J
LETTER FROM THE OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

10

The Honorable Anne Brunsdale
Acting Chairman
United States International
Trade Commission
Washington, D.C. 20436

Dear Chairman Brunsdale:

I am writing in response to your letter requesting our views on a study being conducted by the International Trade Commission (ITC) entitled, "Assessment of Rules of Origin Under the Caribbean Basin Economic Recovery Act."

During Congressional deliberations on the Caribbean Basin Economic Recovery Expansion Act -- more commonly known as the Caribbean Basin Initiative (CBI) II -- the Administration sought approval for Presidential authority to proclaim new rules of origin for CBI beneficiaries. Congress was reluctant to provide such authority without knowing the details of the new rules of origin. Instead, Congress directed the ITC study noted above.

Our motivation in seeking new rules of origin is based on concerns expressed by business and government officials in the region that existing rules of origin are too subjective. That is, they believe that the "substantial transformation" criterion is too discretionary and unpredictable. Without judging the merits of this complaint, substantial transformation is a principle based on case law and, therefore, subject to change.

More explicit rules, that give the criteria up front and that are stable, would be easier for CBI exporters to use. Once an exporter learns the particular rule applicable to his production, he essentially no longer needs to worry about rules of origin. Customs would be able to administer more easily clear specific rules -- either the product meets the test or it does not.

We believe an approach for developing new CBI rules of origin would be the principle used in the Canada - United States Free Trade Agreement (FTA). In brief, transforming a product is defined as a change in tariff classification. However, we may want to tailor the rules of origin to the particular situation of CBI exports and not simply to adopt the exact FTA rules.

Thank you for the opportunity to express our views on this issue. Mr. Ralph Ives, Director for Caribbean Basin and North/South Affairs, has contacted Mr. DiRicco to see how we can be of further assistance during the ITC study.

Sincerely,

S. Linn Williams
Acting

SLW:isa

APPENDIX K
LETTER FROM THE SECRETARY OF COMMERCE

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

December 21, 1990

332-298

Honorable Anne Brunsdale
Acting Chairman
U.S. International Trade Commission
Washington, D.C. 20436

Dear Ms. Brunsdale:

Thank you for your letter requesting the Department's views on the International Trade Commission's "Assessment of Rules of Origin Under the Caribbean Basin Economic Recovery Act." I understand that you also corresponded with J. Michael Farren, Under Secretary for International Trade. We appreciate the opportunity to contribute to your review of possible modification in the Caribbean Basin Initiative (CBI) rules of origin.

An agreement establishing GATT disciplines on the rules of origin has been tentatively reached in the Uruguay Round. This tentative agreement establishes principles and procedures governing the use of rules of origin and a work plan to harmonize nonpreferential rules of origin (e.g., those used to determine most-favored-nation status). Certain of the principles and procedures in the GATT agreement will also apply to rules of origin used for preferential purposes (e.g., U.S.-Canada and U.S. Israel free trade agreements and the CBI and Generalized System of Preferences programs). For this agreement to take effect, however, requires a successful completion of the overall Uruguay Round negotiations, which are at an impasse over the agricultural issue.

The Department has received few complaints concerning the CBI rules of origin. Business comments indicate that the CBI rules are responsive to the needs of the U.S. business community and the desire for economic development in the CBI-designated countries. The rules appear to maximize trade from the CBI countries while providing safeguards to assure that CBI countries are not used as points of transshipment for products from more developed countries.

We do not see structural problems in the current CBI rules of origin. Contacting those agencies and groups that are more directly in contact with users of the rules, such as customs agencies, American Embassies in designated countries, brokerage houses that work with CBI countries, and relevant chambers and associations, could give you additional information regarding the efficacy of the CBI rules of origin.

We appreciate the opportunity to review with you our experience with rules of origin.

Sincerely,

Robert A. Mosbacher

APPENDIX L
LETTER FROM THE DEPARTMENT OF THE TREASURY

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

JAN 08 1991

332-298

The Honorable Anne Brunsdale
Acting Chairman
U.S. International Trade Commission
Washington, D.C. 20436

Dear Chairman Brunsdale:

Thank you for your letter of November 15 to Secretary Brady, asking for the views of the Treasury Department on rules of origin for the Caribbean Basin Economic Recovery Act (CBERA).

