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Challenges and Reform Proposals for the application of Article 2(1) of the WTO Agreement on Rules of Origin

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Abstract. Rules of origin constitute a fundamental legal instrument in modern international trade, determining the country of origin of goods for purposes of applying trade policy measures. Article 2(1) of the WTO Agreement on Rules of Origin (ARO) serves as a transitional provision intended to regulate administrative determinations of general application pending the completion of the Harmonization Work Programme (HWP). However, due to its ambiguous terms and the prolonged stagnation of the HWP, the clause faces numerous application difficulties and operational fragmentation in practice. By examining hypothetical scenarios and WTO jurisprudence (especially DS 243), this paper identifies structural deficiencies in the provision's three criteria—tariff classification change, ad valorem percentage, and manufacturing or processing operations—and analyzes their underlying institutional causes, including structural ambiguity, lack of multilateral supervision, and incompatibility with global value chains (GVCs). To resolve these dilemmas, this paper proposes principled reform suggestions emphasizing legal certainty, transparency, administrative oversight, and GVC adaptability without over-prescribing rigid technical formulas. Furthermore, it evaluates China's constructive coordinating position and the impact of its partial waiver of Special and Differential Treatment (S&DT). The paper concludes that reforming Article 2(1) is vital for restoring legal certainty, preventing hidden trade protectionism, and strengthening the multilateral trading system in the era of fragmented global production.

Keywords: WTO Agreement on Rules of Origin, Article 2(1), Application Difficulties, Reform Proposals, Global Value Chains

1. Introduction

In the context of international trade and legal systems, the WTO Agreement on Rules of Origin (ARO) is a multilateral trade agreement and a core legal document that connects tariff policies, trade remedies, and cross-border production. It is not only the criterion for determining the nationality of goods but also the fundamental premise for the implementation of core trade regimes such as most-favored-nation treatment, anti-dumping measures, and trade statistics [1, 2].

This paper focuses on Article 2(1) of the WTO ARO. The selection of this provision is based on three considerations. First, because of the suspension of the HWP, the provision remains in a

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transitional state, and its regulatory limitations have become practical obstacles in global trade governance [1]. Secondly, the ambiguous expression of the provisions has led to frequent trade disputes, as will be further demonstrated through relevant jurisprudence in subsequent sections. Thirdly, the tetxual design of Article 2(1) reflects a traditional single-country manufacturing model, making it increasingly incompatible with modern Global Value Chain (GVC) operations. Consequently, reforming this article is closely related to the trade interests of both developed and developing members of the WTO.

Article 2(1) of the Agreement stipulates the following: Pending the completion of the work programme outlined in Part IV—aimed at harmonizing rules of origin—Members shall guarantee that, in issuing administrative rulings of general applicability, all relevant requirements are explicitly and unambiguously articulated. Specifically: (i) Where origin determination relies on the tariff classification change criterion—including both the core rule and any permitted exceptions—the applicable tariff headings or subheadings must be expressly identified within the rule; (ii) Where an ad valorem percentage threshold serves as the basis for origin attribution, the rule must clearly prescribe the methodology used to compute that percentage; (iii) Where origin is conferred based on specific manufacturing or processing activities, the precise operation—or set of operations—that imparts origin to the product must be rigorously defined.

This paper examines the implementation difficulties of Article 2(1) and proposes possible rerform pathways. Through case-based analysis and legal scrutiny, it evaluates structural defects and further considers the role of China's coordinating stance and its identity adjustment in order to provide a feasible reform proposal for this WTO multilateral system.

2. Application difficulties of Article 2(1)——based on hypothetical cases and WTO case law

2.1. Three hypothetical ABC cases: direct reflection of clause defects

To visually illustrate the operational flaws existing in the original clause, three simplified and fictional cases involving Country A, Country B, and Country C are presented, corresponding to the three sub-clauses of the article 2(1).

