THE EU-USA DISPUTE CONCERNING THE NEW AMERICAN RULES OF ORIGIN FOR TEXTILE PRODUCTS

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Rules of origin are the rules which aim at determining the geographical origin of goods (and sometimes services) imported on the territory of a State[2]. This origin will allow the customs administration of the importing State to apply the correct customs duties and commercial policy measures (quantitative restrictions, licensing requirements, antidumping or countervailing duties...) to the imported products. Rules of origin constitute therefore an important part of the commercial policy of States. Minutious rules can define precisely the origin, and therefore the applicable measures.

The way rules of origin are defined can give a good image of the commercial philosophy of the importing State. They can be defined very liberally, and therefore facilitate trade. They can also be used as a protectionist instrument. Rules of origin can be defined in such a way that they are nearly impossible to fulfil, or that they will give a disadvantageous origin to the imported product. Confronted with such rules, operators may prefer to stop importing goods from certain sources, in favour of goods originating in the importing country itself, or in countries with which preferential trade agreements have been concluded.

It must also be noted that the determination of the origin of a product is important for the labelling of this product. In general, trademarks play a considerable role in the choice of the consumers. Well known trademarks will be much more sought after, if they are associated with quality in the mind of the customers. Those will be ready to pay a premium for a product bearing a famous trademark. Trademarks do no~~n~~'t give however any indication about the country of origin of the product. They only mean that a firm has accepted to put its name on a product, wherever it was made. In order to inform the consumer about the origin of the product, most countries impose that a label indicating the country of origin of the product has to be affixed on it. This can cause disagreements to the producing firm. Consumers may be reluctant to pay a premium, even if the product bears a well known trademark, if this product appears to be originating in a low cost third world country. The quality of the product may be questioned by that origin label.

In some cases, the origin of the product is determined by the origin of its components. Transformations took place on the territory of an industrialized country, but those are considered to be insufficient to determine the origin of the product.

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[2] See N. ZAIMIS, *EC Rules of Origin*, London, Wiley/Chancery Law Publishing, 1992, p. 5 and F. DEHOUSSE and P. VINCENT, *Les règles d'origine de la Communauté européenne*, Brussels, Bruylant, 1999, p. 3.

Consumers will ignore the (sometimes symbolic) value added by the substantive operations having taken place on this territory. The problem is particularly true for textile products. Special rules have to be taken to insure that the operations performed on the territory of industrialized countries will effectively be notified to the consumers.

The international legal status of the rules of origin is a little bit puzzling. The problem is fundamental for the development of trade exchanges. Its legal setting in the GATT has remained nevertheless limited for a long time. If many provisions of the GATT refer to the origin of products[3], it contained until 1994 no specific definition of this notion. The problem was largely dealt with in the context of the World Customs Organisation, whose rules are also limited. The Kyoto Convention of 1973 defines indicatory rules only in one of its annexes[4]. Litigations have remained limited, though there were regular problems in the negotiation of bilateral or multilateral trade agreements (the cars' origin in the NAFTA agreement, for example).

During the Uruguay Round, WTO members agreed to harmonise non-preferential rules of origin for all agricultural and industrial products. The work was initiated first in the World Custom Organisation (WCO), in order to solve technical interpretations. It went then to WTO level for final negotiation. This work was planned to end by 1996. Due to wide divergences between the European Community and the USA, and, afterwards with developing countries, the WTO was forced to post-pone twice the conclusion of the negotiations. While technical discussions in the WCO are closed, a big amount of "unsolved items" remains to be negotiated before, hopefully, the WTO Ministerial Conference in Doha (November 2001). Textile and clothing is one of the sectors for which the biggest number of unsolved problems is found.

A serious dispute arose in 1996 between the European Community and the United States concerning a change in the American legislation for the determination of the origin of some textile and clothing products[5]. This change generated the opposition of some European Community (EC) producers. According to them, the modification was violating the international rules. Consequently, they asked the European Commission to begin a Trade Barrier Regulation (TBR) process[6].

The TBR was established in 1994 by Regulation 3286/94 EC[7]. This instrument was the successor of the New Trade Instrument created in 1984 by Regulation 2641/84 EEC[8]. In 1994, in the context of the establishment of the single market, the TBR regulation increased the possibilities offered to the EC exporters to complain about trade barriers in third countries. The complaint about the new American rules of origin was the first one in that new context.

This litigation presents therefore a double interest. Firstly, it lightens a fundamental trade question where litigation has remained rare till now. Secondly, it gives precious indications about the functioning of the new European regulation. This

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[3] See for example articles I and XXIV § 8 GATT.

[4] Annex D1; for the text, see decision 77/222 EEC, *OJ* 1977, L 166/1. See also *infra*, § 2.1.3.

[5] For the sake of brevity, textile and clothing products will be henceforth contracted to "textile products", except when expressly indicated. By this, one means to cover products in categories 50 to 73 HS of the Harmonised System of the World Customs Organization.

