

*The International
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Determining the Preference Criterion under NAFTA and other Free Trade Agreements.

The basis for determining whether a good is originating (eligible) under a particular free trade agreement (FTA) is found in the Rules of Origin related to the FTA which you are working with. Depending upon which Rule of Origin applies to the good will determine the preference criterion for that good.

There are two geographic categories of FTAs; bilateral and regional. A bilateral FTA is one between the U.S. and one other country. Examples are U.S./Israel, U.S. Australia. The second category is regional FTAs. These are between the U.S. and two or more countries. The most common example is the NAFTA; U.S./Canada/Mexico. Though each of the FTAs that the U.S. has entered into is unique in respect of many of its terms and conditions, the one constant is the Rules of Origin.

1. Goods wholly obtained or produced entirely in United States or the territory of the FTA partner(s) that contain no foreign materials or parts from outside the FTA territory. Goods wholly produced or obtained in the FTA territories are:
 - Mineral goods extracted in the territory of one of the parties.
 - Vegetable goods, as defined in the Harmonized System, harvested in the territory of one of the parties.
 - Live animals born and raised in the territory of one of the parties.
 - Goods obtained from hunting, trapping, or fishing.
 - Goods (fish, shellfish, and other marine life) taken from the sea by vessels registered or recorded in the territory of one of the parties and flying its flag.
 - Waste and scrap derived from production in the territory of one of the parties.
 - Used goods collected in the territory of one of the parties, provided such goods are fit only for the recovery of raw materials.
 - Goods produced in the territory of one of the parties exclusively from goods referred to in the preceding bullets or from their derivatives at any stage of production.
2. Depending on which FTA you are working with, Rule of Origin 2 can have two variations. For example, the NAFTA is based on the transformation (tariff change) of non-originating (foreign)

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materials used to make the good being evaluated or, possibly, the quantification of value added by the producer in the territory of one of the parties – known as Regional Value Content.

- **Tariff Change.** Each of the non-originating materials used in the production of the good must undergo the applicable change as a result of production occurring entirely in the territory of one of the parties. This means that the non-originating materials are classified under one tariff provision before processing and classified under another on completion of processing. The *Specific Rule of Origin* (for NAFTA found in Annex 401) defines exactly what change in tariff classification must occur for the goods to be considered originating.
- **Regional Value Content.** Some *Specific Rules of Origin* require that a good have a minimum regional value content (RVC), meaning that a certain percentage of the value of the goods must be from within the territory of one of the parties. The FTAs provide two formulas for calculating the RVC. In general, the exporter or producer may choose between these two formulas: the *Transaction Value Method* (build-down) or the *Net Cost Method* (build-up).

A second variation of Rule of Origin 2 is one whose only measure is the value added to the good (domestic content value) within the territory of one of the parties.

- The sum of the cost or value of the materials produced within the territory of one of the parties, PLUS the direct cost of processing operations performed within the territory of one of the parties is not less than 35% of the appraised value of the good at the time it is entered into the territory of the other party. The cost or value of a material produced in the territory of one or both of the Parties includes:
 - (a) the price actually paid or payable by the producer of the good for the material;
 - (b) when not included in the price actually paid or payable by the producer of the good for the material, the freight, insurance, packing, and all other costs incurred in transporting the material to the producer's plant;

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(c) the cost of waste or spoilage, less the value of recoverable scrap;

(d) taxes or customs duties imposed on the material by one or both of the parties, provided the taxes or customs duties are not remitted on exportation.

3. Goods also originate if they are produced entirely within the territory of one of the parties exclusively from materials that are considered to be originating from within the territory of one of the parties, according to the terms of the agreement. In other words, everything that went into producing the good, every single material, was itself an originating material.

It is imperative that when evaluating a good for eligibility (origination) under a free trade agreement you must research the provisions of that particular FTA. No two FTAs are identical.

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