European Community Customs Duties: A Significant Trading Consideration for U.S. Companies

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EUROPEAN COMMUNITY CUSTOMS DUTIES: A SIGNIFICANT TRADING CONSIDERATION FOR U.S. COMPANIES

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I. INTRODUCTION

Like income taxes and social security payments, customs duties represent a significant and inescapable financial obligation for companies engaged in international trade. For a country to collect income taxes and social security payments from a company, it must establish that the company has a sufficient nexus to the country. However, no such nexus is needed for a country to impose a customs duty.

When a United States business produces goods in the European Community (EC), whether through a local subsidiary that imports its raw materials from outside the EC, or simply exports its products to the EC, it must be familiar with customs issues. It must consider significant customs issues such as the classification, valuation, and origin of goods, as well as special trade measures accorded to particular countries. The impact of a customs duty is felt immediately when a company moves its goods across customs borders. Awareness of the applicable customs rules can minimize a company’s exposure to unnecessary customs duties. This is of particular significance to U.S. companies because the United States is currently one of only five countries subject to the full impact of the EC’s customs tariff.¹

This article provides an overview of the EC’s customs duty system. Part II outlines the EC’s customs duty system and highlights important steps in its development. Part III explains the EC’s preferential trade arrangements, in which certain countries are accorded favorable customs treatment. Part IV discusses the EC rules of origin, which determine how a manufactured product obtains its “nationality.” Part V outlines some of the most common instances of specific product exemptions from customs duties.

Once the origin of a good and the applicable customs rules are established, the good must be valued in order to calculate the amount of the customs duty. Customs valuation is covered in Part VI. Finally, Part VII looks at some special customs procedures designed to facilitate international business, such as the increasingly common practice of using more than one country in the production of the good.

II. THE STRUCTURE AND DEVELOPMENT OF THE EUROPEAN COMMUNITY’S CUSTOMS DUTY SYSTEM

In 1957, the Treaty of Rome established the European Economic Community. The main goal of the EEC was to create a single “common market” in Europe. As part of its common commercial policy, and in order to ensure equal treatment in all member states for goods imported into the EEC from non-EEC countries, the EEC Treaty provided for the introduction of the Common Customs Tariff (CCT).

The single customs territory of the EC has one external customs frontier. All customs and trade measures generally apply

2. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY], art. 3(b). The EEC Treaty is also referred to as the Treaty of Rome or the Rome Treaty. See ROBERT H. FOLSOM, ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 940 (2d ed. 1991). C. Edward Galfand, Comment, Heeding the Call for a Predictable Rule of Origin, 11 U. PA. J. INT’L BUS. L. 469, n.171 (1989). The notion of a common basis for customs tariffs was initiated by the 1927 World Economic Conference. The Geneva nomenclature resulting from that conference was completed in 1931 and was later used as the basis for the Brussels Tariff Nomenclature. The trading nations were France, Germany, Italy, the Netherlands, Luxembourg, and Belgium. The B.T.N. was intended to be a uniform commodity classification system. See JOSEPHINE STEINER, TEXTBOOK ON EEC LAW 3 (2d ed. 1988). The original member states were France, Germany, Italy, Belgium, the Netherlands and Luxembourg. Id. The United Kingdom, Denmark, and the Republic of Ireland joined the Community in 1973. In 1980, Greece joined the Community, followed by Spain and Portugal in 1986. Id. at 4.

3. Id. at 5. The general goals of the EC are set out in the EEC Treaty, article 2: The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

EEC TREATY art. 2.

4. Id. The common customs tariff is also referred to as the common external tariff. Id. The operation of the CCT is provided for in articles 18-29 of the EEC Treaty. See EEC TREATY, supra note 2, arts. 18-29.

5. Id. art. 3(b).
when goods enter the EC and are subject to the CCT.\(^6\) Hence, an elaborate customs system has been established to regulate the importation of goods from non-EC countries to ensure the uniform application of customs duties, quotas, and other trade arrangements.\(^7\)

The genesis of this system was in 1950,\(^8\) when the original member states signed the Convention on Nomenclature for the Classification of Goods.\(^9\) The convention's nomenclature was subsequently adopted by the entire EC.\(^10\) It based the CCT on the so-called Brussels Nomenclature which was also annexed to the Convention.\(^11\)

The CCT also contains general rules and explanatory notes which are binding on the member states. After the original EC member states adopted the CCT, the Customs Co-operation Council\(^12\) was formed to administer the operation of the Brussels Nomenclature. The Council publishes the explanatory notes to the Brussels Nomenclature.\(^13\) The explanatory notes and the classification opinions are an authoritative, but non-binding, guide to the classification of goods.\(^14\) The final interpretation of the CCT lies with the EC institutions, subject to review by the European Court of Justice (ECJ).

Before January 1, 1988, there were two different coding systems in place, the CCT itself and the NIMEXE which was used to measure trade between member states.\(^15\) The EC's external tariff covered not only the normal CCT duty rates, but also an extensive range of specific measures, such as tariff suspensions for industrial products, tariff quotas, generalized tariff preferences, special tariff preferences for the Mediterranean countries, and the like.

In 1988, the introduction of the Combined Nomenclature (CN) and TARIC—the EC's integrated tariff—provided a single EC coding system. The CN is based on the so-called har-

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6. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
monized system, which was developed as part of the Tokyo Round of GATT negotiations. The harmonized system draws on nomenclatures used in international trade to comprise a modern and comprehensive worldwide nomenclature.