As you may know, the U.S. Customs Service, a bureau of the Treasury Department, is required to determine the origin of goods entering the United States in order to administer laws that treat imported goods differently on the basis of their origin. CBERA is but one of the laws that require an origin determination to be made.

CBERA requires, inter alia, that goods entitled to preference must be products of Caribbean countries designated as eligible for preferential treatment. Products of Caribbean countries fall into two categories: goods that wholly originate in the country and contain no foreign materials, and goods comprised of foreign materials that have been substantially transformed in a Caribbean country.

The long-standing difficulty in determining origin of goods lies in defining substantial transformation. U.S. courts have recognized that Congress may provide for different country of origin rules depending on the policies that Congress seeks to advance through laws it enacts. However, unless Congress specifies in a statute the criteria to be used in determining whether substantial transformation has occurred, Customs will use the court-made rules, and Customs' interpretations of those rules, that have evolved through court decisions over the last eighty years.

In the case of CBERA, and all U.S. tariff preference programs other than the U.S.-Canada Free Trade Agreement, Congress has not specified particular rules for determining what constitutes a substantial transformation. Therefore, Customs' origin determinations in connection with these laws are based on precedents established in rulings issued by courts and the Customs Service.

Unfortunately, these precedential rulings, both those issued by the Customs Service and those handed down by U.S. courts, are highly fact specific. That is, the decision reached in a particular case is applicable only to the specific facts of that case, and provides little or no guidance for other situations that are at all different.

Moreover, neither the courts, nor the U.S. Customs Service in its attempts to follow court rulings, has successfully articulated a consistent rationale for determining when substantial transformation has occurred. Ample evidence of the confusion and dismay caused by this failure can be found in the opinion of the U.S. Court of Appeals, First Circuit, in the case of United State v. Murray, 621 F. 2d 1163, at 1169 (1980).

In the absence of useful precedents that can confidently be applied to facts beyond those at issue in particular rulings, and in the absence of a workable and consistent rationale for determining when substantial transformation has occurred, commercial parties residing in the United States and in its trading partners have had no guidance for determining the treatment to which their goods are subject under U.S. law. Although the U.S. Customs Service offers to provide advisory rulings, there have been limitations on the number of rulings Customs can issue and on the ability of Customs to provide rulings with sufficient timeliness.

It was in recognition of this situation, and at the urging of the U.S. trade community, that the Treasury Department undertook in 1987 to devise a wholly new method for determining substantial transformation in the U.S.-Canada Free Trade Agreement. That new method, which is based primarily on change in tariff classification under the Harmonized System nomenclature, appears, from the perspective of both U.S. and Canadian government and private sector observers, to be working fairly well. Although problems have arisen from the use of a supplemental value-content criterion attached to rules of origin for some product sectors, the basic tariff classification change methodology is transparent, predictable, and consistent.

Consequently, both the U.S. and Canadian governments have stated their preference for a similar rule of origin in a free trade arrangement with Mexico. In addition, the U.S. proposal to the Uruguay Round for a study of rule of origin harmonization, on which there is now agreement, assumes that a harmonized rule will be based primarily on change in tariff classification. Moreover, several U.S. industry associations have petitioned Treasury to publish regulations establishing a tariff classification

based rule of origin as the basis for all origin determinations affecting their products under U.S. law.

With respect to your specific request for information about ways in which the current rules of origin used for CBERA have made it more difficult to achieve the purposes of the Act, I believe there are two kinds of problems. The first kind of problem involves Caribbean exporters (and U.S. importers) whose good faith claims for tariff preference are denied by U.S. Customs after importation has already occurred and goods have already been resold. Because CBERA, unlike the U.S.-Canada FTA, has no published rules of origin covering all products, Caribbean exporters are unable, without an explicit advance ruling from the Customs Service, to be assured of the treatment their goods will receive on entry into the United States.

In addition, because CBERA requires that 35 percent of the value of goods eligible for preference be attributable to Caribbean materials and labor, Caribbean manufacturers are required to maintain detailed records that they might not ordinarily maintain.

The second kind of problem involves Caribbean manufacturers who are, often in good faith, claiming preference despite not engaging in operations that substantially transform third-country materials. Such a circumstance occurs because there is no published standard against which manufacturers can judge whether their processing operations in the Caribbean result in a substantial transformation.

As a result, preferential treatment may be granted in circumstances in which operations in the Caribbean are relatively superficial and do not generate the investment in plant, equipment, and job training that CBERA was intended to stimulate. Because the U.S. Customs Service is unable to review adequately all claims for preference, these conditions can continue for years, significantly diminishing the effectiveness of the CBERA program.

