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## **1 ARTICLE 2**

### **1.1 Text of Article 2**

#### **Article 2**

##### *Disciplines During the Transition Period*

Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that:

- (a) when they issue administrative determinations of general application, the requirements to be fulfilled are clearly defined. In particular:
  - (i) in cases where the criterion of change of tariff classification is applied, such a rule of origin, and any exceptions to the rule, must clearly specify the subheadings or headings within the tariff nomenclature that are addressed by the rule;
  - (ii) in cases where the ad valorem percentage criterion is applied, the method for calculating this percentage shall also be indicated in the rules of origin;
  - (iii) in cases where the criterion of manufacturing or processing operation is prescribed, the operation that confers origin on the good concerned shall be precisely specified;

- (b) notwithstanding the measure or instrument of commercial policy to which they are linked, their rules of origin are not used as instruments to pursue trade objectives directly or indirectly;
- (c) rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade. They shall not pose unduly strict requirements or require the fulfilment of a certain condition not related to manufacturing or processing, as a prerequisite for the determination of the country of origin. However, costs not directly related to manufacturing or processing may be included for the purposes of the application of an ad valorem percentage criterion consistent with subparagraph (a);
- (d) the rules of origin that they apply to imports and exports are not more stringent than the rules of origin they apply to determine whether or not a good is domestic and shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned<sup>2</sup>;

*(footnote original)*<sup>2</sup> It is understood that this provision is without prejudice to those determinations made for purposes of defining "domestic industry" or "like products of domestic industry" or similar terms wherever they apply.

- (e) their rules of origin are administered in a consistent, uniform, impartial and reasonable manner;
- (f) their rules of origin are based on a positive standard. Rules of origin that state what does not confer origin (negative standard) are permissible as part of a clarification of a positive standard or in individual cases where a positive determination of origin is not necessary;
- (g) their laws, regulations, judicial decisions and administrative rulings of general application relating to rules of origin are published as if they were subject to, and in accordance with, the provisions of paragraph 1 of Article X of GATT 1994;
- (h) upon the request of an exporter, importer or any person with a justifiable cause, assessments of the origin they would accord to a good are issued as soon as possible but no later than 150 days<sup>3</sup> after a request for such an assessment provided that all necessary elements have been submitted. Requests for such assessments shall be accepted before trade in the good concerned begins and may be accepted at any later point in time. Such assessments shall remain valid for three years provided that the facts and conditions, including the rules of origin, under which they have been made remain comparable. Provided that the parties concerned are informed in advance, such assessments will no longer be valid when a decision contrary to the assessment is made in a review as referred to in subparagraph (j). Such assessments shall be made publicly available subject to the provisions of subparagraph (k);

*(footnote original)*<sup>3</sup> In respect of requests made during the first year from the date of entry into force of the WTO Agreement, Members shall only be required to issue these assessments as soon as possible.

- (i) when introducing changes to their rules of origin or new rules of origin, they shall not apply such changes retroactively as defined in, and without prejudice to, their laws or regulations;

- (j) any administrative action which they take in relation to the determination of origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures, independent of the authority issuing the determination, which can effect the modification or reversal of the determination;
- (k) all information that is by nature confidential or that is provided on a confidential basis for the purpose of the application of rules of origin is treated as strictly confidential by the authorities concerned, which shall not disclose it without the specific permission of the person or government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings.

## 1.2 General

### 1.2.1 Disciplines prescribed by Article 2(b) through (d) and Members' discretion regarding rules of origin

1. With respect to the provisions prescribed by Article 2 of the Agreement on Rules of Origin, the Panel in *US – Textiles Rules of Origin* explained that subparagraphs (b) through (d) lay down a negative set of disciplines that apply during the transition period (until the work programme set out in Part IV is completed). After this transition period, i.e. upon implementation of the results of the harmonization work programme, Members will apply harmonized rules of origin, and the application of those rules will be subject to the provisions of Article 3. According to the Panel, during the transition period members enjoy "considerable discretion in designing and applying their rules of origin":

"With regard to the provisions of Article 2 at issue in this case – subparagraphs (b) through (d) – we note that they set out what rules of origin should not do: rules of origin should not pursue trade objectives directly or indirectly; they should not themselves create restrictive, distorting or disruptive effects on international trade; they should not pose unduly strict requirements or require the fulfilment of a condition unrelated to manufacturing or processing; and they should not discriminate between other Members. These provisions do not prescribe what a Member must do.