The CN comprises: (1) the nomenclature of the harmonized system; (2) the EC subdivisions of the harmonized system nomenclature, known at their most detailed level as “CN subheadings”; and (3) general notes referring to the CN subheadings. There are 99 chapters in the CN, classified under 21 Sections. The CN determines the rates for “autonomous” and “conventional” duties within the CCT. Conventional duties, which are lower than autonomous duties, are the duties determined by the General Agreement on Tariffs and Trade (GATT) and other applicable conventions. Autonomous duties are lower than conventional duties and are applied if the EC wishes to express its “displeasure” toward a particular country engaging in unfair trading practices in particular products.

TARIC is the most recent addition to the EC customs system; it was established by the Commission on the basis of the CN. TARIC includes, in addition to the CN itself, additional subdivisions describing goods covered by specific EC regulations. The TARIC also indicates, for each category of products concerned: (1) applicable rates of customs duties and other charges; (2) TARIC code numbers, identified by two digits added to the CN code; and (3) further information required for the administration of relevant EC regulations—for example, to identify products subject to anti-dumping measures.

III. PREFERENTIAL TRADE ARRANGEMENTS

Before implementation of the harmonized system, the EC, recognizing that exposure to full customs duties imposed significant hardships on developing neighboring European coun-

16. The harmonized system was developed by the Customs Cooperation Council. It is a detailed classification system categorizing over 5,000 articles of trade. See Office of United States Trade Representative, Conversion of the Tariff Schedules of the United States into the Nomenclature System of the Harmonized System (1986).
18. Id.
19. Id.
20. Id. art. 2 (as amended by Regulation 2886/89, 1989 O.J. (L 282) 1).
tries, entered into preferential trade agreements and granted trade benefits to these countries. 21 These arrangements fall into four broad categories: association and cooperation agreements; agreements with the European Free Trade Association; agreements with the African, Caribbean and Pacific countries; and unilateral trade benefits under the GATT doctrine of General System of Preferences.

The EC’s preferential trade arrangements have two underlying aims: to create a free-trade zone within Europe and help developing countries improve their economies. The objective in question determines the type of preference granted by the EC. 22 Because of the breadth of countries benefiting under at least one of these preferential trade agreements, only a limited number of countries remain subject to EC customs duties in their entirety. These countries include Australia, Canada, the countries of Central and Eastern Europe, Japan, South Africa, and the United States.

A. Association Agreements and Cooperation Agreements

An association agreement is a special, bilateral relationship between the Community and a third country or group of third countries. 23 The EEC Treaty indicates that an association signifies close and continuous cooperation between the EC and the third country involved. 24 Thus, the eligibility of a third country for association depends on its interest in sharing the EEC’s ideals and efforts. 25 An interest in financial or trade agreements alone is not enough. 26 Other agreements involve

21. When the EC was established, its member states maintained special relations with colonial and ex-colonial territories. See ANTHONY PARRY & STEPHEN HARDY, EEC LAW § 37-20 (1973). Article 131 of the EEC Treaty directs the EC to further the economic, social, and cultural development of these countries or territories. Id. (citing EEC TREATY, supra note 2, arts. 131-136, annex IV). The EEC Treaty contains a general provision allowing for the conclusion of trade agreements with third non-EC states. See 6 HANS SMIT & PETER E. HERZOG, THE LAW OF THE EUROPEAN ECONOMIC COMMUNITY—A COMMENTARY ON THE EEC TREATY 6-402 (1992) (citing EEC TREATY art. 238). Article 238 has been used as the basis to conclude many of the trade agreements entered into by the EC. See P.J.G. KAPTEYN & P. VERLOREN VAN THEMAAT, INTRODUCTION TO THE LAW OF THE EUROPEAN COMMUNITIES 836 (Lawrence W. Gormley ed., 2d ed. 1989).

22. PARRY & HARDY, supra note 21, § 37-20.

23. See 6 SMIT & HERZOG, supra note 21, at 6-412.

24. Id. at 6-413.

25. Id.

26. Id.
only an exchange of reciprocal benefits, while "association" implies common goals and an institutional framework. For these reasons, the concept of association involves extension of the EC's customs union to the associate country.

Both European and non-European countries have entered into association agreements with the EC. Currently, the EC has an Association Agreement in force with Turkey with which it foresees a high degree of integration and, eventually, full membership in the EC. Less extensive association agreements also exist with Cyprus and Malta. All three of these countries have formally applied to join the EC as full members.

Other agreements, not rising to the level of true association agreements but which normally grant financial aid and trade advantages, are often referred to as "cooperation agreements." The EC has extended trade benefits to Israel, Yugoslavia, the Maghreb countries (Algeria, Morocco, and Tunisia), the Mashreq countries (Egypt, Jordan, Lebanon and Syria), Yemen, Pakistan, the Gulf states (Qatar, Kuwait, Bahrain, Saudi Arabia, the UAE, and Oman), and Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama).

