

# The Rule of Origin – A Major Challenge for Developing Countries – A Case Study of Vietnam Under the CPTPP

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**Abstract:** The rules of origin in FTAs ensure that goods considered "originating" in the FTA will benefit from preferential tariffs, while goods originating outside FTAs will not benefit from preferential tariffs. Although such a rule provides many benefits to exporting countries, it also imposes additional burdens on the exporting Party, such as increasing the localization rate for goods and preventing goods imported from non-members of FTAs from enjoying preferential treatment. This paper examines the challenges that Vietnamese products face in terms of origin rules under the CPTPP agreement.

**Keywords:** CPTPP, FTAs, origin rule, Vietnamese products

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## 1. Introduction

Rules of origin are criteria for determining the country of origin of a product. Such standards aid in the determination of customs policy and taxation of a specific import product. Furthermore, origin rules and procedures are an essential component of any free trade agreement (FTA). They serve as a foundation for traders and parties to identify goods that are eligible for preferential tariff treatment under the agreement. There are two types of rules of origin: preferential rules of origin and non-preferential rules of origin.

### *Origin preference rules*

According to Annex II of the Rules of Origin rules, the general principles and requirements of the agreement on non-preferential rules of origin related to transparency, positive standards and administrative assessments, judicial, non-retroactive assessments, and confidentiality apply to preferential rules of origin as well. Laws applicable under the (Generalized System of Preferences) and EPAs (Economic Partnership Agreements) [1] are examples of rules of origin preference.

### *Non-preferential origin rules*

In terms of non-preferential rules of origin, each country has its own set of rules governed by the WTO. According to Article 5.1 of the Agreement, each Member shall provide the Secretariat with applicable rules of origin, judicial decisions, and administration of general application related to rules of origin within 90 days of the WTO Agreement's entry into force. The secretariat distributes to all members a list of information received and available to them [2].

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### 2. The outstanding point in the CPTPP's origin rules

In comparison to other FTAs signed by Vietnam, the CPTPP includes new provisions such as rules of origin, formulas for calculating NAFTA Regional Value Content (RVC), rules of origin for refurbished and recycled goods, and Production Surveillance Reporting (PSR).

#### *Rules of Origin and CPTPP Unique Features*

The CPTPP grants preferential treatment to non-originating goods if all of the non-originating materials used in their manufacture are met:

Any changes to the tariff classification requirements that are applicable;

The requirements of the manufacturing process;

Value content requirements by region;

or any of the other requirements listed in Annex 3-D (Product Specific Rules of Origin).

#### *Full accumulation*

The CPTPP, according to the World Customs Organization, provides for "full accumulation." According to Article 3.10 of the CPTP, an Originating Good or Material of one or more Parties used in the production of a good in the territory of another Party is deemed to have originated in that other Party's territory. Full accumulation allows the production process to be more fragmented and distributed across Member Territories. It will lower tariffs on the movement of CPTPP members' materials, build supply chains among members, increase supply of CPTPP members' materials and parts, and increase investment in CPTPP countries in the materials/parts sector. The various FTAs provide for varying levels of accumulation, and the CPTPP model is thought to be more trade-friendly than existing ASEAN agreements.

#### *System of self-certification*

For businesses, the rule of origin can be a limiting factor in procurement and production. This is especially true when ROO differs between FTAs and results in different certification of origin (C/O) procedures. The majority of the region's FTAs require government authorities to issue origin FTA certificates, which raises the administrative cost of claiming preferential duty.

Claimants can claim preferential treatment under the CPTPP self-certification system based on a C/O completed by the exporter, producer, or importer. There is no need for the C/O to be approved or authenticated by a government authority. The self-certification process will help to untangle the spaghetti bowl and simplify trade. However, as we discussed in our previous blog post, auto-certification under the CPTPP requires sufficient records to be kept for five years.

### 3. The impact of the CPTPP's origin rules on the Vietnamese economy

Vietnam expects the CPTPP to have a positive impact on its economy. The CPTPP includes more flexible rules of origin, which are critical for Vietnam to receive preferential tariff treatment, most notably:

Canada has agreed to eliminate duties in 95 percent of tariff lines, accounting for 78 percent of total Vietnamese export value. Canada has made a complete commitment to seafood and furniture products. When these items are imported into Canada, they will be duty-free. Vietnam also promises to eliminate tariffs on 66 percent of tariff lines upon joining the CPTPP. It raises duty-free tariff lines to 86.5 percent in three years while keeping tariff quotas on sugar, eggs, salt, and automobiles.