As I noted earlier, the rules of origin in the U.S.-Canada Free trade Agreement were designed to avoid these problems, and we believe that they are working well. Although the value-content requirement of certain rules under the FTA has caused problems, those problems arise only for limited number of products, whereas under CBERA there is a value-content requirement for all product sectors. Therefore, we recommend that the FTA rules, with a minimum number of suitable modifications, be considered as a basis for rules of origin under CBERA. We shall be pleased to provide USITC with support for that effort.

I hope that this information is helpful to you in completing your study. Please let me know if we may be of further assistance.

Sincerely,

Peter K. Nunez
Assistant Secretary
(Enforcement)

APPENDIX M
LETTER FROM THE U.S. CUSTOMS SERVICE

DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE
WASHINGTON, D.C.

RECEIVED
MAR 11 P1:42
OFFICE OF THE SECRETARY

MAR 9 1991

CLA-2 CO:R:C:S
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The Honorable
Anne Brunsdale
Acting Chairman
U.S. International Trade Commission
Washington, D.C. 20436

Dear Chairman Brunsdale:

This is in further reference to your letter of November 15, 1990, to the Commissioner of Customs, requesting our views in connection with a study the USITC is conducting regarding the possible modification of the rules of origin under the Caribbean Basin Economic Recovery Act (CBERA).

As you are aware, the Customs Service is responsible for determining whether merchandise imported from designated CBERA beneficiary countries (BCs) qualifies for duty-free treatment under this preferential tariff program. Such treatment is accorded only to eligible articles which are imported directly to the U.S. from a BC and which satisfy the CBERA rules of origin. These rules require, first, that the article be the growth, product, or manufacture of a BC. An article is the "product of" a BC if it is made entirely of materials originating in a BC, or, if the article consists of materials of non-BC origin, those materials are substantially transformed in the BC into a new or different article of commerce. In addition, the sum of the cost or value of materials produced in a BC, plus the direct costs of processing incurred there, must not be less than 35% of the article's appraised value.

There clearly has been a long-term evolution in the structure, use and impact of rules of origin relating to tariff preference programs, due primarily to a growing sensitivity toward trade policy ramifications and a need to take account of changes in economic and business realities. Rules of origin are necessary in preference programs to ensure that merchandise manufactured in non-BCs are not merely transshipped through BCs for minimal processing (so called "pass-through" situations), and to determine when and how goods not entirely originating in a BC become eligible for preferential tariff treatment.

We believe that our views and recommendations regarding the CBERA rules of origin can best be understood in the context of a brief description of the evolution of, and our overall experience with, tariff preference programs.

Evolution of Rules of Origin for Tariff Preference Programs

Special tariff treatment programs date back to at least the 1870's when a treaty with the Hawaiian Islands provided for the free entry of certain articles "the growth and manufacture or produce of" the Islands. Soon after the turn of the century, a program was initiated which provided for the duty-free treatment of articles from certain U.S. possessions, provided they satisfied one of two alternative origin rules: (1) that articles be grown, produced or manufactured in the possession from materials the growth or product of the possession or of the U.S., or of both; or (2) that articles not contain foreign materials to the value of more than 20% of their total value.

The U.S. insular possession program later was revised to require satisfaction of both the "product of" and value-added requirements. The permissible foreign material content for products from U.S. possessions also was subsequently changed; an increase to 50% and, in 1983, another increase (for most articles) to 70%. These increases in the foreign value limitation were designed to discourage the use of questionable practices to satisfy the value-added requirement, and to maintain the competitive position of the insular possessions relative to beneficiary countries under other tariff preference programs.

The Generalized System of Preferences (GSP), which was implemented in 1976, includes rules of origin substantially similar to the CBERA. Eligible articles must be the "product of" the BC and satisfy the same 35% value-content requirement. The rules of origin set forth in the U.S.-Israeli Free Trade Agreement, which was implemented in 1985, also closely parallel those in the CBERA.

The incorporation in the above-described programs of hybrid rules of origin (i.e., "product of" and value-content requirements) was designed to ensure that benefits are conferred on developing countries, without encouraging "pass-through" operations. Depending upon the particular type of product and processing involved, the creation of a new or different article may occur with little effort or expense. Similarly, even though a particular processing operation may add significant value to an article, this is no guarantee that a new or different article will result.

