



Transforming Africa's Trade

African Export-Import Bank
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TRADE POLICY BRIEF

PREFERENTIAL RULES OF ORIGIN UNDER THE AfCFTA

This Trade Policy Brief is a joint publication between Afreximbank and the AfCFTA Secretariat. For more information contact ARTP@afreximbank.com



September 2021

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Introduction

African leaders made history on 21 March 2018, when they came together in Kigali, Rwanda at the 10th Extraordinary Summit of the African Union and signed an agreement launching the African Continental Free Trade Area (AfCFTA), a flagship project of the African Union's Agenda 2063: The Africa We Want. The AfCFTA Agreement will provide a comprehensive and mutually beneficial trade agreement among the member states of the African Union, covering trade in goods and services, investment, intellectual property rights and competition policy. Negotiations towards the AfCFTA have been divided into two phases. Phase I negotiations cover Trade in Goods, Trade in Services and Dispute Settlement, while Phase II negotiations addresses Intellectual Property, Investment and Competition Policy, and Digital trade.

Among the agreements signed in Kigali was the framework agreement establishing the AfCFTA and a Protocol on Trade in Goods. In terms of the Protocol on Trade in Goods, AfCFTA State Parties are required to eliminate tariffs on 90 percent of their tariff lines, with the remaining 10 percent retained as either “sensitive” products with longer liberalisation periods, or as “excluded” products at the same tariff level. To achieve this level of liberalisation and ensure that trade is facilitated under the AfCFTA, the Protocol on Trade in Goods is supported by 9 Annexes, covering: Schedule of Tariff Concessions; Rules of Origin (RoO); Trade Facilitation; Non-Tariff Barriers; Customs Cooperation and Mutual Administrative Assistance; Technical Barriers to Trade; Sanitary and Phytosanitary Measures; Transit; and Trade Remedies. While negotiations in all the above areas have advanced, leading to the start of trading on 1 January 2021, negotiations on some outstanding RoO remain, delaying the finalization of tariff offers which are necessary to facilitate tariff preference reductions and the full implementation of the Protocol on Trade in Goods.

Understanding Rules of Origin

The basic role of RoO is to determine the economic nationality—as opposed to the geographic nationality—of a given good. Determining the economic nationality of a good is critical to ensure that goods claiming tariff preferences under a Preferential Trade Agreement (PTA) do in fact originate from Parties to the agreement. In this context such Rules of Origin are referred to a preferential Rules of Origin.¹

Preferential RoO are an essential component of any PTA such as the AfCFTA. They provide the technical criteria against which to assess whether a given product originates in a particular country for the purpose of granting preferences. For instance, in the context of the AfCFTA, RoO will ensure that producers in non-African states do not simply channel their goods through an AfCFTA State Party with the lowest tariffs to obtain better access into other AfCFTA State Parties—such as zero tariffs—and thereby undermine domestic production and the benefits of the AfCFTA intended for African producers and traders. The design and application of RoO are therefore intended to prevent “trade deflection” or “tariff jumping” whereby products are imported from states outside a PTA and re-exported under the market access preferences of that PTA (Erasmus and others: 2004).

Under international trade rules there are generally two basic criteria to determine the country of origin or economic nationality of goods: (i) where the good is produced or obtained; and (ii) the level of transformation the good has undergone. A good is considered wholly obtained if it is produced entirely in the territory of a country. This will generally include goods naturally occurring in a country, such as live animals born and raised in the country, fish from territorial waters, minerals extracted, agricultural produce grown, etc. It also includes any processed goods that are made from naturally occurring goods as well as waste and scrap resulting from manufacturing or processing activities.

1 In contrast, non-preferential Rules of Origin govern goods traded outside a preferential trade arrangement and are generally used for the purposes of collecting trade statistics, trade remedies, quotas, origin labelling, health regulations etc. (Naumann: 2021). This paper focuses on preferential Rules of Origin only.

However, given that a large number of products, especially manufactured products, rely on utilizing source materials or intermediate inputs from other countries, a product can also acquire originating status through processing or having been transformed. In this instance, RoO provisions stipulate the level of processing or transformation required to ensure that the final product can claim originating status under a PTA (Naumann: 2021). The level of transformation required to claim originating status is usually determined on the basis of a change in tariff classification, a value-added percentage criterion or a technical or specific processing criteria.