By setting out what Members cannot do, these provisions leave for Members themselves discretion to decide what, within those bounds, they can do. In this regard, it is common ground between the parties that Article 2 does not prevent Members from determining the criteria which confer origin, changing those criteria over time, or applying different criteria to different goods.

Accordingly, in assessing whether the relevant United States rules of origin are inconsistent with the provisions of Article 2, we will bear in mind that, while during the post-harmonization period Members will be constrained by the result of the harmonization work programme, during the transition period, Members retain considerable discretion in designing and applying their rules of origin."<sup>1</sup>

## 1.3 Article 2(b)

### 1.3.1 Purpose of Article 2(b)

2. The Panel in *US – Textiles Rules of Origin* explained that Article 2(b) is intended to preclude Members from using rules of origin "to substitute for, or to supplement, the intended effect of trade policy instruments":

"In our view, Article 2(b) is intended to ensure that rules of origin are used to implement and support trade policy instruments, rather than to substitute for, or to

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<sup>1</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.23-6.25.

supplement, the intended effect of trade policy instruments. Allowing Members to use rules of origin to pursue the objectives of 'protecting the domestic industry against import competition' or 'favouring imports from one Member over imports from another' would be to substitute for, or supplement, the intended effect of a trade policy instrument and, hence, be contrary to the objective of Article 2(b)."<sup>2</sup>

### 1.3.2 Pursuit of trade objectives

3. In *US – Textiles Rules of Origin*, the Panel, examining a claim under Article 2(b), found that the two key issues in applying this provision were how to assess the purpose for which rules of origin are being used, and how to interpret the "trade objectives" that may not be pursued via rules of origin:

"The Panel agrees with the parties that the operative part of Article 2(b) is the phrase 'rules of origin are not [to be] used as instruments to pursue trade objectives directly or indirectly'. It is clear from this phrase that in order to establish a violation of Article 2(b), a Member needs to demonstrate that another Member is using rules of origin for a specified purpose, *viz.*, to pursue trade objectives. ... this interpretation of Article 2(b), which is not in dispute, confronts the Panel with the following two issues. *First*, how is the Panel to determine whether a Member's rules of origin are used for the purpose specified in Article 2(b)? And *second*, what are 'trade objectives'?"<sup>3</sup>

### 1.3.3 Examination of objectives for which rules of origin are used

4. The Panel in *US – Textiles Rules of Origin* had the task of evaluating the objective for which rules of origin are used, in order to apply the phrase in Article 2(b), "used as instruments to pursue trade objectives". The Panel decided to utilize the approach taken by the Appellate Body to evaluating purpose in the context of *de facto* discrimination claims under Article III of the GATT 1994, drawing on structural and other objective indicia of intent:

"[W]e agree with India that the Appellate Body has already taken a position on how panels should conduct an inquiry into the objectives of a measure. The Appellate Body did so in the context of an analysis under Article III:2, second sentence, of the GATT 1994. In examining whether a tax measure was applied 'so as to afford protection to domestic production', the Appellate Body stated that:

'[...] it is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent.' The *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters. It does not follow, however, that the statutory purposes or objectives – that is, the purpose or objectives of a Member's legislature and government as a whole – to the extent that they are given *objective* expression in the statute itself, are not pertinent. To the contrary, as we also stated in *Japan – Alcoholic Beverages*:

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the *design*, the *architecture*, and the revealing *structure* of a measure. (emphasis added)'

The reasons cited by the Appellate Body in support of its view do not appear to be specific to the provisions of Article III:2, second sentence, of the GATT 1994. Hence, these reasons apply with equal force in the context of Article 2(b) of the RO

<sup>2</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.43. See also *ibid.* para. 6.84.

<sup>3</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.36.