27. Id.
28. Id. A "customs union" is created when a group of countries removes all restrictions on mutual trade and sets up a common system of quotas with respect to third countries. Eric Stein et al., European Community Law and Institutions in Perspective 364 (1976). An important principle of the initial EC associations granted under articles 131-136 and annex IV of the EEC Treaty was that products from these associations would enter the EC on equal terms with products of member states. See John Paxton, The Developing Common Market: The Structure of the EEC in Theory and in Practice 43 (1976).
29. See 6 Smit & Herzog, supra note 21, at 6-416 to 6-438.
30. See 6 Smit & Herzog, supra note 21, at 6-352, 6-416.
31. 1975 O.J. (L 156) 1.
32. 1983 O.J. (L 41) 1. Readers should note that relations with Yugoslavia are currently in a state of flux.
35. 1985 O.J. (L 26) 1 (not yet implemented).
36. 1986 O.J. (L 108) 1 (not yet implemented).
37. 1989 O.J. (L 54) 1.
38. 1986 O.J. (L 172) 1.
B. Agreements with European Free Trade Agreement Countries

The European Free Trade Agreement (EFTA) was established in 1957 by nations that were not originally part of the EC in 1957.\textsuperscript{39} The United Kingdom and other Western European countries feared that the successful integration of the EC would prejudice their traditional trade interests.\textsuperscript{40} Thus, seven nations (United Kingdom, Sweden, Denmark, Norway, Austria, Switzerland, and Portugal) countered by establishing their own trade association.\textsuperscript{41}

The EC later entered into bilateral trade agreements with the EFTA countries.\textsuperscript{42} Currently, agreements that eliminate customs duties on industrial products are in effect between the EC and the six remaining EFTA countries (Austria, Sweden, Switzerland, Iceland, Norway, and Finland). In addition, Iceland was granted substantial concessions relating to fishery products, its principal export.\textsuperscript{43} Recent developments establishing a European Economic Area between the EC and EFTA countries aim to further liberalize trade rules.\textsuperscript{44}

C. Agreements with African, Caribbean, and Pacific Countries

 Preferential trade arrangements for African, Caribbean and Pacific countries grew out of the EEC Treaty's initial grant of association to member state colonies in Africa.\textsuperscript{45} When the African territories gained their independence, the EC entered into association agreements with the newly independent states.\textsuperscript{46} The associations were set up by the Yaoundé Conventions,\textsuperscript{47} which created a free trade area between the EC and each associated state, and granted financial and technical

\textsuperscript{39} See Stein et al., supra note 28, at 4.
\textsuperscript{40} Id. These countries attempted to create a larger free trade area that would include the six EC countries and all of the other members of the Organization for European Economic Cooperation, but negotiations failed. Id.
\textsuperscript{41} Id. The convention establishing the EFTA was signed in November, 1959. Id. Finland joined the EFTA in 1961, and Iceland joined in 1970. Id. at 11.
\textsuperscript{42} Id. at 6.
\textsuperscript{43} Council Regulation 1440/76, 1976 O.J. (L 161) 1.
\textsuperscript{44} See 3 Smit & Herzog, supra note 21, at 3-712.53 to 3-712.54.
\textsuperscript{45} See Kapteyn & Themaat, supra note 21, at 831.
\textsuperscript{46} Id.
\textsuperscript{47} Yaoundé I was signed on July 20, 1963, and Yaoundé II was signed on July 29, 1969. 1970 O.J. (L 282) 1.
assistance for economic development in the African states. The African states, in addition, were afforded latitude to take protective measures against EC imports. The Yaoundé Conventions spurred other similarly situated developing countries to seek similar trade concessions. The EC, in seeking to maintain a coherent policy toward similarly situated developing countries, subsequently extended through the Lomé Conventions favorable trade treatment to a large number of other developing states in Africa, south of the Sahara desert, in the Caribbean, and in the Pacific Ocean region.

Generally, the Lomé Conventions concern trade and commercial cooperation, stabilization of export revenue, financial and technical cooperation, and industrial cooperation. The conventions require that almost all exports from the ACP states be admitted into the EC free of import duties and quantitative restrictions. The Convention does not mandate reciprocal free access for EC exports to the ACP. Instead, it only requires the ACP to afford the EC most favored nation treatment. Additionally, the ACP states are prohibited from discriminating against the EC member states.

D. The General System of Preferences

In 1971, the EC adopted the General System of Preferences (GSP) as a broad, unilateral means to create preferential trade arrangements with developing countries. The GSP concept was originally advanced during a 1973 round of GATT negotiations and was taken up by the United Nations Conference on
The GSP is based on the idea that industrialized countries can effectively aid the efforts of developing countries by unilaterally granting tariff preferences to them. Consequently, the United Nations called for tariff preferences to be introduced autonomously by all industrialized countries on a non-reciprocal basis.

As of 1990, approximately 150 developing countries were covered by the EC’s preference rules, which are updated and expanded annually. GSP status has been extended to most countries in Africa, Central and South America, South and Southeast Asia, and a variety of countries in the Caribbean and Pacific. Before the demise of the Eastern European countries, only Romania and Yugoslavia were included.

While the GSP reduces or eliminates import duties on industrial and agricultural products from developing countries, these measures are subject to a system of quotas and ceilings designed to prevent serious harm to member states from imports. For processed agricultural products, duties have been reduced, but they may be reimposed if the product causes serious economic harm to the Community.