New Zealand: The CPTPP will improve access to the Vietnamese market for New Zealand's goods and services exports. The CPTPP will eliminate all outstanding tariffs on New Zealand exports to Vietnam, including 27% duties on paper and paperboard products by 2021, 18% duties on remaining fish and seafood tariff lines by 2021, and 59% tariffs on wine, beer, and spirits by 2029.

Japan: As soon as the trade agreement goes into effect, Japan will eliminate 86 percent of tariff lines for Vietnam, and nearly 90 percent after five years. This is the first time Japan has waived duties on most of Vietnam's agricultural and seafood imports. Japan has also promised to eliminate the import duty on Vietnamese leather shoes. The tax will be phased out in the 16th year after the CPTPP goes into effect.

#### **4. The current state of affairs in Vietnam in terms of the rule of origin issue**

Currently, Vietnam has signed and negotiated a number of free trade agreements that provide numerous benefits to the Vietnamese economy, such as receiving preferential treatment, gaining export advantages, broadening Vietnam's market, promoting globalization, and so on. Although Vietnamese products have gradually become more familiar to foreign markets, an increase in trade frauds, particularly trade frauds through the origin, has had a negative impact on Vietnam's economic growth.

##### **4.1. External cases**

In recent years, several countries have tended to use Vietnam origin in order to receive preferential bases from Vietnam under FTAs. After the performance of a commercial war between China and America, this issue has become increasingly contentious.

According to the statistics of the Vietnam International Arbitration Center (VIAC) of the Vietnam Chamber of Commerce and Industry (VCCI), the agency received 110 letters from 2018 to 2019 requesting a re-examination of 287 sets of Certificate of Origin (C/O). The items that must be examined are primarily clothes, leather shoes, tires, aquatic materials such as shrimp, fish, food items, and so on, from EU markets (90 percent), Taiwan, India, and Middle Eastern countries (about 10 percent) [3].

The EU saw a significant increase in the number of electric bicycles imported from Vietnam in 2018, which coincided with the time the European Commission (EC) was investigating and implementing anti-dumping and countervailing measures on products imported from China. To be more specific, according to data collected by the Vietnam Ministry of Industry and Trade, the amount of imported electric bicycles from Vietnam to the EU increased by 47,4 percent in the first 11 months of 2018, and the value of this item increased by 22,6 percent when compared to the same period in 2017.

As a result, there is a risk that Vietnam export enterprises will be investigated for tariff evasion, influencing other legitimate export enterprises. Furthermore, a similar case occurred in the United States, where steel enterprises in Vietnam were subjected to high import tariffs (over 400 percent) imposed by the United States. The reason for this was that goods had been identified that had previously originated in other countries and were then exported to Vietnam for export to the United States [4]. According to VIAC experts, the increase in the number of cases to check and retrieve the origin of goods is due to partners' concerns about counterfeiting signatures authorized to sign C/O and the issuing organization C/O following the law for goods not qualifying for "Vietnam origin." The "suspected" products of "Vietnamese origin" are frequently subject to a trade defense tax, which is widely exported to Vietnam's main markets [5].

##### **4.2. Internal cases**

In recent years, there has been an increase in trade fraud through labeling of origin goods produced in Vietnam. Many Vietnamese products and goods have proven to be of high quality, stability, and dependability. As a result of this fact, there are cases where goods are imported from abroad or outsourced, but they are still labeled as "Made in Vietnam" for commercial fraud and consumer misinformation. Furthermore, some businesses, such as Khaisilk, are involved in cases involving the origin of goods in Vietnam.

When silk towels were imported from China and sold with a brand made in Vietnam, Khaisilk violated rules on the origin principle. Khaisilk violated the Government's Decree No. 43/2017/ND-CP on the labeling of goods, dated April 14, 2017, because one of the contents that must be inscribed on goods labels was the origin of the goods. As a result, production and import organizations, as well as individuals, determined and recorded the origin of their goods, but they must be honest and accurate, as well as comply with the provisions of the law on goods origin. Furthermore, when Khaisilk became a well-known brand in the Vietnamese silk industry, it eroded consumer trust and severely harmed national pride.