(i) *The criterion of change of tariff classification:* Country A applies a tariff classification change criteria for toys and claims that it has clearly defined the relevant HS subcategories. However, it only lists the general HS subcategories and sets a vague exception clause of "non-substantial processing." Even though the toy assembly in Country C has already completed the tariff classification change, Country A still arbitrarily denies the origin of the products. The core issue lies in that the terms do not clearly define the HS subcategory levels and the scope of the exceptions, resulting in an unclear exception clause.

(ii) *The ad valorem percentage criterion:* Both Country A and Country B apply the ad valorem percentage standard for shoes. However, Country A calculates based on the factory price (excluding transportation costs), while Country B calculates based on the dutiable price (including transportation costs). As a result, the same batch of shoes from Country C receives opposite origin determination results in Country A and Country B. The problem lies in the fact that the calculation basis and standards for the terms are not unified, leading to problems in actual operation.

(iii) *The criterion of manufacturing or processing operation:* Country A has formulated electronic component processing rules, claiming that it has made precise specifications but only stating "key processing is required," without defining the specific content of "key processing." Under this standard, the origin determination results for the same welding operations by enterprises

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B and C were opposite. This clause does not clearly specify the specific content of the "precise specifications," causing unfair result determination.

2.2. WTO case law: analysis of DS243

The institutional vulnerabilities of Article 2(1) have also been fully demonstrated in WTO dispute settlement jurisprudence, particularly in United States—Rules of Origin for Textiles and Apparel Products (DS243) [3].

In DS243, India challenged statutory amendments made by the United States to its national rules of origin under Section 334 of the Uruguay Round Agreements Act and Section 405 of the Trade and Development Act of 2000. Under the modified US framework, origin for flat goods and certain textiles was conferred primarily by the country of fabric formation (weaving or knitting), whereas subsequent processing operations—such as dyeing, printing, and finishing—were generally denied origin-conferring status unless accompanied by specific statutory exceptions. India argued that by imposing arbitrary processing conditions and withholding origin recognition for value-adding processes, the US rules failed to meet the obligation under Article 2(1)(iii) to "precisely specify" origin-conferring operations, thus acting as trade-distorting measures.

The WTO Panel evaluated whether the US regulatory framework satisfied Article 2(1)(iii). While the Panel ultimately determined that India had not conclusively established that the US rules violated Article 2(1) per se due to the broad discretionary leeway left to Members during the interim period, the proceedings laid bare the profound structural loophole of the provision. Because Article 2(1)(iii) contains no definitive threshold defining how detailed a description must be to count as "precise," national authorities retain wide authority to construct origin rules that favor domestic industry under the guise of procedural compliance.

To summarize the operational deficiencies identified through hypothetical scenarios and jurisprudence, Table 1 provides a legal mapping of Article 2(1).

Table 1. Structural deficiencies of Article 2(1) of the ARO

Provision	Origin Criterion	Main Deficiency	Practical Consequence
Article 2(1)(i)	Change of Tariff Classification	Absence of specific HS digit-level mandates, undefined exception boundaries	Arbitrary denial of origin shift via unharmonized, open-ended national exception clauses
Article 2(1)(ii)	Ad Valorem Percentage	Mandates calculation "method" but fails to standardize calculation "basis"	Identical goods receive contradictory origin determinations across importing countries
Article 2(1)(iii)	Specific Manufacturing/Processing	Absence of standardized criteria defining "precisely specified" processing steps	National customs authorities possess broad discretion, creating disguised trade barriers

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2.3. Summary of application difficulties

In summary, combined with hypothetical cases and case law, the core application difficulties of Article 2(1) manifest in four primary areas:

(1) Core legal terminology such as "clearly defined" and "precisely specified" lacks definitive legal boundaries,

(2) The tariff classification change leaves HS digit levels and exceptions under-regulated,

(3) The ad valorem percentage criterion lacks a baseline valuation metric,

(4) The processing operation criterion remains vague and unable to provide predictability for modern multi-stage international manufacturing [1, 3].