Tariffs on industrial products have been completely eliminated for several of the least-developed countries. For other GSP countries, particular groups of products are subject to import ceilings. Import-sensitive products are also subject to more general EC quotas. While these ceilings and quotas both restrict the amount of goods imported from GSP countries, ceilings limit the impact of the imported goods on the entire Community. In contrast, quotas limit the impact on each Community member. Like agricultural products, tariffs

58. Id.
59. Id.
60. KAPTEYN & THEMAAT, supra notes 21, at 797. The GSP objective is to foster the export revenues, industrialization, and economic growth of developing countries. Id.
61. Id.
62. SMIT & HERZOG, supra note 21, at 3-712.79.
63. GSP benefits are being gradually extended to Hungary, Poland, and Czechoslovakia. Id.
64. Id. at 797-98.
65. 3 SMIT & HERZOG, supra note 21, at 3-712.79.
66. 3 SMIT & HERZOG, supra note 21, at 3-712.80.
67. Id.
68. KAPTEYN & THEMAAT, supra note 21, at 798.
69. Id.
on industrial products may also be reimposed if the importation poses serious economic harm to the Community.\textsuperscript{70}

GSP countries represent a significant opportunity for foreign companies that are based in countries subject to either high customs duties, labor and operating costs, or to antidumping duties on certain goods. By locating manufacturing operations in a GSP country, a company can reduce customs duties and significantly lower its labor costs. The country may benefit from investment aid, thereby reducing initial capital outlay.\textsuperscript{71}

IV. RULES OF ORIGIN

The EC has adopted various rules that establish criteria for determining a product's origin—the place where the product or its constituent parts have been produced.\textsuperscript{72} Origin rules primarily identify goods subject to EC customs duties. The EC origin rules also identify goods produced in certain countries benefitting from preferential customs treatment. To determine the appropriate customs rules and duties, it is necessary to establish a product's origin.\textsuperscript{73}

\textsuperscript{70} Id. at 793.

\textsuperscript{71} For example: Highco manufactures Product X in Country A. According to the EC's CCT, Product X is subject to 20% customs duties when imported into the EC because it originates from Country A. The same product having the origin of Country B would benefit from a zero-rate customs duty, but would be subject to antidumping duties of 10% for a period of five years, unless the period were extended. Product X having Country C's origin bears a 5% customs duty. The establishment by Highco of a subsidiary, Lowsub, in Country C to manufacture Product X would result in a 15% customs duty saving and would avoid the anti-dumping duties.

In fact, special rules would permit Highco to demonstrate that Lowsub is a "newcomer" to the market of Country B, unrelated to existing exporters, and has been created and begun exporting only subsequent to the anti-dumping proceedings against Country B's exports of Product X. But this is a time-consuming and expensive process which Highco would prefer to avoid. Moreover, Highco would be ill-advised to locate Lowsub in a jurisdiction with a history of anti-dumping proceedings concerning the very product it wishes to manufacture. Even if Lowsub does not dump, it will inevitably be subject to anti-dumping proceedings. (This example does not consider special outward processing regimes, discussed in Part VII.B.)

\textsuperscript{72} Council Regulation 802/68, Common Definition of the Concept of the Origin of Goods, 1968-1969 O.J. SPEC. ED. 165, 166. The regulation deals with "certificates of origin" issued to certify the country of origin for imported goods. See id. Regulation 802/68, however, does not establish criteria for labelling goods as originating in a particular country. Rather, origin labelling falls within the domain of consumer protection or false advertising, matters that are left primarily to national law.

\textsuperscript{73} The administrative formalities for determining goods subject to trade meas-
A. Rules of Non-Preferential Origin

There are no internationally accepted rules for determining the origin of goods. The EC rules reflect, however, the International Convention on the Simplification and Harmonization of Customs Procedures, commonly known as the Kyoto Convention. The EC origin rules, however, are autonomous and unilateral rules of the Community, and are subject solely to the Community's own interpretations and application.

The EC's rules of origin apply to external, non-preferential trade and to certain instances of internal Community trade. The rules are simplified by use of a certificate of origin. The certificate of origin is prima facie proof of the product's origin. In addition, the certificate of origin assures the producer of obtaining the benefits of certain trade advantages reserved to Community products when they are exported to other countries. Council Regulation 802/68, art. 9, 1968-1969 O.J. SPEC. ED. (L 148) 2-3. Article 9 of Regulation 802/68 requires a certificate of origin to meet the following criteria:

(a) It must be prepared by a reliable authority or agency duly authorised for that purpose by the country of issue;
(b) It must contain all the particulars necessary for identifying the product to which it relates . . .
(c) It must certify unambiguously that the product to which it relates originated in a specific country.

Notwithstanding the existence of a certificate of origin, if there is serious cause for doubting a product's origin, EC and member state authorities may request additional information to ascertain its true origin. Id. art. 9(2), at 3. A classic example would be an attempt to avoid anti-dumping duties or trade boycott by providing a false certificate of origin indicating a country not subject to such measures. To further prevent the use of false certificates, Regulation 802/68 contains an anti-fraud provision, which states:

Any process or work in respect of which it is established, or in respect of which the facts as ascertained justify the presumption, that its sole object was to circumvent the provisions applicable in the Community or the Member States to goods from specific countries shall in no case be considered, under Article 5, as conferring on the goods thus produced the origin of the country where it is carried out.

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The origin rules distinguish between goods wholly obtained and produced in one country and goods obtained and produced in two or more countries.\textsuperscript{78} Determining the origin of goods wholly obtained or produced in one country is relatively straightforward.\textsuperscript{79} However, determining the origin of goods obtained or produced in two or more countries is more complicated.

