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## Innovative aspects of preferential rules of goods origin in the economy of global chains: applicability for the Eurasian Economic Union (EAEU)

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# Innovative aspects of preferential rules of goods origin in the economy of global chains: applicability for the Eurasian Economic Union (EAEU)

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**Abstract.** The investigations show that cross-cumulation of origin is a new tool of easing stringent rules of origin of goods (ROG) in the regional trade deals (RTD) in the economy of global chains and growing protectionism, which is not characteristic of the Eurasian Economic Union (EAEU). The article gives consideration to a legal and institutional commitment of EAEU to using innovation in the sphere of preferential ROG. The existence of multiplicity of wordings of cumulation concept, its types as well as verification systems in different RTD determines the use of comparative analysis of preferential ROG in EU (European Union), ASEAN (Association of South East Asian Nations) and EAEU as the main investigation method. The following findings have been made on the basis of analysis of regulatory and legal framework of preferential rules of EAEU and practice of application thereof: legislation of the Union is developing, though, it is incomplete — a key document on preferential rules is absent, which creates a legal uncertainty in the sphere of ROG; organization of free-trade zones (FTZ) of EAEU with the third countries is progressing slowly not meeting the requirements of development of Big Eurasia; application of diagonal and full cumulation is admissible in EAEU agreements on FTZ, but due to a requirement of direct supply and a complicated system of certification and verification of origin, customs offices frequently refuse to grant preferential tariffs to foreign trade operators. Signing of new EAEU agreements on FTZ, activation of all forms of cumulation in the existing and new FTZ will contribute to expanding the ‘zone of origin’ in the territory of the Eurasian space with the center in EAEU. Full change-over to electronic certification and verification of origin will help reduce business expenses, hence, make EAEU countries more attractive for integration into transcontinental supply chains.

## 1. Introduction

The innovations are being actively incorporated into all spheres of government control [1–3]; they did not keep away from the sphere of rules of origin of goods, which are characterized by the plurality and nebulosity of wordings in different regional trade deals. The stringent and intricate ROG under



globalization conditions influence the expanding geography of supply 'chains' beyond RTD boundaries restraining the use of cheap components from the third countries [4–7]. The application of such innovative tool as cross-cumulation outside the boundaries of unified RTD may play an important role in imparting flexibility to preferential rules of origin under conditions of growing protectionism [8]. A digitization of origin administration will help simplify the customs formalities when the goods cross the borders. The purpose of this study is to reveal commitment of the countries of the Eurasian Economic Union to incorporation of different types of cumulation and electronic system of certification and verification of origin with the development of recommendations for activating these processes. The specific features of using different types of cumulation in a number of RTD are considered to be a theoretical basis. Further, the analysis is made of regulatory and legal framework of EAEU and agreements on FTZ with the Union countries as well as the practice of using preferential ROG in EAEU. Recommendations are given on the basis of obtained findings on the use of cumulation principle on the internal market of the Union and integration into supply chains with the partners in FTZ in the light of organization of Big Eurasia.

## 2. Theoretical basis

The rules of origin of goods are used for determining 'economic ethnic origin' of goods in international trade. They distinguish between preferential and non-preferential rules. The non-preferential rules are used for the countries, to which the most favoured nation condition is applied. The preferential rules are used for the partner countries according to the regional trade deals and recipients of unilateral trade concessions giving certain advantages, in particular, duty-free exchange of goods. In order to use preferential rules, the proofs are necessary that the imported goods have been entirely produced or sufficiently reworked in the country receiving tariff preferences.

It is difficult to find a product manufactured in one country in global value chain (GVC) economy. The materials, parts, processes on reworking and production services are scattered in different countries [9]. For instance, it is difficult to determine the country of origin of sea products produced on 'offshore' ship in territorial waters of one country and processed in the other country, wherefrom they have been supplied to a destination country. Therefore, the criterion of processing is the most important in ROG and can include variations of three conditions: minimal share of content of 'home' cost in the final product; change of tariff classification in the final product as compared with its components from the third countries; list of production and technological operations recognized sufficient without changing cost of tariff code.

Inherent ROGs are envisaged in every RTD, where *de minimis* level, cumulation type and certification have the greatest importance for the preferential rules. *De minimis* level determines percentage of import materials, which utilization does not influence identification of the country of origin. The cumulation concept expands the basic ROG principle making it possible to 'accumulate' materials/operations taking place in the partner countries according to a preferential agreement and take them into account as taking place in the country of final product manufacture for its export to RTD countries at zero tariff rates. The concepts of cumulation and its types worded by the World Customs Organization are used in this work. It has been proven in a number of investigations that the use of cumulation has a wholesome effect on intraregional trade [10] and formation of regional production chains [11].