3. Institutional causes of the application difficulties of Article 2(1)

The operational dilemmas detailed in Section 2 are not merely isolated administrative errors, rather, they arise from systemic institutional limitations embedded within the WTO legal architecture [4].

3.1. Structural vagueness as a result of uruguayan political compromises

First, the textual vagueness of Article 2(1) directly reflects the incomplete political compromise achieved during the Uruguay Round negotiations. When the ARO was negotiated, Member states could not reach a consensus on unified substantive non-preferential rules of origin. Consequently, Article 2 was designed as a transitional framework providing general disciplines rather than a fully harmonized substantive system.

To secure agreement among Members, the final text incorporated broad and flexible language as a result of political compromise, granting Members extensive discretionary latitude in drafting domestic origin regulations. This constructive ambiguity, while facilitating agreement in 1994, undermined legal certainty in subsequent trade practice.

3.2. Root cause of rule fragmentation: deadlock of the HWP

Second, the lack of unified operational standards stems directly from the long-term stagnation of the HWP established under Part IV of the ARO [5, 6]. The HWP was originally mandated to harmonize non-preferential rules of origin within three years of initiation. However, due to sharp divergences between major trading powers—particularly regarding agricultural products, textiles, and high-tech sector criteria—the harmonization process has remained unresolved for decades.

Because the transitional regime under Article 2 was conditioned to operate only "until the work programme... is completed," the failure of the HWP transformed an interim regime into a permanent legal state, leaving Member domestic rules fragmented.

3.3. Mismatch with Global Value Chains (GVCs)

Third, the draft logic of Article 2(1) reflects a traditional, single-country manufacturing model that fails to accommodate contemporary Global Value Chains (GVCs) [2, 7]. Modern manufacturing relies heavily on multi-country input sourcing, trade in intermediate goods, and regional value-accumulation.

However, Article 2(1) provides no standardized framework for calculating cumulative processing or intermediate value-added across multiple jurisdictions, permitting importing Members to disregard intermediate processing performed in third countries and leading to market distortion.

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3.4. Institutional absence of effective supervisory mechanisms

Fourth, the operational dilemmas persist due to the structural absence of an effective WTO oversight mechanism [8]. Although Article 5 of the ARO mandates notification of origin modifications, the Committee on Rules of Origin (CRO) does not possess an explicit enforcement mandate to review, reject, or penalize non-compliant national regulations prior to their implementation.

Member compliance relies on self-notification, while the CRO's review functions remain largely deliberative. Without a proactive surveillance mechanism, Members can maintain non-transparent or restrictive origin criteria with limited possibility of compulsory correction outside formal dispute settlement procedures.

4. Proposed revision of Article2(1)

Based on the defects identified above and the relevant WTO jurisprudence, this section proposes a textual revision. The proposed revision aims to improve legal certainty, enhance transparency, and establish clearer supervisory mechanisms while maintaining sufficient regulatory flexibility for Members [9].

Proposed Texual Revision of Article 2(1): Until the work programme for the harmonization of rules of origin set out in Part IV is completed, members shall ensure that: (a) when they issue administrative determinations of general application,the requirements to be fulfilled are clearly defined and predictable, so as to avoid arbitrary or disguised restrictions on trade. In particular:

(i) When origin is determined using the tariff classification change criterion—including both the principal rule and any allowable exceptions—the rule must unambiguously identify the exact Harmonized System (HS) headings or subheadings to which it applies; moreover, any exception must be narrowly construed and its boundaries explicitly and strictly defined. (ii) Where an ad valorem percentage threshold forms the basis for origin attribution, the rules must not only set out the exact computational method but also specify the valuation framework—aligned with internationally recognized standards—to ensure transparency, reproducibility, and harmonized implementation across jurisdictions. (iii) In cases where origin hinges on manufacturing or processing operations, the rule must objectively and verifiably define the precise operation(s) or technical processes that confer originating status. For products involving multi-stage production across transnational supply chains, origin assessments must duly recognize and evaluate whether a substantial transformation has occurred at any intermediate stage of production.