[6] *OJ* 1996, C 351/6.

[7] *OJ* 1994, L 349/71, modified by Regulation 356/95 CE (*OJ* 1995, L 41/3).

[8] *OJ* 1984, L 252/1.

one has meanwhile become a cornerstone of the EC trade policy. After having described the origin of the conflict (§ 1) and the American rules of origin (§ 2), we will study the development of the conflict (§ 3) and the harmonization process underway within the WTO (§ 4). We will conclude with some general comments (§ 5).

1. The birth of the conflict

1.1. The special regime of textile products under the GATT

Trade in textile products has for a long time escaped to the free-trade principles established in the GATT 1947. The USA was among the hardest proponents of a protectionist policy in that field. The reasons for this are to be found in the importance of the textile sector for the employment policy of industrialised States. Textile remains a labour-intensive industry, which requires low skilled workers. Once laid off, those encounter great difficulties to recover a new job.

The textile sector was however one of the first in which developing countries choose to invest in their industrialisation process. From the mid-50s, those countries began to export more and more to the markets of developed countries. In order to fight against the imports of products originating in low wages countries, protectionist measures were taken as early as the end of the 50s. The United States concluded then bilateral export restraint arrangements with Italy and Japan.

The conclusion of bilateral agreements was however an unsatisfactory solution. Market shares of countries subject to those agreements were taken over by others, such as Egypt, Pakistan and India. Moreover, the patronage of the GATT was asked to enforce the legality of these agreements, which was doubtful. This led to the conclusion in 1961 of the "Short Term Agreement on Cotton Textiles" (STA). This was replaced in 1962 by the "Long Term Agreement" (LTA), and eventually in 1975 by the Multifibre Agreement (MFA)[9].

The contents of these agreements were very similar. Their official motivation was the expansion of world trade in textile. In fact, they allowed the conclusion of bilateral agreements aiming at limiting the exports of textile products from the developing countries. Those agreements were qualified as ”voluntary export restraint agreements”. Exporting countries were considered to have voluntary accepted to conclude them in exchange of the certainty of a minimum guaranteed access for their products in the industrialised countries.

Those agreements took a great deal of textile trade outside the scope of the GATT. Their legality was doubtful. None of them was however ever challenged, even through the limited dispute settlement mechanism of the GATT 1947.

1.2. The progressive reintegration of textile trade within the rules of the GATT

[9] For a comment about the evolution of the monitoring of international trade in textile products, see N. BLOKKER, *International Regulation of World Trade in Textiles. Lessons for Practice. A Contribution to Theory,* Dordrecht, Martinus Nijhoff Publishers, 1989.

The application of such measures was however a challenge for the credibility of the GATT. The Leutwiler Report, published in 1985, proposed their abolition and the return of textile trade within the rules of the General Agreement[10]. The Uruguay Round negotiations led to the adoption of an Agreement on textile and clothing (ATC). This organised a 10 years phase-out (ending in 2005) of all specific trade restraints imposed to the imports in the textile and apparel sectors[11].

2. The reaction of the American textile industry and the 1996 modification of American rules of origin for textile products

American textile producers were afraid about the effects of this new liberalisation perspective. They feared the loss of market shares. They asked subsequently the adoption of protection measures to their political representatives. Those took the form of a modification of the US rules of origin for textile products.

2.1. The different fabrication stages of a textile product

It has to be remembered that a textile fibre undergoes several fabrication stages before becoming a finished product. The silk or cotton fibres have first to be spinned into yarns. Yarns are woven together in order to form cloths. Those, at the final stage, are transformed into articles of clothing. Each of these stages means a change in the tariff heading of the subsequent product[12].

2.2. The old US system

2.1.1. <u>The rules of origin in force until July 1st, 1996</u>

According to US legislation, up to July 1st, 1996, a textile product was recognised as originating in the country where it underwent any of the (5) following operations[13]:

1) dyeing of fabric and printing, when accompanied by two or more of the following operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing or moireing.

This rule was known as the "four operations rule". Four operations had to find place on the territory of a State to qualify this State for attributing its origin to the final clothing product.

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[10] For the text of the Leutwiler Report, see *Trade Policies for a Better Future. The Leutwiler Report*, Dordrecht, , Martinus Nijhoff Publishers, 1987.

[11] See BAGCHI, The Integration of Textile Trade into GATT, *JWTL* (1994/6), pp. 31-42.

[12] This means that the product is classified in a tariff position different than those of its components.

[13] 19 CFR 12.130.

2) spinning fibres into yarn;

3) weaving, knitting or otherwise forming fabric;

4) cutting of fabric into parts and the assembly of those parts into the completed article;

5) substantial assembly by sewing and/or tailoring of all cut pieces of apparel articles which have been cut from fabric in another territory or country, or insular possession, into a completed garment (e.g. the complete assembly and tailoring of all cut pieces of suit-type jackets, suits and shirts).