There are three main cumulation types: bilateral (between two deal parties), diagonal (on the regional basis) and full (any processing activity in RTD partner country may be considered sufficient irrespective of the origin of materials). A bilateral cumulation is comprised by nearly all legislative and regulatory acts on the origin of goods. For instance, it is used for all five FTZ of ASEAN: ASEAN-Korea, ASEAN-China, ASEAN-Japan, ASEAN-India, ASEAN-Australia-New Zealand. The bilateral cumulation is efficient for short value chains in primary industries, when raw materials are recovered in one FTZ country, processed in the other country and supplied tax-free to the country of recovery. The diagonal cumulation can be used, when there is no unified RTD, but there exist bilateral FTZ between all countries such as, e.g., in the framework of Regional conventions on Pan-Euro-

Mediterranean (PEM) preferential rules of origin. Full cumulation is the next step in integration development stimulating development of production ‘links’ of value chains, and it is especially relevant for small countries with scarce resources, but well-developed processing industry. So, full cumulation is admissible in European Free Trade Association (EFTA).

The expansion of a traditional cumulation concept is implemented through relatively new cross-cumulation tool permitting ‘accumulations’ with countries not included into a unified RTD, but having trade deals therewith. The cross-cumulation can be an efficient mechanism of fostering reproduction process going beyond RTD boundaries under conditions of growing protectionism. It should be pointed out that cumulation is not an alternative to the processes of liberalization of unifying the rules of origin on the multipartite basis, since it is used at the regional level within RTD framework. By virtue of the liberal rules of origin at the global level, the manufacturers can use resources from all over the world selecting the most contestable producers for the best price within RTD framework. In this regard the convergence of preferential and non-preferential rules of origin at the regional and global level appears to be a logical task in the field of trade facilitation in the long run [12].

On the threshold of Brexit a discourse on using the tools of cross-cumulation has intensified for keeping the established production links in the region. It is expected that association of Great Britain with PEM will bring about lesser disintegration of regional chains, while using the cross-cumulation tool with respect to individual goods will support participation of Great Britain in GVC through expansion of cumulation zone despite its exit from EU [13, 14].

In order to use preferential ROG, the companies need to confirm compliance with the criterion of origin through certification and verification. An electronic system of confirmation of the country of origin introduced in many developed countries simplifies the use of preferential ROG.

### **3. Investigation method**

The ROG, including cumulation systems, need a legal framework to keep track of an original status of the accumulated resources as well as supervise origination thereof along entire chain. Since there are multiple wordings and differences between concepts of cumulation, its types as well as verification systems in the EU, NAFTA (the North American Free Trade Agreement), ASEAN and EAEU, the basic investigation method is the method of comparative analysis of theory and practice of using cumulation.

The regulatory and legal framework with regard to ROG of the World Trade Organization and the World Customs Organization (WTO, WCO) has been studied at the first conceptual stage. The methods of reflecting a principle of cumulation in the texts of some RTD have been analyzed at the second theoretical stage. The cumulation rules referred to as the ‘cumulation of origin’ are specified in an individual article in some trade deals, in the other deals it is ‘integrated’ into general text in definitions or in the requirements ‘received in full’ or ‘sufficient processing’. A semantic analysis of RTD provisions had been made further to reveal different types of cumulation not directly referred to in the texts of deals, which was followed by the literature review to reveal the practice of application thereof. The regulatory and legal framework of EAEU deals with the FTZ partner countries published on the website of the Eurasian Economic Commission as well as practice in the application of preferential ROG and cumulation available in the public sources have been analyzed in the course of investigation stage. The recommendations have been given at the final stage proceeding from the drawn conclusions on the use of origin cumulation for the EAEU administration.

### **4. Results and recommendations**

The application of cumulative principle, which determines origin of this or the other piece of goods in the course of its subsequent processing is to be declared in all free trade deals, where Russia takes part for the sake of determining the country of origin of goods manufactured in participating states. The Council of the Eurasian Economic Commission (EAEC) approved new Rules for identification of the origin of goods imported to the customs territory of EAEU on April 8, 2018, which will take effect at the lapse of 180 days since the date of official publishing. The document will replace the rules adopted

as far back as 2008. According to information placed on the website of EAEC, the new rules will be used for all import purposes except receiving tariff preferences, i.e. they are non-preferential rules. Since the documents on preferential rules of origin are just being developed in EAEU, let us give consideration to the rules of origin used in the FTZ of the Commonwealth of Independent States (CIS).