The recently implemented U.S.-Canada Free Trade Agreement (FTA) represents a marked departure from the previously-discussed rules of origin. Through the use of the Harmonized Tariff System nomenclature, product-specific rules were developed to determine origin when goods are not "wholly obtained or produced" in either or both countries. Under the FTA, a product is deemed to "originate" in Canada and/or the U.S. if the production process utilizing third country materials is sufficient to effect a change in tariff classification, as described in the rules. In certain cases involving assembled articles, sensitive products, and articles in which a change in classification is not indicative of a substantial processing operation, a value-content requirement is applicable.

For all the U.S. tariff preference programs referenced above, except the FTA, the "substantial transformation" determination is made on a case-by-case basis to decide whether an article not entirely originating in a BC is considered a "product of" the BC. The substantial transformation standard, which has been in existence since at least the early part of this century, has evolved through many years of judicial and administrative construction. A substantial transformation has been held by U.S. courts to occur when a product emerges from a processing operation with a name, character, and/or use different from that possessed by the product before processing. The substantial transformation test also is used as a rule of origin in determining the applicability of country of origin marking requirements, most favored nation treatment, import quotas (including voluntary restraint agreements), antidumping and countervailing duty determinations, special tariff treatment for articles assembled abroad of U.S. components, and entitlement to drawback.

The most recent development in the evolution of tariff preference programs concerns the creation of new rules of origin for articles processed in Caribbean countries from materials of Puerto Rican or U.S. origin. Section 215 of the recently-enacted Customs and Trade Act of 1990 amended the CBERA to provide an exception from the normal rules of origin for CBERA-eligible articles which are products of Puerto Rico and which are processed in CBERA BCs. Under this provision, duty-free treatment is accorded to such articles if they are advanced in value or improved in condition by any means in a BC, and, if any materials are added to the article in a BC, those materials are a product of a BC or the U.S.

Section 222 of the 1990 Act amended U.S. Note 2, subchapter II, Chapter 98, Harmonized Tariff Schedule of the United States (HTSUS), to provide for the duty-free treatment of articles (other than certain specified products) which are assembled or

processed in a CBERA BC wholly of fabricated components or ingredients of U.S. origin. Articles satisfying the conditions set forth in section 215 or 222 are entitled to duty-free treatment regardless of whether the Caribbean processing operations result in a substantial transformation or add 35% to the value of the article. Thus, it is clear that these provisions significantly liberalize the rules of origin for such articles.

Customs Experience in Administering Preference Programs

Because the section 215 and 222 provisions only recently became effective (October 1, 1990), we are not as yet able to relate our experience in administering these preference programs. However, we perceive that certain problems will arise in the administration of the two programs, due in large part to their relaxed rules of origin. First, we believe it will be difficult for the importer to establish, and for Customs to verify, that the components or articles being exported to the Caribbean are, in fact, wholly of Puerto Rican or U.S. origin. Second, Customs will have difficulty in ascertaining whether the articles are transshipped through a non-BC (for additional operations) either before arrival in a BC or during their return to the U.S. Problems also may arise in ensuring that ineligible foreign materials (from non-BC or non-U.S. sources) are not used in the Caribbean processing operations. Moreover, there is a general concern that the minimal nature of these rules of origin may encourage the abuse of these programs for purposes of obtaining free treatment for materials or articles originating in developing countries. In an effort to address the above concerns, we have imposed relatively stringent documentation requirements for articles entered pursuant to these provisions. It remains to be seen whether our concerns are justified.

Our experience in administering the other preferential tariff programs described above reveals that each program presents certain operational difficulties for Customs and creates uncertainties for the importing public. Specifically in regard to textile products from insular possessions, problems formerly were experienced in determining a single country of origin for such products for various statutory purposes. For example, a textile article assembled in a possession may have been determined to be a product of the possession for tariff and marking purposes pursuant to the substantial transformation standard set forth in those statutes. However, for quota purposes, a determination may have been made, by application of the somewhat more stringent origin rules for textiles set forth in the Customs Regulations (19 CFR 12.130), that the assembly process was insufficient to confer origin. Such disparate origin

findings understandingly caused confusion to both Customs officers and importers. This problem has been rectified by the publication of a change of practice indicating that the 19 CFR 12.130 origin rules for textile products are to be applied for all purposes.