Agreement. Accordingly, in applying Article 2(b), we will follow the above-quoted statement by the Appellate Body."<sup>4</sup>

#### 1.3.4 "trade objectives"

5. In *US – Textiles Rules of Origin*, the Panel then interpreted the meaning of the term "trade objectives" as it appears in Article 2(b). While the Panel considered that it would not be necessary to develop a general definition of this term, it concluded that "the objectives identified by India – i.e., the objectives of 'protecting the domestic industry against import competition' and 'favouring imports from one Member over imports from another' – may, in principle, be considered to constitute 'trade objectives' in pursuit of which rules of origin may not be used."<sup>5</sup>

#### 1.3.5 Trade effect is not necessarily a trade objective

6. In *US – Textiles Rules of Origin*, India claimed that a US measure ("section 405") providing exemptions to the general origin rule for flat textile goods was being used to pursue the trade objective of favouring imports from the European Communities over imports from other countries (particularly from developing countries such as India). Section 405 had been agreed with the European Communities to settle an earlier EC dispute against the United States. The Panel found that section 405 had been adopted to create exceptions from the general rule for products of export interest to the European Communities and that the US objective was to settle a bilateral WTO dispute with the European Communities.<sup>6</sup> However, it found that the EC concerns were solely with market access for its own products, not with gaining an advantage over other suppliers in the US market; settling a bilateral dispute did not imply any intention by either the EC or the United States to disfavour third parties.<sup>7</sup> Finally, the Panel found that even if this provision actually had a discriminatory effect, it could not infer discriminatory intent from mere effects:

"[E]ven if section 405 had the practical effect of favouring goods imported from the European Communities over competitive goods imported from other Members, that effect might be incidental rather than intentional. In other words, we do not think that the mere effect of favouring European Communities imports over imports from other Members would in itself justify the inference that creating such an effect is an objective pursued by the United States."<sup>8</sup>

### 1.4 Article 2(c), first sentence

#### 1.4.1 "themselves"

7. The Panel in *US – Textiles Rules of Origin* considered that the term "themselves" in Article 2(c) means that Article 2(c) focuses on a Member's rules of origin as a policy instrument, rather than the underlying commercial policy. The Panel discussed the term "themselves" as follows:

"[W]e consider that, in the first sentence of Article 2(c), the pronoun 'themselves' is used mainly to emphasise the preceding term 'rules of origin'. By emphasising the term "rules of origin", the pronoun 'themselves' brings out very clearly that the first sentence of Article 2(c) is concerned with a Member's rules of origin, as distinct from something other than rules of origin, and that it is rules of origin, as opposed to something other than rules of origin, that must not 'create restrictive, distorting, or disruptive effects on international trade'.

...

The term 'themselves' is meant to highlight that, although there may be commercial policy measures which create restrictive, distorting, or disruptive effects on international trade, the rules of origin used to implement and support these commercial policy measures must not create restrictive, distorting, or disruptive

<sup>4</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.37-6.38.

<sup>5</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.44.

<sup>6</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.112 and 6.114.

<sup>7</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.113-6.114.

<sup>8</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.117.

effects on international trade additional to those which may be caused by the underlying commercial policy measures.<sup>9</sup> Similarly, in cases where an underlying commercial policy measure does not cause any restrictive, distorting, or disruptive effects on international trade, the word 'themselves' would serve to underscore that rules of origin must not create any new restrictive, distorting, or disruptive effects on international trade."<sup>10</sup>

#### 1.4.2 "create"

8. The Panel in *US – Textiles Rules of Origin* continued exploring the interpretation of terms used in Article 2(c) first sentence, and explained that the term "create" ensures that there should be a "causal link" between a certain rule of origin and a prohibited trade effect for that rule of origin to be considered inconsistent with the first sentence of Article 2(c):

"The next element of the text of the first sentence of Article 2(c) to be considered is the term 'create'. The ordinary meaning of the term 'create' is to 'cause, occasion, produce, give rise to'. Thus, it is implicit in the term 'create' that a Member's rules of origin only contravene the first sentence of Article 2(c) if there is a causal link between those rules and the prohibited effects specified in the first sentence."<sup>11</sup><sup>12</sup>

#### 1.4.3 "restrictive, distorting or disruptive effects"

9. The Panel in *US – Textiles Rules of Origin* explained that the prohibited "restrictive, distorting or disruptive effects" listed in the first sentence of Article 2(c) form "alternative bases" for a claim:

"Turning to the prohibited effects – *i.e.*, 'restrictive, distorting, or disruptive effects' – the Panel notes that these effects constitute alternative bases for a claim under the first sentence of Article 2(c), as is confirmed by the use of the disjunctive 'or'. Accordingly, independent meaning and effect should be given to the concepts of 'restriction', 'distortion' and 'disruption'. In this regard, we note that the ordinary meaning of the term 'restrict' is to 'limit, bound, confine'; that of the term 'distort' is to 'alter to an unnatural shape by twisting'; and that of the term to 'disrupt' is to 'interrupt the normal continuity of'. Thus, the first sentence of Article 2(c) prohibits rules of origin which create the effect of limiting the level of international trade ('restrictive' effects); of interfering with the natural pattern of international trade ('distorting' effects); or of interrupting the normal continuity of international trade ('disruptive' effects)."<sup>13</sup>