The alternative to the "four operations rule" was a substantial transformation (resulting in fact in a change in tariff heading) of a textile product on the territory of a State.

2.1.2. Examples of application of those rules

a) the determination of the origin of silk scarves

Silk cloths were generally woven in China, where they got a Chinese origin (the silk being itself of Chinese origin or not). They were then exported to the territory of a Member State of the Community (for example, Italy). They were dyed and printed, and they underwent the preparing or finishing operations on the territory of that State. The subsequent silk scarves were therefore considered as originating in the State where they had undergone the four operations (*in casu*, Italy).

b) the determination of the origin of bed linens

The same kind of rules was applied to bed linens. The cloths were often woven on the territory of an Asian country (for example Pakistan). They were then exported to the territory of a Member state of the Community (the United Kingdom, for example), where they underwent dyeing, printing and two other operations. Those allowed the finished product to be considered as originating in that State (*in casu*, the UK), because they had undergone the four operations on its territory.

2.1.3. Comparison with the rules in force in the European Community

The legislation of the European Community is far more complex. It must be noted that a fundamental distinction is made between textile products originating in countries with which the EC has concluded preferential agreements[14] and those originating in countries with which the EC has not concluded such an agreement. All preferential agreements concluded by the Community contain a protocol devoted to the definition of the origin of the products[15]. For products originating in countries for which

[14] This concerns the Eastern European and the EEA countries, the Maghreb, Mashreq and ACP ones, and those benefiting from the EC GSP.

[15] For countries benefiting of the GSP, the rules are laid down in articles 67 to 79 of Council Regulation 2454/93 EC (*OJ* 1993, L 253/1).

no preferential agreement exists, rules of origin are laid down in Council regulation 2454/93 EC[16]. In this regulation, the basic rule is that textile products are originating in the country where they undergo a change in tariff heading[17]. Many products have however to fulfil specific requirements[18]. Sometimes, a specific operation will confer the origin to the product.

The EC makes a difference in its origin rules in order to limit tariff preferences to products really originating in the territory of its preferential partners. In the case of a woven fabric, non-preferential rules state that dyeing or printing operations are sufficient to confer a non-preferential origin. EC preferential rules are more stringent. Woven fabrics are considered as originating in the country where they underwent printing accompanied by at least two preparatory or finishing operations. Moreover, a value added criteria has often to be fulfilled. Loom state fabrics (i.e. not dyed and not printed) will therefore be considered as originating in the country in which they were woven. This means that a cloth woven in Pakistan (whatever the origin of the yarn) will get a non-preferential Pakistani origin if it doesn't undergo a transformation process (i.e. printing) on the territory of another State. If it undergoes printing and preparation or finishing operations on the territory of the UK, for example, it will get a Community origin.

As a matter of consequence, the American non-preferential rules of origin (i.e. dyeing and printing) are more stringent than EC ones, but are similar to the preferential rules applied by the EC

The Community legislation has also recourse to a value added criterion in some cases. Sometimes, this criterion is also combined with a specific process requirement. There can also be an alternative between both criterions. This is for example the case for embroidered scarves and handkerchiefs. They will get the origin of the country where they are woven. Unembroidered cloths can however be used, if a value of 60% is added by the process. In addition woven printed fabrics obtained the preferential origin if additional processes confer at least a 52.5% added value.

Such rules are often seen as being drastic. Annex D1 of the Kyoto Convention of 1973, devoted to the definition of rules of origin, suggests the use of three kinds of techniques for the determination of the origin[19]. Those techniques are: change in tariff heading of all components of the finished product; minimum added value; technical operation. In this context, both the USA and the EC resort to technical criterions often combined with others. The use of such rules allows insuring that a substantive part of the production process will take place on the territory of developed States (or countries with which they concluded preferential trade agreements).

The generalized use of the change in tariff heading criterion would make the attribution of origin easier. In this hypothesis, the transformation of a dyed or printed silk cloth (positions 5007 2059 or 5007 2071 of the Harmonized Nomenclature) into a tie (position 6215) is sufficient to attribute to the tie the origin of the country where it was transformed. A silk cloth printed in China (whatever the country in which it was

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16 *OJ* 1993, L 253/1.

17 Articles 36 to 38 of Council Regulation 2454/93 EC.

18 Annex 10 of Council Regulation 2454/93 EC.

19 For the text of the annex, see decision 77/222 EEC (*OJ* 1977, L 166/1).

woven) and cut in Italy to be transformed into a tie would get a EC origin. The same reasoning applies for the transformation of a cotton cloth (positions 5209 31 or 5209 51), dyed or printed in China, into a bed linen (position 6302 10) in Italy. In this hypothesis, printing or dyeing operations may take place outside the territory of the Community without any result for the final attribution of a EC non-preferential origin to the finished product.