I. Goods Obtained or Processed in Two or More Countries

The general rule for determining the country of origin for products obtained in two or more countries, whether inside or outside the EC, is set forth in article 5 of Regulation 802/68: "A product . . . shall be regarded as originating in the country in which the last substantial process or operation that is economically justified was performed . . . resulting in the manufacture of a new product or representing an important stage of manufacture."\textsuperscript{80} Article 5 is actually a composite of origin rules that were used by EC member states prior to the enactment of Regulation 802/68. The Regulation now serves as the legally binding rule for all origin decisions taken by Community customs authorities or individual member state customs authorities.\textsuperscript{81}

Article 5 sets forth four cumulative conditions to be applied in origin determinations. Under article 5, the last substantial processing must (1) be carried out in that country, (2) be economically justified, (3) be carried out in an undertaking equipped for that purpose, and (4) result in the manufacture of a new product or represent an important stage of manufacture.\textsuperscript{82} For purposes of these conditions, the member states are considered as a single territorial unit.\textsuperscript{83}

The determination of whether the conditions of article 5 have been met is the responsibility of each member state's cus-

\textsuperscript{78} Council Regulation 802/68, arts. 4, 5, 1968-1969 O.J. SPEC. ED. at 166.
\textsuperscript{79} Id. art. 4, at 166. Goods defined as coming from one country are primarily non-processed agricultural, mineral, animal and sea products. Id.
\textsuperscript{80} Id. art. 5, at 166.
\textsuperscript{81} Id. art. 17, at 168.
\textsuperscript{82} Id. art. 5, at 166.
\textsuperscript{83} Id. art. 8, at 166.
toms authorities. Any specific determination may be subject to appeal to the Commission and eventually the European Court of Justice.

Surprisingly, article 5 has generated few cases. It is instructive, however, to consider the few ECJ decisions that have considered the issue of origin. In Gesellschaft für Überseehandel mbH v. Handelskammer Hamburg, the ECJ interpreted the first condition of article 5 and established that in order to be substantial, an operation or process must "bring about a significant qualitative change in [a product’s] properties." Specifically, the product resulting from the operation or process must have "its own properties and a composition of its own, which it did not possess before that process or operation." The ECJ determined that origin must be "based on a real and objective distinction between raw material and processed product, depending fundamentally on the specific material qualities of each of those products."

To date, no ECJ case has interpreted the second cumulative condition of article 5, which requires that the operation be economically justified. One may logically assume that operations or processes that qualify as substantial will also fulfill the requirement of economic justification.

The third condition, which requires that the operation be carried out in an undertaking equipped for that purpose, has an economic goal. This third criterion seeks to ensure that the operation or process contributes to the developing country’s economy. For example, in Yoshida GmbH v. Industrie-und-

84. Id. art. 9, at 166.
85. Id. art. 13, at 167.
87. Id. at 53.
88. Id.
89. Id. In Handelskammer Hamburg, the ECJ held that the grinding and grading of raw casein into different degrees of fineness did not constitute a substantial operation because the process did not bring about the required qualitative change in the product’s properties. Id. A later ECJ case held that the process of boning meat from beef quarters, removing sinews and fat, cutting the meat into pieces and vacuum packing it did not give the meat the origin of the country where these operations were carried out. The meat remained meat, having the same properties and composition as before. Case 93/83, Zentralgenossenschaft des Fleischergewerbes e.G. v. Hauptzollamt Bochum, 1984 E.C.R. 1095, 1106.
The ECJ gave weight to the fact that the manufacture of the goods in question was an undertaking "remarkably well-equipped and which [had] modern machines and large staff." The fourth condition emphasizes that the operation or process must result in a new product or be an important stage in the manufacture of a new product. If there is no significant qualitative change in its properties, then a particular origin is not conferred. The last requirement has proven to be the most difficult element to establish in determining a product's origin.

In *Yoshida*, for example, the ECJ overturned the EC Commission's regulation adopting origin rules for slide fasteners, which are commonly known as zippers when assembled. The Commission sought to make the place of manufacture of the slider, a component part of the zipper, a determining factor of origin. The *Yoshida* decision rejected the requirement that virtually all components of a product, even those of little value that are of no use in themselves unless they are "incorporated into a whole," must be of EC origin. Under the requirements of article 5 of Regulation 802/68, the "last substantial process or operation" resulting in the manufacture of the slide fasteners was the assembly process of a completed and functional zipper. In support of its position in *Yoshida*, the ECJ noted that the objectives of the origin regulations are to ensure that an "objective distinction [is made] between new material and processed product."
The determination of a product's origin is important to producers concerned about external trade restrictions. In *Yoshida*, the practical effect of the Commission's ruling was to deny the manufacturer a certificate of origin that would allow exports and duty-free sales of the slide fasteners to Community markets. Additionally, the restrictive rules advanced by the Commission could create trade obstacles much like tariffs that operate to suppress trade. Such obstacles to international trade are prohibited by other trade agreements and would have the practical effect of restricting external trade.

2. Origin Rules for Specific Products

Pursuant to article 14 of Regulation 802/68, the EC Commission has the power to enact regulations specifying origin criteria for specific products. When enacting these regulations, the Commission is bound by the general criteria of article 5 of Regulation 802/68. The Commission, nevertheless, within limits, retains discretion in interpreting this provision.

One limit on the Commission's discretion in enacting specific origin criteria is the principle of equality. The Commission may interpret article 5 in a restrictive manner, but not in a way that would result in treatment different than that accorded to other products. In other words, the Commission must implement Regulation 802/68 in a consistent manner unless its decision to use a particular methodology to determine product origin is based on an objective justification relating to the nature of the products or processes involved.