#### 1.4.4 "effects on international trade"

10. The Panel in *US – Textiles Rules of Origin* determined that the term "effects on international trade" could not be interpreted as covering adverse effects on trade in different goods:

"[W]e cannot assume that Members intended to bring adverse effects on different types of goods within the ambit of the prohibition set out in the first sentence of Article 2(c). Indeed, as the Appellate Body has said in a different context, '[t]o sustain such an assumption and to warrant such a far-reaching interpretation, treaty language far more specific [...] would be necessary'. We consider that the same could be said of Article 2(c), first sentence.

<sup>9</sup> (footnote original) It is worth noting in this context that Article 3.2 of the *Agreement on Import Licensing Procedures* on non-automatic licensing contains provisions along these lines. Specifically, it states that "[n]on-automatic licensing shall not have trade-restrictive or -distortive effects on imports *additional* to those caused by the imposition of the restriction" (emphasis added).

<sup>10</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.136-6.137.

<sup>11</sup> (footnote original) It is relevant to point out here that the Appellate Body has given a similar interpretation to the previously mentioned Article 3.2 of the *Agreement on Import Licensing Procedures*. Appellate Body Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products* ("EC – Poultry"), WT/DS69/AB/R, adopted 23 July 1998, DSR 1998:V, 2031, paras. 126-127.

<sup>12</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.140.

<sup>13</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.141.

Therefore, we consider that it would not be appropriate to interpret the phrase 'effects on international trade' as covering adverse effects on trade in different (but closely similar) types of finished goods. We construe the phrase 'effects on international trade' to cover trade in the goods to which the relevant rule of origin is applied (e.g., cotton bed linen)."<sup>14</sup>

## 1.5 Article 2(c), second sentence

### 1.5.1 "unduly strict requirements"

11. In *US – Textiles Rules of Origin*, the Panel explained the meaning of the phrase "unduly strict requirement" in the context of India's claim that the United States' measures at issue imposed strict requirements that did not assist the United States in determining the country with which the product had the most significant economic link. The Panel explored the meaning of the sentence examining each term:

"First, we need to examine what kind of 'requirements' are covered by the obligation that Members must ensure that their rules of origin not 'pose unduly strict requirements'. In this regard, we note the view of the United States that the clause 'as a prerequisite for the determination of the country of origin' qualifies also the phrase '[rules of origin] shall not pose unduly strict requirements'. While the English version of Article 2(c) may be susceptible of such an interpretation, the equally authentic French version is not. Nevertheless, the clause 'as a prerequisite for the determination of the country of origin' is part of the immediate context of the term 'requirements'. Considered as relevant context, the clause at issue lends force to the argument that the 'requirements' which must not be unduly strict include the kind of requirements which must be fulfilled as a prerequisite for the determination of the country of origin. Article 2(a) of the *RO Agreement* provides further contextual support for such an interpretation. The first sentence of that provision states that the 'requirements to be fulfilled' must be clearly defined. It is clear to us that these requirements include the substantive requirements which must be met for a good to be determined to originate in a particular country. For these reasons, we read the term 'requirements' in the second sentence of Article 2(c) as encompassing the substantive origin requirements<sup>15</sup> that must be met for a good to obtain origin status.<sup>16</sup>

Another issue presented by the phrase 'unduly strict requirements' is the interpretation to be given to the adjective 'strict'. The most pertinent dictionary definitions of the term 'strict' are 'exacting' and 'rigorous'. Thus, a 'strict' requirement is an exacting or rigorous requirement. In the specific context of Article 2 of the *RO Agreement*, and also bearing in mind our interpretation of the term 'requirements', 'strict' requirements are, therefore, those requirements which make the conferral of origin conditional on conformity with an exacting or rigorous (technical) standard.

The second sentence of Article 2(c) only precludes Members from imposing requirements which are 'unduly' strict. The dictionary meaning of the adverb 'unduly'

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<sup>14</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.1466.147. See also para. 6.172.

<sup>15</sup> (*footnote original*) For the purposes of this dispute, we need not decide whether the "requirements" mentioned in the second sentence of Article 2(c) would also encompass the formal, or administrative, requirements which may be imposed in order to assess compliance with rules of origin (e.g., documentation requirements).