The objective of drastic rules is to prevent textile products from easily receiving the origin of countries in which they underwent limited transformations. Some new industrialised countries of Southeast Asia could otherwise try to circumvent the quantitative restrictions applied to their exports of textile products. They could do so by exporting semi finished products (*in casu* dyed or printed cloths) to third countries, in the hope that the origin of those countries (for which no quantitative restrictions for the exports of textile products are applied) would be attributed to the finished cloths. During the glorious period of the Multifibre Agreement, this was used for example by Japanese textile producers, who sent their products to Asian underdeveloped countries. Chinese operators go along exactly the same line in the present period.

The severity of the rules of origin applied by industrialised countries prevents such circumvention. Textile products have to undergo a substantial transformation (and dying and/or printing accompanied by preparing or finishing operations are considered as such both by the EC and the US) on the territory of a State to be considered as originating in this State. This is at the advantage of developed countries. As their exports were not subject to quantitative restrictions, it is advantageous to finish cloths on their territory, even if the wages were higher than those applied in Southeast Asia.

2.2. The new 1996 US rules

In order to soften the effects of this liberalization, the United States administration decided to harden the rules of origin for those products. The new rules were applicable from July 1, 1996.

According to the 1996 legislation[20], the product originates in a country if:

1) the product is wholly obtained or produced in that country;

2) the product is a yarn, thread, twine, cordage, rope, cable or braiding, and: i) the constituent staple fibres are spun in that country, or, ii) the continuous filament is extruded in that country;

3) the product is a fabric, and the constituent fibres, filaments or warns are woven, knitted, needled, tufted, felted, entangled or transformed by any other fabric-making process in that country, or

4) the product is any other textile or apparel product that is wholly assembled in that country from its components pieces.

[20] 19 USC § 3592, known as the "Breaux-Cardin" rules.

The "four operations rule" disappeared in the 1996 legislation. A textile product was considered as originating in the country in which the fabric was woven or sewed. The final product had to be assembled in a country to get the origin of this country.

2.2.2. Examples of application of those rules

a) the determination of the origin of silk scarves

If we take the previous examples, silk scarves were considered as finished products. Even if the original material was dyed and printed in Italy, they were considered as originating in the country in which the constituent fibres were woven, *in casu* China. Even such economically important operations as dyeing and printing were not considered as sufficiently important to attribute the origin.

b) the determination of the origin of bed linens

The same line reasoning applied to bed linens. These were also considered as finished products. They were therefore considered as originating in the country in which the cloths were woven, *in casu* Pakistan, even if dyeing, printing and two other operations were realised in the United Kingdom.

3. The dispute between the US and the EU

3.1. The problems caused to EU textile producers by the new US rules of origin

The new US rules of origin caused different problems to EU textile producers.

3.1.1. The submission of previously freely exported products to quotas

The European producers of textile fabrics, who used to export them freely to the US clothing producers, were now subject to quotas. According to the pre-1996 legislation, the printing and dyeing of a cloth, with two other operations, were enough to attribute the origin of a Member State of the EU[21] to the finished product. Now, the fabric had to be woven in the European Union to be considered as originating in one of its Member States. Fabrics printed and dyed in the European Union from cloths woven in Turkey, for example, were now considered as of Turkish origin by the US administration, no matter where the cloth was last proceeded. In case of a fabric woven in a developing country whose exports were submitted to US quotas (such as Egypt, Indonesia, Malaysia, Pakistan, Thailand and Turkey), the fabric was now subject to the quotas allowed to these countries[22]. As a consequence, the exports of European textile products to the US were *de facto* restricted.

[21] The US legislation does not recognise the Community origin. A product of the EC can only have the origin of a Member state of the EC.

[22] According to the ATC, the trade in textile products and apparel will only be fully liberalised (between the Member States of the WTO) in 2005. This evidently does not take into consideration a quicker liberalisation foreseen between specific countries in regional free trade agreements, for example.

3.1.2. The labelling problem

There was another connected consequence. A problem appeared in the field of labelling of silk accessories, such as scarves and foulards. According to the pre-1996 legislation, foulards printed in Italy were considered as originating in this country. A "made in Italy" label could therefore be affixed on it. From July 1996, the same foulards were henceforth considered as originating in China, were the fabric was woven. A "made in China" label had therefore to be sewed on the foulard instead of a "made in Italy" one. The new appellation was, of course, less appealing for wealthy American consumers than the old one.

3.2. The first WTO dispute settlement procedure

The European Community took the decision to challenge the new American rules of origin in the WTO[23]. The new WTO dispute settlement system states that conflicts between WTO Members States must first be subject to a conciliation procedure. If litigating parties cannot agree on an acceptable solution, a panel of experts will be charged with the resolution of the conflict[24]. In this dispute, parties didn't go further than the conciliation phase. No panel was ever appointed.