A second limitation on the Commission's discretionary powers derives from the ECJ's decision in *Yoshida*. In *Yoshida*, the ECJ held that the Commission is bound by the four conditions set forth in article 5 of Regulation 802/68. Further, the Commission has no discretion when it applies the provi-

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100. *Id.* at 154-55.
101. *Id.* Obstacles to trade are prohibited by articles III(1), VII(1)(c), and XI(1) of the General Agreement on Tariffs and Trade, 61 Stat. A3, 55 U.N.T.S. 194 [hereinafter GATT].
103. See *id.* art. 5, at 166.
104. See EEC TREATY, supra note 2, art. 9; see also generally B2 ENCYCLOPEDIA OF E.C. LAW, B10-022 (1981).
106. *Id.* at 156.
sion concretely.\textsuperscript{107} Thus, the Commission is precluded from establishing origin requirements concerning a phase of manufacture that precedes the phase constituting the last substantial transformation.\textsuperscript{108}

The EC Commission has enacted specific regulations relating to the origin of a variety of products, including eggs,\textsuperscript{109} spare parts,\textsuperscript{110} radio and television receivers,\textsuperscript{111} basic wines,\textsuperscript{112} tape recorders,\textsuperscript{113} meat and offal,\textsuperscript{114} textile products,\textsuperscript{115} ceramic products,\textsuperscript{116} grape juice,\textsuperscript{117} roller bearings,\textsuperscript{118} and integrated circuits.\textsuperscript{119} The reasons for such rules vary. For example, the special rules for radio and television receivers are sensitive to the complex international markets that provide components for these products, recognizing that assembly of the parts may take place virtually anywhere. The detailed rules on textiles specify the minimum amount of working or processing necessary to determine the products origin.\textsuperscript{120} This is of particular importance in the EC’s rules of preferential

\begin{itemize}
  \item \textsuperscript{107} \textit{Id.}
  \item \textsuperscript{108} See \textit{id. at 168.}
  \item \textsuperscript{109} Council Regulation 641/69, 1969 O.J. (L 83) 15.
  \item \textsuperscript{110} Council Regulation 37/70, 1970 O.J. (L 7) 6.
  \item \textsuperscript{111} Council Regulation 2632/70, 1970 O.J. (L 279) 35.
  \item \textsuperscript{112} Council Regulation 315/71, 1971 O.J. (L 36) 10.
  \item \textsuperscript{113} Council Regulation 861/71, 1971 O.J. (L 95) 11.
  \item \textsuperscript{114} Council Regulation 964/71, 1971 O.J. (L 104) 12.
  \item \textsuperscript{115} Council Regulation 1364/91, 1991 O.J. (L 130) 18.
  \item \textsuperscript{116} Council Regulation 2025/73, 1970 O.J. (L 206) 32.
  \item \textsuperscript{117} Council Regulation 2026/73, 1973 O.J. (L 206) 33.
  \item \textsuperscript{118} Council Regulation 1836/76, 1976 O.J. (L 210) 49.
  \item \textsuperscript{119} Council Regulation 288/89, 1989 O.J. (L 33) 23.
  \item \textsuperscript{120} See Commission Regulation 1364/91, 1991 O.J. (L 130) 18. In general, Regulation 1364/91 breaks down the garment manufacture processes into the production of the yarn, fabric, and the garment itself. If any of the specific processes take place in a member state, then the product will have EC origin. For example, regarding yarn, the regulation provides that the origin of yarn of man-made fibres not carded, combed, or otherwise processed for spinning is the place where the “manufacture from chemical materials or textile pulp” takes place. \textit{Id.} annex II, at 22.

  In weaving fabric, the critical working or processing that confers origin is its “manufacture from yarn.” \textit{Id.} annex II, at 23. In order to benefit from cheaper labor or more expert craftsmanship, the fabric may be sent from the EC to a non-EC country to be made into clothing. According to Regulation 1364/91, finished articles of apparel and clothing accessories originate in the place where “complete making-up” takes place. \textit{Id.} annex II, at 25. This means the country where the operations following cutting, knitting or crocheting the fabric to shape are performed. \textit{Id.} If the country where complete making up takes place is subject to quotas on textile exports to the EC, then the garments in question will be included in that country’s relevant quota arrangements. The rules for obtaining preferential origin are somewhat more complex. \textit{See infra} Part IV.B.
origin.\textsuperscript{121}

The specific origin regulations use several methods to determine the products origin. These methods include providing a detailed description of the processing that is necessary to confer originating status on the product in question,\textsuperscript{122} testing for a change of tariff heading after the processing in question,\textsuperscript{123} and testing against the value-added percentage requirement.\textsuperscript{124}

The value-added percentage requirement is generally deemed to be the most suitable criteria for products that incorporate advanced technology or require more complex international manufacturing processes. This requirement is preferred because it measures the actual economic values added during the various stages of processing.\textsuperscript{125} The Commission has used the value-added approach in its regulations relating to radio and television receivers, and tape recorders.\textsuperscript{126} Under a value-added origin rule, the country of assembly determines the product's origin, provided that the increase in value acquired in the assembling a given percentage—usually 45%—of the "ex-works invoice price."\textsuperscript{127} The 45% figure does not constitute a strict rule, although it is often cited formally and informally by customs authorities.