<sup>16</sup> (*footnote original*) The negotiating history of the *RO Agreement* tends to confirm that the term "requirements" refers to the substantive origin requirements that must be met for a good to obtain origin status. The first clause of Article 2(c), second sentence, appears to originate in two provisions proposed by Japan. The first of these proposed provisions states that "the *requirements to be fulfilled in the determination of origin* shall be clearly defined. [...] Rules of origin which state only what does not confer origin [...] or state only abstract conditions or *unduly strict conditions* shall be prohibited". MTN.GNG/NG2/W/52, p. 5 (emphasis added). The other provision proposed by Japan states that "[t]echnically excessive requirements as a prerequisite for the determination of country of origin shall be prohibited". *Ibid.*

is 'more than is warranted or natural; excessively, disproportionately'. Accordingly, an origin requirement can be considered to be 'unduly' strict if it is excessively strict."<sup>17</sup>

### 1.5.1.1 "fulfilment of a certain condition not related to manufacturing or processing"

12. In *US – Textiles Rules of Origin*, the Panel noted that the sentence "fulfilment of a certain condition not related to manufacturing or processing" requires Members to ensure that the conditions that their rules of origin impose as a prerequisite for the conferral of origin do not include a condition unrelated to the manufacturing or processing:

"[W]e consider that the ordinary meaning of the second clause is clear. It requires Members to ensure that the conditions their rules of origin impose as a prerequisite for the conferral of origin not include a condition which is unrelated to manufacturing or processing.<sup>18</sup> We note the example offered by the United States that a rule of origin would not conform to this requirement if it stated that a good can only be ascribed the origin of a country if the good has been certified by several authorities through a time-consuming process in the exporting country."<sup>19</sup>

## 1.6 Article 2(d)

### 1.6.1 Scope of application of non-discrimination rule

13. In *US – Textiles Rules of Origin*, India argued that rules of origin violate Article 2(d) if they result in unjustifiably differential treatment of "closely related (Indian and European Communities) products". The Panel rejected India's claim and explained that India's argument was partly based on the erroneous assumption that Members should apply "the same rule of origin, or at least equally advantageous rules, to 'closely related' products imported from different Members". The Panel then determined that Article 2(d) does not intend to preclude discrimination across different (but closely related) goods imported from different Members:

"[W]e recall that the second clause of Article 2(d) states that rules of origin 'shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned'. It does not state that rules of origin 'shall not discriminate between closely related goods of other Members [...]'. Thus, the plain terms of the second clause do not support India's reading.

Moreover, the expression 'the good concerned' in the singular indicates that the second clause of Article 2(d) is not concerned with discrimination across different (but closely related) goods. Were it otherwise, the second clause would arguably have referred to 'the goods concerned' in the plural. In our view, the use of the singular suggests that, for the purposes of assessing whether there is discrimination 'between Members', a comparison should be made between the rule of origin applicable to a particular good when imported from one or more Members and the rule(s) of origin applicable to the same good – 'the good concerned' – when imported from one or more other Members.

If the second clause of Article 2(c) were intended to preclude discrimination across different (but closely related) goods, we consider it likely that the drafters would have provided some textual guidance as to the product scope of the prohibition set forth in the second clause. Indeed, we note that other WTO non-discrimination provisions, such as Articles I, III and IX of the GATT 1994, do specify the product scope of the prohibitions they contain.

Finally, our reading of the second clause of Article 2(d) is consistent with the objective of that clause. In our view, the principal objective of the second clause of Article 2(d)

<sup>17</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.204-6.206.

<sup>18</sup> (*footnote original*) We are aware that the third sentence of Article 2(c) states that "costs not directly related to manufacturing or processing may be included for the purposes of the application of an ad valorem percentage criterion consistent with subparagraph (a)". But the third sentence opens with the word "however", which implies a contrast between the second and third sentences.

<sup>19</sup> Panel Report, *US – Textiles Rules of Origin*, para. 6.208.

is to ensure that, for a given good, the strictness of the requirements that must be satisfied for that good to be accorded the origin of a particular Member is the same, regardless of the provenance of the good in question (*i.e.*, Member from which the good is imported, affiliation of the manufacturers of the good, etc.).<sup>20</sup>

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<sup>20</sup> Panel Report, *US – Textiles Rules of Origin*, paras. 6.245-6.248.