Under the GSP, CBERA and U.S.-Israel FTA programs, Customs may request the submission of a Certificate of Origin, Form A, to substantiate an importer's claim for duty-free or reduced-duty treatment. The Form A is to be completed and signed by the exporter in the BC, but need not be certified by the BC government. Problems frequently arise when Customs requests a Form A, or additional documentary evidence, to verify a claim. The broker or importer often will advise that the form and/or supplementary evidence cannot be produced, and that they would prefer to pay full duties rather than attempt to obtain the necessary information. This is due primarily to the failure of many importers and, to an even greater extent, foreign manufacturers to fully understand the programs' origin requirements.

We also find that when certificates of origin are filed with Customs, they often do not reflect separate value-content percentages for each type of product, as required by the form. When an entry is rejected for this reason, the importer/exporter usually is unable to comply with our request for separate percentages, resulting in the assessment of full duties for all the merchandise in the entry. It frequently is difficult for importers to obtain from manufacturers in BCs the cost information necessary to verify to Customs satisfaction compliance with the 35% value-content requirement. This may occur because the manufacturer refuses to provide it, is unaware of the types of costs which may or may not be included in the value-content calculation, or does not maintain his records in a manner conducive to verifying includable costs.

Because of limited resources, this agency is able to scrutinize only a small percentage of claims for duty-free treatment under the various preference programs. Based on our experience, as described above, there appears to be no question that if every such claim were subjected to a thorough verification process, significantly fewer entries would benefit from these programs.

The administration of the traditional case-by-case application of the substantial transformation test in determining whether articles are deemed to be "products of" BCs also presents Customs and the importing community with certain problems. The principal difficulty relates to the subjective nature of the

standard, which is due in large part to the absence of clearly defined rules in the statutes themselves for determining when a substantial transformation takes place. The absence of such rules, coupled with other factors such as the almost limitless variety of production processes and the continuous introduction of new products, necessarily requires that substantial transformation determinations be made by Customs on a case-by-case basis. Although a substantial body of administrative and judicial case law has developed over the years on this issue, only a limited degree of predictability has been achieved. The different purposes of the statutes containing the substantial transformation standard, the divergence of substantial transformation criteria enunciated by the courts, as well as the inconsistent application of those criteria, necessitate that prudent importers/exporters obtain advance rulings from this agency.

The issue which most frequently is raised in requests for rulings on eligibility for treatment under the GSP, CBERA and U.S.-Israel FTA concerns whether materials imported into a BC from a non-BC are subjected to a "dual substantial transformation." Under these programs, the cost or value of such materials may be included in the 35% value-content calculation only if they are substantially transformed in the BC into a new or different intermediate article of commerce, which is, itself, substantially transformed in the BC during the production of the final article. Because many BCs, particularly those in the Caribbean, lack natural resources, they must import raw materials or components to support their manufacturing operations. Due to the low wages in BCs, importers/exporters frequently find that their products cannot satisfy the 35% requirement without counting the value of these non-BC materials.

The previously-cited problems in making substantial transformation determinations are compounded when Customs is requested to rule on whether certain processes result in a dual substantial transformation. These decisions require consideration of such difficult issues as whether the intermediate product is a separate "article of commerce," and the appropriateness of applying a more lenient standard to the purported second substantial transformation where the overall processing is complex and clearly benefits the BC's economy.

The principal advantage in continuing with the current method of applying the substantial transformation standard under the CBERA is the familiarity acquired by the trading community, BCs and Customs over the years that this standard has been in use. However, we believe there is little likelihood that the level of predictability, certainty and clarity demanded by

today's industrial patterns under preferential trade programs can be achieved by the case-by-case determination of substantial transformation, irrespective of the resources and diligence applied by this agency.

The U.S.-Canada FTA rules of origin also are not without their administrative problems. The change of tariff heading methodology, while clearly more objective than the substantial transformation standard, has proven to be more complex and difficult to apply than originally envisioned. To some extent, this may be attributed to the relatively short time period that the U.S.-Canada FTA and its unique change of classification origin rule have been in effect (two years). Nevertheless, we find that not all brokers and importers claiming tariff treatment under this program have a proper understanding of the change of classification rules. This causes administrative problems for Customs since personnel processing such claims are required, in many instances, to reclassify both the third country materials and the imported goods according to U.S.-Canada FTA rules and, in some cases, to assess additional duties which importers had not originally contemplated paying. At this early stage in the implementation of this program, it is understandable that the volume and variety of product-specific rules constitute an intimidating factor not only to importers/exporters and brokers but to Customs personnel charged with implementing the origin rules.