3.2.1. The arguments invoked

a) the Agreement on rules of origin

An Agreement on rules of origin was adopted at the end of the Uruguay Round negotiations[25]. This Agreement provides for the elaboration of uniformed rules of origin for non-preferential trade relations. Those could however not be invoked. The harmonization process had to be finished for July 20, 1998. No result could however be reached within this delay. A new deadline had been fixed in 1999. It has also been breached. Consequently, at the moment when the dispute broke up, there were not yet uniform rules of origin applicable in this context[26].

Article 2 (c) of the Agreement states however that, during the transition period, Members shall ensure that their rules of origin shall not themselves create restrictive, distorting or disruptive effects on international trade. This argument, however, was not the main one in the dispute.

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[23] Case WT/DS85.

[24] For comments on the WTO dispute settlement procedure, see E-U PETERSMANN, *The GATT/WTO Dispute Settlement System*, Deventer, Kluwer, 1997.

[25] For comments on the Agreement on rules of origin, see KEIJZER, GATT Agreement on Rules of Origin: its Purpose and Implications from a European Community Perspective, *in* J. BOURGEOIS, F. BERROD and E. GEPPINI FOURIER (eds.), *The Uruguay Round Results. A European Lawyers' Perspective*, Bruges, College of Europe and European Interuniversity Press, 1995, pp. 331-352, and VERMULST, Rules of Origin in the Future: Selected Issues, *idem* , pp. 353-360.

[26] For a discussion about the harmonization process of rules of origin within the WTO, see § 5.

b) article 4 § 2 of the Agreement on textile and clothing (ATC)

The EC choose to challenge the new US legislation on the ground of article 4 § 2 of the ATC. The drafters of the ATC were aware that the liberalization of trade in textile products would incite Member States to adopt technical measures in order to impede as much as possible the liberalization process. Article 4 § 2 of the ATC provides therefore that "Members agree that the introduction of changes, such as changes in practices, rules, procedures and categorization of textile and clothing products (...) should not upset the balance of rights and obligations between the Members concerned (...); adversely affect the access available to a Member; impede the full utilization of such access; or disrupt trade under this Agreement". Article 4 § 4 provides moreover that "when changes mentioned in paragraph 2 (...) are necessary, however, Members agree that the Member initiating such changes shall inform and, whenever possible, initiate consultations with the affected Member or Members prior to the implementation of such changes, with a view to reaching a mutually acceptable solution (...)".

US negotiators quickly recognized that the new legislation was a breach of article 4 § 2 of the ATC. It was therefore unnecessary to go further in the dispute settlement process.

3.2.2. The conclusion of the first "Procès-verbal"

A first agreement, known as the "Procès-Verbal" (herein referred as PV), was; reached between the parties to the dispute. This agreement covers dyed and printed textile and apparel products (§ 2 *ab initio* of the PV). It contains different commitments.

a) the US commitments contained in the PV

The US Administration accepted to amend the US legislation on rules of origin for textile products. It proposed that this change could happen after the conclusion of the WTO harmonization process in the field of the rules of origin, scheduled for July 20, 1998. In this harmonization process, the US committed to reintroduce their prior rules of origin for silk accessories and fabrics, and for dyed and printed cotton, man-made fibre and vegetable fibre fabrics (§ 2 *in fine* of the PV).

The US Administration announced also that it would submit to the Congress an amendment to the US rules of origin for the "above" products (without mentioning if it refers to the categories listed at the end of § 2, or to the "dyed and printed textile and apparel products", such as referred at the beginning of § 2), in order to bring these rules in accordance with those set forth in 19 CFR 12.130, or with the results of the WTO harmonization process (§ 3 of the PV).

In order to facilitate trade between the two parties, the US made three further commitments in the PV:

- European silk scarves and fabrics were allowed to be marked with an appellation equivalent to "designed in (a Member State of the EC)". This was supposed to make those silk products more attractive on the American market;

- different categories of cloths originating in Egypt, Turkey, Thailand and Indonesia were exempted from quantitative restrictions and textile visa requirements;

- the US administration also committed to take the necessary procedures to remove from quota coverage some categories of printed fabrics originating from Malaysia, Indonesia and Thailand (§ 6 of the PV).

b) the EC commitments

In exchange of these commitments, the EC accepted to suspend the case referred to the WTO Dispute Settlement Body (§ 7 of the PV).

3.2.3. The proposition of implementation of the first US-EU agreement

On July 20, 1998, no agreement was reached in the WTO harmonization process of rules of origin. On July 30, a bill was submitted to the Senate of the United States in order to amend the rules of origin of textile products[27]. This bill set forth special rules of origin for certain textile products.