From the point of view of cumulation legalization in case of CIS the cumulative principle is spelled out in terminological section of the ‘Agreement on the Rules for identification of CIS country of origin of goods’, while the cumulation rules in the FTZ between EAEU and Vietnam are comprised in individual article 4.7 ‘Cumulation of origin’. Russia also uses cumulation of origin in trading some items with Serbia. The cumulation is also envisaged in the provisional arrangement of EAEU on free trade with Iran signed recently. The cumulation rules are laid down in individual articles in the agreements with Serbia and Iran (table 1).

**Table 1.** Cumulation and ‘de minimis’ in FTZ of EAEU/Russia.

| FTZ stage          | Partners in FTZ  | Name of agreement/ document  | De minimis | Cumulation legalization                                | Type of cumulation             |
|--------------------|--|--|------------|--|--------------------------------|
| FTZ in force       | FTZ of CIS (Armenia, Belarus, Kazakhstan, Kirghizia, Moldova, Russia, Tadjikistan, Ukraine <sup>a</sup> , Uzbekistan (according to special procedure))   | Agreement on the Rules for identification of CIS country of origin of goods (dd 20.11.2009) with revisions of 03.11.2017). Section 1. Terms and definitions. Cumulative principle. | 5% EXW     | Section 1. Terms and definitions. Cumulative principle | Diagonal (full is permissible) |
|                    | EAEU-Vietnam   | Agreement on free trade between EAEU and its member states on one side and the Socialist Republic of Vietnam on the other side, 29.05.2015.  | 10% FOB    | Article 4.7. Cumulation of origin                      | Bilateral                      |
|                    | EAEU/Russia-Serbia   | Rules for identification of country of origin of goods.  | –          | Article 5. Cumulation of origin                        | Bilateral/ diagonal            |
| Tempo-<br>rary FTZ | EAEU-Iran  | Temporary agreement leading to establishing FTZ between EAEU and its member states on one side and the Islamic Republic of Iran the Islamic Republic of Iran dd 17.05.2018.        | 5% EXW     | Article 6.7. Cumulation of origin                      | Bilateral                      |
| Negotia-<br>tions  | India, Israel, Egypt, Singapore  | Status of routes of the dialogue on free trade.  | –          | –  | –                              |
| Potential          | Republic of Korea, Mongolia, PRC Cambodia, Greece, Shanghai Cooperation Organization, BRICS countries (Brazil, Russia, India, China, South Africa), etc. | Primary areas of EAEU international activity for 2018.   | –          | –  | –                              |

<sup>a</sup> Conflict between Russia and Ukraine and FTZ between Ukraine and EU became the reason for publishing Decree No. 628 ‘On suspension of Treaty on FTZ with respect to Ukraine by Russia’. Ukraine has introduced retaliatory measures.

Source: Compiled by authors according to EAEC data.

In terms of two types of cumulation envisaged for application in FTZ of EAEU with other countries, then, proceeding from the wordings of the applicable articles, one can come to a conclusion that it is supposed to use, basically, a bilateral and a diagonal cumulation. So, a bilateral (or rather quadruple) cumulation can be used in the agreements on free trade between EAEU and Vietnam, EAEU/Russia with Serbia and EAEU with Iran. For instance, supposing that a furniture factory in Vietnam would use Russian timber and Byelorussian furniture fittings, then it could sell furniture to EAEU countries at the preferential rate, as if all the materials for furniture production had originated from Vietnam. In the framework of FTZ of CIS a diagonal cumulation of origin is applicable and full cumulation of origin is admissible.

In this case proper rules and criteria of goods origin are provided for in every free trade agreement. So, the Rules for identification of CIS country of origin of goods comprise a substantial list of conditions and operations required for imparting the status of CIS origin to the goods when using in the production of goods of the third countries. 'De minimis' condition is also articulated in different ways in all agreements with EAEU. It shall be understood that for the sake of adaptation of national economies of EAEU countries to the regime of free trade with Vietnam, Serbia and Iran transition periods have been established for some goods ranging from 5 to 10 years, when a gradual decrease of rates of import duties will take place, as well as withdrawals of some goods are supposed to take place.