As previously stated, various sensitive products are considered "originating" goods under the U.S.-Canada FTA only if they satisfy both the change of tariff heading requirement and a value-content requirement. Both requirements also must be met in certain cases in which the classification change does not reflect the type of significant processing envisioned by the Agreement. Moreover, where, for certain specified reasons, the assembly of goods does not effect a change of classification, the U.S.-Canada FTA provides that such goods are considered "originating" only if they satisfy a 50% value-content requirement. Reliance on a value-content test in the U.S.-Canada FTA, although limited in its applicability, has caused the most difficult problems in administering this program. These problems include not only the operational and enforcement concerns associated with the value-content requirements under the GSP, CBERA and U.S.-Israel FTA, but others as well.

For example, the scope of the term "direct costs of processing" has been made more ambiquous by the question of whether certain interest costs -- usually considered "indirect" costs under accounting standards -- should be allowed as "direct costs of processing." At this time, much uncertainty remains in

determining whether articles are "originating goods" because questions on whether certain costs are allowable, such as mentioned in the above example, cannot be readily answered.

We expect that the problems presently being experienced in applying the FTA change of heading and value-content requirements will diminish as the trading community and Customs acquire more experience in the use of both the Harmonized System and the FTA origin rules. There clearly is an ongoing need to "fine-tune" the FTA rules of origin, and, in this connection, bilateral efforts continue to proceed. However, this underscores one of the most desirable features of the FTA methodology, in that it lends itself well to both the use of technical expertise of customs authorities as well as the use of appropriate public notice process for orderly industry input.

Since the FTA went into effect on January 1, 1989, this agency has issued significantly fewer rulings on the FTA rules of origin than have been issued in regard to the substantial transformation standard under the other tariff preference programs. While this obviously shows a reduced resource burden on Customs, it more importantly demonstrates the greater measure of certainty and predictability provided to industry by the rules of origin under the FTA. Moreover, such an approach is consistent with the U.S. position and the general direction of GATT negotiations on the harmonization of rules of origin.

Recommendations

Most observers agree that rules of origin under tariff preference programs should satisfy certain basic criteria: (1) they should be consistent with the objective of the program; (2) they should be clear and objective, with a minimum of ambiguous language; (3) they should produce predictable results; and (4) they should be capable of efficient and effective administration by Customs.

As previously discussed, we believe that, to a greater or lesser extent, each of the U.S. tariff preference programs has shortcomings in terms of the origin criteria set forth above. The proliferation of different origin standards for various preference programs, especially in the last ten years, clearly has exacerbated the problem. Experience has shown that an increase in the diversity of origin criteria inevitably gives rise to more confusion and uncertainty on the part of the trade community, which, in turn, results in increased administrative problems for customs authorities. The hybrid nature of the origin rules for U.S. preference programs also contributes to the overall problem. For the reasons explained earlier, the

substantial transformation and 35% value-content requirements of the GSP, CBERA and U.S.-Israel FTA are each inherently difficult to establish and verify. Having to satisfy both constitutes a significant obstacle to obtaining preferential treatment under those programs. The U.S.-Canada FTA also has hybrid rules of origin, but to a lesser extent than the other preference programs; a limited range or products from Canada are subject to both the change in classification and supplemental value-content requirements.

Specifically in regard to the possible modification of the CBERA rules of origin, we favor, to the greatest extent possible, the institution of a single origin methodology in lieu of the present hybrid system. Such a single origin methodology should be consistent with the general direction of the GATT negotiations on the harmonization of rules of origin, i.e., a rule based primarily on a change in tariff classification. Because it relies on a universally-accepted and uniform nomenclature, a classification-based rule of origin comes closer than any other to achieving the goals of predictability, consistency, transparency, and administrability. Its adaptability also makes it best able to address today's rapidly changing and multiple sourcing patterns, as well as the explosion of global trade. Finally, as all nations have more experience with the Harmonized System, it can be expected that there will be significantly less need to resort to a residual or supplemental value-content computation with its implicit difficulties.

We appreciate the opportunity to provide our views on this important matter. If you have any questions regarding our comments or require additional information, please let us know.

Sincerely,

Samuel H. Banks
Assistant Commissioner
Office of Commercial Operations