- fabric of silk, cotton, man-made fibre or vegetable fibre should be considered to originate in the country in which the fabric is dyed and printed if at least two of the following finishing operations are performed in such country: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing or moireing;

- silk accessories should be considered to originate in, and be the growth of, the single country in which the fabric for the accessory is cut into parts and assembled into a completed good. If the fabric of a silk accessory is not cut into parts and assembled in a single country, it shall be considered to originate in the country in which the fabric for the accessory originates.

The first rule saw the come back of the "four operations rules", but only for the fabrics. The comeback to the old rules of origin was therefore limited. The two main problems remained.

3.2.4. The negative reaction of the EC

According to the EC, two problems would have remained, even if the Congress had adopted the bill.

The first problem concerned silk accessories. According to the old legislation, a scarf had the origin of the country in which it was dyed and printed. According to the new one, it would have been considered as originating in the country in which the cloth was woven, *e.g.* China. The solution didn't change compared to 19 USC § 3592.

The second problem concerned finished products (such as bed linens). These were excluded from the scope of the amendment. They remained subject to the 1996

[27] 105th Congress, 2d session, S.2394

rules. They were considered as originating in the country in which the fabric was knitted or woven (instead of the country in which the four operations took place). This would have led to unrealistic situations. A fabric woven in China but dyed, printed and finished in Italy would have been considered as originating in Italy. If the same fabric was then cut and sewn to produce a tablecloth, it would have got a Chinese origin (the country in which the fabric was woven) again.

The solution was therefore unsatisfactory for the European textile producers. In a letter dated October 2nd, 1998, the Commission reproached the United States Administration to have introduced specific exceptions in the legislation, instead of a general "four operations rule" covering all textile products. It made therefore technical proposals for amending the draft bill. It has also indicated that it reserved the right to request WTO consultations if the amendments were not correctly enacted.

No changes were however brought in the US legislation on rules of origin. The Congress refused to enact the amendments proposed by the US administration. The draft bill for an amendment of the general marking rules was also refused. The change in the marking legislation concerning the "designed in Italy" label did not happen.

The European Community pretended therefore that the United States did not fulfil their obligations resulting from the PV. The US administration, however, considered that its sole obligation was to *submit* the propositions of amendment to the Congress ("The US Administration will propose to the Congress", § 3 of the PV; "The US will immediately begin the process in accordance with its domestic laws and procedures", § 6 of the PV).

According to the US Administration, the finished products (such as bed linens) were excluded from the scope of the PV. This concerns only "silk accessories, silk fabrics, dyed and printed cotton fabrics, dyed and printed man-made fibre fabrics and printed vegetable fibre fabrics" (§ 2 of the PV). The obligations of the American administration were therefore considered as being fulfilled, and the EU could not complain. The EC, on its side, argued that the "above products" referred to in § 3 of the PV are the "dyed and printed textile and apparel products" mentioned at the beginning of § 2 of the PV.

Another problem had come to light more recently. European textile producers have invented a new production technique of yarns (called "devorage"). Two fibres are melted to make a single one. According to the European textile producers, this technique brings a "substantial transformation" to the fibres. It should consequently be considered as sufficient to attribute the origin of the country in which it takes place. This operation was not taken into consideration by the US legislation. The only solution seemed to incorporate this technique in the discussions underway on the harmonization of rules of origin within the WTO.

The EC accepted to postpone the formal conclusions in the WTO "in view of the commitments by the US in respect of forthcoming *legislative amendments*"[28] (§ 7 of the PV). These did not happen. The EU reserved the right to revive the consultations in the event that the US *do not introduce, and thereafter timeously (without further precision) enact, the legislative amendments as proposed above*. It was therefore clear that in the

[28] We stress.

view of the EC, the suspension of the consultations was conditioned by a real legislative amendment, not by an attempt to do it. The EC revived therefore the consultations within the WTO[29].

3.3. The second agreement

Parties to the dispute reached a new agreement (also known as "Procès verbal", hereinafter referred as PV II) in August 1999. In this agreement, the US Authorities committed themselves to submit to the Congress a bill aimed at modifying 19 USC 3592. This text was adopted on 18 may 2000, as Section 405 of the Trade and Development Act of 2000 entitled "Clarification of Section 334 of the Uruguay Round Agreement Act"[30].

This text introduced a § 2 B and C in 19 USC 3592. According to the new § 2 B, "notwithstanding § 1 C, fabrics made of silk, cotton, synthetic or vegetable fiber(s) shall be considered to originate in, and be the growth, product or manufacture of, the country, territory or possession in which the fabric is both dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing".

The text as amended sees the comeback of the "four operations" rule. Fabrics (except those of wool) will be considered as originating in the country where they underwent the final transformation operations. The only difference with the pre-1996 legislation is therefore the exclusion of wool fabrics from that general rule.