B. Rules of Preferential Origin

If the Community is bound by preferential trade agreements concerning specified products originating in the countries in

\begin{itemize}
\item[121.] See infra Part IV.B.
\item[122.] See, e.g., id.
\item[123.] See, e.g., Regulation 2025/73, supra note 116.
\item[124.] See, e.g., Regulation 2632/70, supra note 111.
\item[125.] Id.
\item[126.] Id.; Regulation 861/71, supra note 113.
\item[127.] Regulations 2632/70 and 861/71 both provide that a 45% increase in value may arise from pure assembly operations or from assembly and incorporation of domestic parts and materials. If less than 45% added value is achieved, the country of origin is where the ex-works invoice price of local parts exceeds 35% of the ex-works price of the final product (this being sufficient to satisfy the "last important stage of manufacture" criterion). If more than a 35% level is reached in two countries without it being possible to determine which of them is the country where the last process or operation was performed, the country of origin is that of the origin of the parts representing the highest percentage. Regulation 2632/70, supra note 111, arts. 1 and 2; Regulation 861/71, supra note 113, arts. 1 and 2.
\end{itemize}
question, Regulation 802/68 does not apply to such trade.\textsuperscript{128} The countries concerned are those belonging to EFTA,\textsuperscript{129} the ACP countries,\textsuperscript{130} certain Mediterranean countries, the so-called "overseas countries and territories" (OCT) of the Community\textsuperscript{131} and the developing countries that benefit from the Community's GSP.\textsuperscript{132}

Producers and exporters operating outside the countries maintaining preferential trade arrangements with the Community can nevertheless benefit from these arrangements. Products originating in these countries generally have zero or substantially reduced duties applied upon importation into the Community. When a foreign producer locates production operations in one of these countries, it too can take advantage of the preferential EC tariffs. Thus, production location and relocation considerations often take into account possible preferential EC import duties, as well as traditional factors such as the costs of labor.

The rules of origin applied to preferred countries are contractual in character. Since the rules are determined pursuant to bilateral or multilateral negotiations, the specific rules of origin may differ with respect to each agreement or arrangement. One must look to the particular arrangement in question on a case-by-case basis. Nevertheless, the basic principles underlying such rules are similar, if not identical, in most cases.

In general, a product will be deemed to originate in a country in accordance with the origin rules applicable to preferential trade arrangements in either of two situations. First, a product will be deemed to originate in a country if the product has been wholly produced in that country.\textsuperscript{133} Second, a product will also be deemed to originate in a specific country if the product was manufactured in that country, even though it was manufactured from products other than those wholly obtained there, provided it has undergone sufficient working and

\begin{itemize}
  \item \textsuperscript{128} Council Regulation 802/68, art. 2, 1968-1969 O.J. Spec. Ed. (L 148) 165, 166.
  \item \textsuperscript{129} See supra Part III.B.
  \item \textsuperscript{130} See supra Part III.C.
  \item \textsuperscript{131} EEC Treaty, supra note 2, art. 131, annex IV.
  \item \textsuperscript{132} See supra Part III.D.
  \item \textsuperscript{133} Council Regulation 802/68, art. 4(1), 1968-1969 O.J. Spec. Ed. (L 148) 2.
\end{itemize}
processing locally.\textsuperscript{134}

The rules relating to products wholly obtained in a particular country are essentially the same as those set forth in Regulation 802/68, and are identical in all of the EC's preferential origin arrangements.\textsuperscript{135} The basic rule when determining whether there has been "sufficient working or processing" is whether the working or processing in question results in a change of tariff classification.\textsuperscript{136} A change of tariff classification will occur if the classification of the final product is different from the classification of each of the non-originating component products.\textsuperscript{137} If so, the final product will have the origin of the country where that working or processing has occurred.\textsuperscript{138} Exceptions to this basic rule are set forth in all of the outstanding preferential origin rules.\textsuperscript{139}

The preferential rules also set forth a general rule relating to transportation that is intended to reduce the possibilities of fraud. The general principle is that goods entitled to preferential EC customs treatment by reason of their origin must be transported directly from the originating country to the EC importing country without passing through the territory of another country.\textsuperscript{140}

While the GSP does not permit cumulation in determining origin, special cumulation rules, however, may apply to certain preferential arrangements. In these cases, the conditions conferring origin will not necessarily have been met in the country of last processing. There are a number of different cumulation

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{134} Id. art. 5, at 166. The country of origin is the place where the "last substantial process or operation took place." \textit{id.}
\item \textsuperscript{135} KELLEY \& ONKELINX, supra note 1, at part 3.4, T111-T139d.
\item \textsuperscript{136} Id.
\item \textsuperscript{137} Id.
\item \textsuperscript{138} Id.
\item \textsuperscript{139} Id. There are three major exceptions found in all preferential origin rules. The first is when a change in tariff heading is not sufficient in itself to confer origin. The second exception is when a change in tariff heading is not always necessary to confer origin. Finally, there is an exception when some minor working or processing will, under no circumstances, confer origin regardless of whether there has been a change of tariff heading or whether other requirements have been satisfied.
\item \textsuperscript{140} Id. However, this rule is more nuanced than may first appear. First, the territories of certain groups of countries, such as the ACP and EFTA, are considered as one for the purposes of this rule. \textit{See, e.g.,} Council Decision 86/283, art. 5, 1986 O.J. (L 175) 49; \textit{see also} supra Part III.B. Second, exceptions to the rule are permitted (subjected to strict conditions) where direct transportation is not possible. \textit{See id.}
\end{itemize}
\end{footnotesize}
rules, namely bilateral,\textsuperscript{141} diagonal or triangular,\textsuperscript{142} regional,\textsuperscript{143} and total.\textsuperscript{144} The basic premise of these cumulation rules is that either:

(a) a product having the origin of a country will retain that origin even if, prior to importation into the EC, it is exported to another country where it is either not subject to further working or processing (e.g., is only tested) or where it is subject to working and processing which is insufficient to enter the origin of that country; or

(b) the sufficient working or processing test need not be fully met by processing operations in one particular country, but may be met by cumulating the working or processing operations carried out in several qualifying countries.