Although most businesses followed the law and practiced business ethics, there were still some Vietnamese enterprises operating illegally and following business ethics. There were several causes of this phenomenon in the case of Khaisilk: (i) Profit targets had caused many businesses to violate the values of social morality and business to benefit; (ii) the phenomenon of societal moral decline. People were willing to "cheat, lie" in order to achieve their goals. Furthermore, foreign goods tended to borrow of Vietnamese origin in order to benefit "freely" and illegally from FTAs to which Vietnam is a party. Furthermore, because Vietnam had no regulations governing the criteria for goods to be labeled as "Made in Vietnam", domestic consumers had no way of distinguishing what was "Made in Vietnam," and they used "Made in Vietnam" products based on self-recognition or trust in unbranded brands [6].

According to the fraudulent information of the Khaisilk brand, Mr Tran Hung, Deputy Director of Market Management Department, stated that the origin of the silk scarf of the Khaisilk Group had seriously harmed the reputation of many Vietnamese people who had trusted the Khaisilk brand. When visiting Vietnam for diplomacy or business, Khaisilk silk towels were frequently given as gifts to international partners and friends.

In short, it is clear from Khaisilk's case that the consequences will have an impact on international customers' perceptions of Vietnamese products and brands. The loss of brand reputation is only one component; the most significant loss is the loss of trust in people such as customers and business partners. Furthermore, violating the origin of origin has a significant impact on the enterprise's business activities as well as the Vietnamese market economy. Fraudulent labeling in Vietnam not only directly affects specific products, but it also has a significant impact on the domestic industry, lowering the reputation and competitiveness of Vietnamese manufactured goods.

## 5. Recommendations

### *To organizations:*

To mitigate the aforementioned phenomena, it is necessary to review and revise ineffective regulations governing the origin of goods. Ministries may work together to investigate and resolve ambiguous rules that are governed by an agreement. Furthermore, negotiating with other partner countries to unify existing regulations.

Furthermore, organizations and agencies routinely research the products and countries that have implemented protection measures from countries with large markets such as the EU, the UK, and so on. Then, they must maintain a high level of alertness toward Vietnam enterprises that own those products and conduct a thorough examination. It is also necessary to construct a flexible and effective information system capable of providing and constantly verifying information about goods. It is necessary to have reliable verification of the authority to grant C/O of teams. More organizations or departments should be established to monitor, check, and issue C/O. Close collaboration is required between organizations and competent Ministries with relevant local agencies to detect and prevent commercial fraud activities as soon as possible, as well as to regularly update the methods used to detect and prevent trade frauds in order to inform enterprises and have appropriate punishments for violators.

*To the enterprises:*

In terms of enterprises, they should have specific knowledge of fraudulent activities as well as a basic understanding of rules or regulations. Furthermore, they should apply for the position of C/O at an organization with sufficient authority and a good reputation.

From the Khaisilk case to the problems associated with violations of the rules of origin in general, businesses must exercise caution when it comes to the origin of goods. Furthermore, enterprises should carefully consider their business plans and avoid violating the laws of origin of goods because of some profits that affect their reputation and Vietnam's reputation in diplomatic relations with international partners.

Furthermore, based on domestic and international practices, regulations on goods labeled in Vietnam are required to create a legal corridor to prevent trade frauds on goods origin and consumer protection. In the short term, labeling in Vietnam should be applied on the basis of voluntariness and self-declaration through an exchange between the Ministry of Industry and Trade and the Ministry of Science and Technology, the Ministry of Justice, the Central Institute for Economic Management (CIEM), the Vietnam Chamber of Commerce and Industry (VCCI), and many industry associations. When individuals or organizations perform labeling in Vietnam, however, the goods must meet the criteria and demonstrate that they meet the required standards. Individuals or organizations who record production stages in Vietnam must demonstrate that the goods undergoing production and processing stages have value in Vietnam [7].

## 6. Conclusion

In any case, rules of origin are a multifaceted policy tool. On the one hand, rules of origin reduce non-FTA countries' competitive advantage, strengthen trade among FTA member countries, and promote bilateral trade between beneficiary countries and GSP (Generalized System of Preferences) countries. Rules of origin, on the other hand, with strict origin criteria and complex rules for issuing and inspecting C/O, have limits on the openness of FTAs and GSP systems so that countries can participate in the FTA or GSP-benefiting countries avoids the effects of incentives higher than the MFN level. As a result, origin rules have both external and extroverted effects in protecting the domestic market. The origin rules reflect an important aspect of international trade: the "open" tendency coexists with "closed" measures, and liberalization coexists with security households. Because of complex economic and political factors, the inherent contradiction of the global trading system is two sides of a problem.

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