§ 2 C is a little bit ambiguous. It states that notwithstanding § 1 C, some goods (such as scarves and handkerchiefs, and bed linens, curtains, furnishing articles and cushions), except if they are classified as of cotton or of wool, or consisting of fibre blends containing 16% or more, shall be considered to originate in, and be the growth, product or manufacture of, the country, territory or possession in which the fabric is both dyed and printed when accompanied by two or more of the following finishing operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing, or moireing".

§ 2 C seems to exclude certain cotton products from the scope of the exception. For the categories concerned, only silk, vegetable or man-made fibres products will benefit from the four operations rule. Others, such as cotton bed linens, will still be subject to the general rule. They will still be considered as originating in the country where the fabric was woven.

§§ 2 B and C have therefore to be read as alternatives. They stress a complex set of rules of origin for textile products:

- wool products remain excluded from the scope of the new rules. Wool products will therefore be originating in the country in which they are knitted or woven;

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[29] Case WT/DS151.

[30] For the interim rules amending the customs legislation adopted by the US Customs services, see the US Federal Register of 1 May 2001 (66 Fed. Reg. 21,660).

- all silk, man-made fibres or vegetable fibres products will be originating in the country in which the four operations took place. In our previous example, silk scarves will be considered as originating in Italy;

- the same rule applies for cotton or consisting of fiber blends containing 16% or more by weight of cotton products, except for certain of them, specifically listed. Those will also be considered as originating in the country in which the fabric was woven. Bed linens will therefore be considered as originating in the country in which the fabric was woven, *i.e.* Pakistan. They will therefore remain subject to quantitative restrictions until the moment of their liberalization.

The EC seems to be satisfied with this solution. It resolves the problem of the quantitative restrictions applied to most goods undergoing their final transformation on the territory of the Community. Those will be considered as originating in the Community. No quantitative restrictions will therefore apply. It also resolves the labelling problem. "Made in (for example) Italy" labels can be affixed on these products, considered as originating in that country.

The EC has however conceded that certain cotton products will remain subject to the ancient rules.

PV II contains also a second point. US authorities agree[31] that a single import visa invoice/licence can be used on multiple shipments of bed, table toilet and kitchen linens, curtains, furnishing articles or cushions.

4. The harmonization process within the WTO

According to the Uruguay Round Agreement on rules of origin, a very ambitious harmonization process will take place within the WTO. It aims at harmonizing the rules applied by all Members States in their non-preferential trade relations (*e.g.* the relations with those countries which they didn't conclude preferential trade agreements with).

The agreement has created a technical Committee on rules of origin. His task is to make harmonization proposals that all the Members States of the WTO will have to accept. If this Committee can fulfil its mission, Members States will lose a great part of their sovereignty in the determination of the origin of the products they import.

The agreement is in favour of the change in tariff heading criterion for the determination of the origin of goods in the production thereof more than one country intervened. For the sectors where the exclusive application of this criterion would be insufficient, the Committee may study the possibility of applying other criterions. Among these, the *ad valorem* and the technical criterions can be considered. Rules of

[31] The relevant US regulation has been amended in that way by the "Amendment of Export Visa and Quota Requirements for Certain Textile Products Produced or Manufactured in All Countries and Made Up in the European Community (EC)", as published in the US Federal Register of 6 December 1999 (64 Fed. Reg. 68,087).

origin will have to be based on positive criterions. Negative criterions can only be used to clarify positive ones (article 9 § 1 g) of the Agreement).

Initially, the harmonization process had to be achieved on July 20th, 1998. The Committee made a proposal in September 1996[32]. No agreement could however be reached on certain products, in particular textile and clothing. There is an opposition between the European Community and its partners. If the Community accepts the use of the change in tariff headings criterion for most products, it proposes a value added criterion of 45% for the most sensible products (textile and clothing, electronical products, telecommunication equipments and cars). There is a double justification for this proposal. The Community seeks to avoid the circumvention of commercial policy regulations by the simple transfer of the assembly of textile products. Those would get the origin of countries in which they got a small added value. The EC textile industry also fears that the recourse to the change in tariff headings criterion would lead to the attribution of the origin of the country were the products were woven, even if an important value was added on the territory of the EC. This would cause labelling problems (*made in China* or *made in Pakistan* labels being less attractive than *made in the EC* ones).

The main trading partners of the EC (the US, Japan, Canada and most developing countries) are in favour of the general recourse to the change in tariff headings criterion. The Community suggests therefore to complete this general criterion by objective ones (still to define) for textile products. It hasn't however succeeded yet in convincing its trade partners. A new deadline has been fixed at the Fourth Session of the Ministerial Conference, or at the latest at the end of 2001[33]. Discussions are underway to determine if certain specific operations could be considered as origin conferring[34]. Concerning silk accessories, for example, the US consider that they should be considered as originating in the country of the fabric (which would mean a comeback to the Breaux-Cardin rule). The EC, on the other side, considers that the fibres should be considered as originating in the country where they were changed from yarns. For the finished products, they should be considered as originating in the country where they were dyed and printed, with preparatory or finishing operations[35]. It must be noted that the EC position is only supported by Turkey, when the US one is supported by countries such as Canada, Japan, Korea, Argentina, Australia, New Zealand, Egypt…The perspective is therefore quite bad for the EC interests. The harmonization process could ironically annihilate the positive results of the WTO dispute settlement procedure.