Besides, a condition for granting tariff preferences in all FTZ is the direct supply, which is difficult to do. Vietnam, for instance, is insomuch geographically remote from the EAEU that it is impossible to do without changing transportation vehicle during transportation of goods. In the absence of any recommendations for customs offices on how a participant of foreign economic activity can confirm compliance with the direct supply rule (art. 4.9 of Agreement on FTZ of EAEU-Vietnam), many companies face a refusal of customs authorities to provide preferences.

Apart from multiplicity of the rules of origin alone the complications arise during confirmation of country of origin with the customs authorities, structures authorized for releasing certificates of goods origin (Chamber of Commerce and Industry of Russia), and business representatives [15]. The origin of goods imported into EAEU can be confirmed by Declaration or Certificate of origin. The order of declaration preparation is much more simple than that of a certificate, but its is applicable in case of low cost of imported goods (in FTZ of CIS with the cost of goods up to 200 USD, while in FTZ of EAEU-Iran — up to 5,000 USD). The legal controversies related to application of this document have not died off during 10 years of existence of old rules of origin in EAEU. In this regard the participants of EAEU put high hopes on incorporation of electronic systems of certification and verification of origin (clause 26, Section IV of new Rules), which is especially relevant under development of electronic declaration of goods and is designed to simplify procedures of documentary confirmation and verification of origin.

The elimination of obstructions on the internal market of the Union is one of the top-priority tasks for EAEU as the integration association. According to EAEC appraisals the elimination of some obstructions only, which have been included into the 'road map' for 2018–2019, will reduce business transaction expenses by 100–120 million USD, while a positive effect will equal up to 2% of mutual trade volume.

The task of eliminating obstructions is extremely pressing in the light of promoting an idea of establishing a Big Eurasian Partnership with participation of the key integration associations and the biggest economies of the region, since EAEU/CIS competes to a certain degree with EU/PEM for participation of medium-sized and especially small economies in locating the value chains in the territory of Big Eurasia. According to calculations of the experts, three countries of the USSR which a currently the members of DCFT (*Deep and Comprehensive Free Trade Areas*) — Georgia, Moldova and Ukraine will get privileges from joining PEM Convention. All the countries have a limited base of intermediate goods and processing thereof, while the raw-material diagonal cumulation in the framework of PEM offers wider capabilities of participation in the regional value chains to them due to tariff preferences in the framework of 60 bilateral FTZ with PEM countries [16]. The main recommendations on using a principle of cumulation for EAEU/CIS are as follows:

- promote initiative of ‘integration of integrations’ of EAEU-EU with the use of bilateral cumulation;
- CIS vs. PEM — preserve easier rules of origin for competition with PEM in case of Moldova and Ukraine;
- strife for using different types of cumulation with PEM countries (Greece, Serbia, Hungary), including full cumulation and cross-cumulation;
- activate application of different types of cumulation in the framework of FTZ with Vietnam, including cross-cumulations with countries of Asian-Pacific Region, with which Vietnam has FTZ;
- activate negotiations of FTZ being discussed (India, Singapore, Egypt, Israel) with possibility of using different types of cumulation.

## 5. Conclusion

The recommendations have been given to EAEU administration in the course of conducted investigation in the sphere of trade policy on the basis of obtained findings. Three FTZ of EAEU (with Vietnam, Serbia and temporary with Iran) are significantly lesser than, for instance, 60 FTZ in the framework of PEM or five FTZ of ASEAN. The legislation on ROG of EAEU is developing, but it is not exhaustive. A key document on preferential rules is absent, while a document on non-preferential rules has not yet taken effect, which creates a legal uncertainty in the sphere of ROG. It is admissible to use diagonal and full cumulation in the agreements of EAEU on FTZ, but due to a requirement of direct supply and a complicated system of certification and verification of origin, customs offices frequently refuse to grant preferential tariffs to foreign trade operators. Signing of new agreements of EAEU on FTZ, active use of diagonal, full and cross-cumulation of origin with respect to some goods in the existing and new FTZ will contribute to expanding the ‘zone of origin’ in the territory of Big Eurasia. Doing away with paper certificates of origin and full change-over to electronic verification will help reduce business time and financial expenses, hence, make EAEU/CIS countries more attractive for integration into transcontinental supply chains. The offered methodology of making ROG comparative analysis in different RTD is a tool making it possible to reveal a degree of development of this or the other ROG aspect and give recommendations on incorporation of the ‘best practices’ in the selected RTD.

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