(2) Members shall promptly notify all new or modified administrative determinations of general appliaction to the Secretariat prior to their entry into force, and shall submit to periodic oversight reviews by the Committee on Rules of Origin to ensure legal consistency and procedural transparency.

5. China's position and the impact of partial waiver of special and differential treatment

5.1. China's coordinated position in Article2(1) reform

As a major trading country deeply embedded within the GVC system, China maintains a firm and constructive position regarding the reform of WTO rules of origin [8]. China advocates upholding the multilateral trading system, opposing the misuse of non-preferential rules of origin as disguised trade barriers, and fostering transparency and procedural clarity [10]. Table 2 outlines Chin's

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institutional stance across key reform dimensions, referencing official positions submitted to the WTO.

Table 2. China's position in Article 2(1) reform

Reform Issue	China's Position	Expected Impact
Multilateral Rule Uniformity	Supports revitalizing the HWP and establishing objective, predictable criteria under Article 2(1).	Reduces administrative discretion by importing countries and curtails trade protectionism.
GVC Integration	Advocates accounting for intermediate processing and cumulative value-addition in multi-country production.	Lowers origin compliance costs for multi-stage electronics and industrial manufacturing.
Transparency & Oversight	Urges mandatory ex-ante notification of domestic rule changes to the WTO Committee on Rules of Origin.	Enhances predictability and strengthens multilateral surveillance over national origin regimes.

5.2. The impact of China's partial waiver of special and differential treatment

In recent WTO negotiations, China has stated its intention to waive certain S&DT provisions applicable to developing countries in new agreements and rule-making initiatives [11]. This positioning exerts a dual impact on the reform and enforcement of Article 2(1):

(1) Positive Institutional Impact: By voluntarily waiving S&DT flexibilities, it demonstrates its willingness to adhere to high-standard multilateral trade disciplines. This stance strengthens China's credibility as a bridge-builder between developed and developing members, driving consensus on strict transparency and mandatory notification standards under Article 2(1).

Adaptive Operational Impact: Waiving S&DT requires Chinese domestic customs authorities and export enterprises to fully align with heightened administrative standards. While this increases short-term compliance requirements for domestic firms, it accelerates institutional modernization, promotes high-value industrial upgrading, and fortifies China's voice in global rule-making [10].

6. Conclusion

Article 2(1) of the WTO Agreement on Rules of Origin represents a pivotal transitional discipline governing non-preferential origin determinations across the global trading system. However, as demonstrated by the case analysis of DS243 and hypothetical trade scenarios, the provision's textual ambiguity—evidenced by unharmonized terms like "clearly defined" and "precisely specified"—has generated structural regulatory uncertainty, permitting members to employ origin rules as disguised non-tariff trade barriers. The institutional analysis reveals that these operational flaws are deeply rooted in Uruguay-era political compromises, the multi-decadal standstill of the Harmonization Work Programme (HWP), the mismatch between single-country legal assumptions and multi-country Global Value Chain (GVC) realities, and the persistent lack of robust WTO supervisory enforcement mechanisms.

To resolve these systemic dilemmas, this paper proposes a textual revision of Article 2(1) that preserves the general, principle-based nature of WTO multilateral instruments while inserting definitive operational requirements. The reform proposal mandates explicit 4-digit or 6-digit Harmonized System classification targets, requires standardized valuation bases for ad valorem

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calculations, incorporates GVC substantial transformation principles for multi-stage processing, and introduces mandatory ex-ante oversight by the Committee on Rules of Origin. Furthermore, China's constructive positioning and its pragmatic partial waiver of Special and Differential Treatment (S&DT) provide political momentum to bridge historic divides between developed and developing members, fostering consensus around high-level transparency and uniform legal application. Reforming Article 2(1) is therefore not merely a technical refinement of administrative rules, it represents an urgent and indispensable step toward restoring legal predictability, safeguarding the multilateral trading framework, and facilitating unhindered global commerce in the modern economic era.

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