What would be the consequences? Silk scarves printed in the EC on fabrics originating in China would again be considered as of Chinese origin. They would therefore be subject to the quantitative restrictions applied by the US on the imports of textile products originating in this country. Trade in textile and clothing will however (normally) be completely liberalized by January 1st, 2005. The situation would therefore only be difficult until that moment. The problem of labelling would however remain. A *made in China* label, less appealing than a *made in Italy* one would still be affixed on them. The EC should therefore negotiate in order to be authorized to affix a *designed in Italy* label on its silk accessories.

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32 Doc. G/RO/W/13/Rev.1.

33 Doc. G/RO/M/33.

34 Doc. G/RO/45/Add.1.

35 *Idem*, § 48.

Concerning bed linens[36], the situation is more or less the same. The US (supported by Argentina, Brazil, Canada, Japan, Korea…) argue that they should be considered as originating in the country of origin of the fabric. The EC (only supported by Turkey) considers that a change in tariff heading (with some restrictions) would be sufficient.

The success of the harmonization process would of course facilitate the expansion of textile trade (and, by the way, bring a solution to the dispute between the EC and the US once for all). The intemperate application of the "change in tariff headings" criterion would probably greatly modify the patterns of international textile trade. Developing countries could print and die themselves the cloths they export to the markets of developed States. The finished products (silk scarves and bed linens) would be considered as originating in the country where they underwent the final transformation.

According to the EC textile industry, the application of this criterion would reduce job opportunities on the territory of developed States, where labour costs are higher than in developing countries for printing and dying operations. The application of a value added criterion or complementary operations in addition to the basic "change in tariff headings" criterion) would therefore soften the results of the rules of origin harmonization process, and leave the textile trade patterns roughly unchanged.

5. Conclusion

Two kinds of conclusions can be drawn from this case. First, the liberalization of textile trade has created many protests among the textile producers. Many of them fear that trade liberalization will mean the disappearing of this industry on the territory of the most industrialized countries. Governments confronted with those complaints have tried to find ways to soften the liberalization process as much as possible. Different solutions were chosen.

The ATC itself allows member States to impose quantitative restrictions on the import of specific textile products during the transition period if certain conditions are met (article 6 of the ATC). It must be demonstrated that a particular product is being imported into the territory of the State in such increasing quantities as to cause serious damage, or actual threat thereof, to the domestic industry producing like and/or directly competitive products. The measures should be applied on a Member-by-Member basis, after consultations. The quota allowed should be fixed at a level not lower than the level The WTO has however exerted a strong control on the use (and abuse) of those measures. The USA were condemned in 1996 for having imposed unauthorized restrictions on the trade of certain textile products originating in India and Costa Rica[37]. Those measures were quickly withdrawn. Since then, the use of such measures seems to remain very limited.

[36] *Idem*, § 59.

[37] WT/DS24 and WT/DS33

Many governments have therefore decided to resort to technical barriers to trade to impede textile flows. Origin legislation has been used, as demonstrated in this case. Other legislations, such as those concerning labelling, have also been used.

The recourse to this kind of technical measures demonstrates a fundamental change in the protectionist habits. For a long time, customs duties and quantitative restrictions have been the favourite weapons of every protectionist policy. With the evolution of GATT and WTO, it is always more difficult to use them. Tariffs have drastically gone down due to the GATT tariff negotiation rounds. Quantitative restrictions are severely supervised. Governments resort therefore to technical weapons to distort international trade.

Those new instruments are much more difficult to fight than the classical ones. It is sometimes very difficult to find a legal argument to fill a complaint against them. Many WTO texts state that Member States will not resort to barriers, or that they will do their best to avoid creating problems to trade. Those prescriptions are very vague. The DSB has not had the opportunity yet to rule about the interpretation of such dispositions.

The second conclusion is that the DSB, in spite of many fierce critics, has proved its usefulness. This very technical and politically important case could be solved without resorting to counter-measures. It was even not necessary to establish a panel. The solution could have been the same under articles XXII and XXIII GATT. Consultations were already possible in that system. Parties to a dispute were however not very encouraged to find a mutually agreed solution. They knew that they could stop the dispute settlement procedure at each moment. The situation has drastically changed now. The defender knows that it cannot avoid the establishment of the panel and the adoption of this report. It is therefore an incentive to find a mutually agreed solution. At the present moment, 40 cases have been solved by a mutually satisfactory agreement (more or less 20% of the initiated cases).