While their primary purpose is to determine the economic nationality of goods, RoO also serve a second and sometimes unintended purpose as a trade and industrial development tool. For instance, RoO within a PTA such as the AfCFTA can serve as a protective tool that could be used to stimulate the emergence of regional value chains and intra-regional trade. Strict RoO can incentivise producers to use raw materials sourced from countries within the PTA and stimulate production of intermediate or primary products to take advantage of market access benefits. However, if too restrictive, they could also have cost-raising effects as producers potentially choose to source raw materials or intermediate inputs from PTA members rather than lower-cost sources outside the PTA. (Erasmus & others: 2004)

Rules of Origin under the AfCFTA

RoO have become increasingly complex due to the expansion of bilateral and multilateral trade agreements which have supported the emergence and proliferation of global value chains. Consequently, determining the most suitable mix of originating and non-originating materials while also promoting industrialization has become increasingly difficult. This is evidenced in the protracted negotiations on AfCFTA RoO as policy makers seek to strike a balance between facilitating trade and supporting industrialisation and structural transformation of Africa. To achieve this balance, AfCFTA negotiating parties adopted the standard approach of “wholly obtained” and “sufficiently worked or processed” as origin conferring criteria and supplemented this with a hybrid approach of general and specific Rules of Origin.

For “wholly obtained products” the Annex on RoO follows a standard approach conferring originating status on a range of products that occur naturally in AfCFTA State Parties or goods processed from naturally occurring goods. For goods not “wholly obtained” the AfCFTA provides that a good will be considered as originating in a State Party if it is substantially transformed.

Following the above general criteria, the Annex on RoO also provides for specific RoO on a range of products. These specific rules set the originating criteria for specific individual products for the purposes of preferential trade under the AfCFTA and are contained in Appendix IV to the Annex and include:

- Value Added: a good is considered substantially transformed when the value added of a good increases up to a specified level expressed by an ad-valorem percentage.
- Non-originating Material Content: a good is considered substantially transformed when the value of non-originating materials used in production is below the prescribed maximum. The value of non-originating materials ranges from 40-60 percent but varies according to products. For example, on machinery, most African countries prefer a value of non-originating material to be 60 percent in order to promote investment and allow countries at the nascent stage of industrialisation to grow these industries.
- Change in Tariff Heading: a good is considered substantially transformed when the good is classified in a tariff heading or subheading (depending on the exact rule) different from all non-originating materials used.
- Specific Processes: a good is considered substantially transformed when the good has undergone specified manufacturing or processing operations.

In addition to setting criteria for determining origin, the AfCFTA also provides activities that are insufficient to confer origin status, such as: breaking-up or assembly of packages; washing, cleaning to remove dust, oxide, oil, paint or other coverings from a product; simple ironing or pressing operations; simple painting or polishing operations; peeling, stoning or shelling of vegetables etc.

The Annex on RoO contains other important provisions that support industrialization and structural transformation such as absorption/roll-up provisions; provisions on goods produced in special economic zones; and cumulation.

The absorption or roll-up principle is one of the most recently adopted provisions in the Annex on RoO, which will allow intermediate products to maintain their originating status when they are used for subsequent manufacturing operations. This means that if a good which contains non-originating inputs satisfies the applicable origin criterion and has acquired originating status, the entire input is treated as originating when assessing the origin of the final good (WCO:2017). Goods produced under Special Economic Zones/Arrangements will also be conferred with originating status where they satisfy rules contained in Annex IV and the Protocol on Trade in Goods and subject to any regulations that may be agreed between State Parties.

The concept of “cumulation” is another important provision supporting the emergence of regional value chains. Under the AfCFTA, cumulation provisions will allow African countries to share production while still allowing market access benefits. Cumulation will allow for products of one AfCFTA State Party to be further processed and/or added to products in another State Party with the final good considered as if they originate in the latter party. In this way, production can be aggregated with other countries’ inputs and still qualify for preferential trade, thus offering additional opportunities and incentives to source input materials from within Africa. In essence, cumulation widens the definition of originating products and provides flexibility and opportunities to develop deeper economic relations between countries within the AfCFTA.

Current Status of Negotiations of Rules of Origin

AfCFTA State Parties have concluded negotiations on about 87 percent of RoO. However, several outstanding issues remain under discussion, including specific RoO on some tariff lines related to textiles, while discussions are in the final stages for automotive, dairy products, edible oils, sugar and sugar confectioneries. Dedicated RoO negotiation sessions are scheduled to ensure that outstanding issues are resolved expeditiously in order to facilitate implementation of tariff schedules.

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