The cumulation rules applicable in any specific case are complex and require a case-by-case analysis.\textsuperscript{145}

V. RELIEF FROM CUSTOMS DUTIES

The EC authorizes partial relief, total relief or exemption from normal customs duties in certain clearly-defined circumstances.\textsuperscript{146} Effectively, it prevents customs duty burdens for a limited period of time when the imported goods are directly used for commercial purposes.

When the goods are to be used for certain specified purposes, total temporary relief from customs duties may be allowed for a period of up to twenty-four months.\textsuperscript{147} For example, total temporary relief is accorded to equipment and accessories of professionals necessary for their trade, goods for display or exhibition, teaching aids, medical equipment,

\begin{itemize}
  \item \textsuperscript{141} These apply to EFTA countries, and to Middle East countries, namely Egypt, Syria, Jordan, Lebanon, Yemen, Israel, Malta, Cyprus, Yugoslavia and the Faroes.
  \item \textsuperscript{142} These apply to EFTA countries and to certain groups of GSP countries.
  \item \textsuperscript{143} These apply to certain groups of GSP countries.
  \item \textsuperscript{144} These apply to the Maghreb countries Centa and Melilla, the ACP countries, and the EC's OCT.
  \item \textsuperscript{145} See KELLEY \& ONKELINX, supra note 1, at part 34, T122-T139d, for a succinct explanation of the different cumulation rules.
  \item \textsuperscript{146} See Council Regulation 3599/82, 1982 O.J. (L 376) 1, as amended and implemented by Commission Regulation 1751/84, 1984 O.J. (L 171) 1.
  \item \textsuperscript{147} Council Regulation 3599/82, arts. 2-4, 1982 O.J. (L 376) 1. This period may be extended in exceptional circumstances. \textit{Id.} art. 4(2), at 2.
\end{itemize}
and goods for disaster relief. 148 Total relief, however, is conditioned upon the actual use being verifiable. 149 In other words, if it is not possible to identify the goods or verify how they have been used, authorization for temporary importation will be denied. Goods that do not fulfill the conditions for total relief may nonetheless be granted partial relief subject to fulfilling other criteria. 150

In addition to relief for temporary importation for indirect commercial purposes, Council Regulation 918/83151 exempts certain categories of personal property and other goods from customs duties. 152 Much of this relief is granted unilaterally as a matter of public policy and is intended to facilitate transactions in goods that do not have a commercial value. 153 Other exemptions are based on the EC’s obligations under international conventions, such as the United Nations Economic and Social Council (UNESCO) arrangements for duty-free imports of cultural, scientific and educational products. 154 Such relief applies to scientific instruments, when no equivalent EC goods exist; educational, scientific and cultural materials; goods for examination, analysis or testing; goods for trade promotion; goods imported by persons or corporations moving into the EC; goods having a minimal value; and goods for charity, handicapped persons and disaster victims. 155

VI. VALUATION OF GOODS

In response to the Tokyo round of GATT, which became effective July 1, 1980, the EC adopted new customs valuation rules in the form of Council Regulation 1224/80. 156 Prior to

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148. Id. arts. 7-13, at 3-5. Other goods may also receive total relief from import duties; see id. arts. 15-23, at 5-7.
149. Id. art. 2(3), at 2.
150. Id. arts. 24-27, at 7.
151. 1983 O.J. (L 105) 1.
152. Id.
153. Id. For example, Regulation 918/83 exempts personal property imported due to a marriage, property acquired from inheritance, household effects, and other generally non-commercial goods. In addition, educational, cultural, research and humanitarian goods are also exempt. Id. arts. 2-126, at 3-25.
154. Id. arts. 50-59, at 10-12.
155. See id. arts. 59-126, at 12-25.
that date, the EC had employed the "Brussels Definition of Valuation."\textsuperscript{157} The Brussels method of valuation was based on the "normal" price of goods: the price the goods would bring at the time the duty was payable on an open market sale between independent buyers and sellers.\textsuperscript{158} Regulation 1224/80 abandoned the Brussels method as arbitrary and fictitious and replaced it with a valuation method that is intended to be fair, neutral, uniform and internationally applicable.\textsuperscript{159} The new GATT Code and the implementing legislation in the various signatory countries effect a number of significant changes in the valuation methods previously used.\textsuperscript{160}

A. Regulation 1224/80 Valuation Methods

Regulation 1224/80 provides for a hierarchical method of valuation, consisting of five methods applied in sequential order to determine customs value. In descending order, the hierarchy consists of transaction value, identical or similar goods value, deductive value, computed value, and a residual value.\textsuperscript{161} Only when one method has been shown to be inappropriate may the customs authorities use the next lower method in the hierarchy.\textsuperscript{162}

1. Transaction Value

The primary basis for customs valuation of imported goods is their transaction value.\textsuperscript{163} The transaction value method will be applied in all instances, unless it is determined inappropriate.

\textsuperscript{157} See Council Regulation 803/68, 1968 O.J. (L 148) 6.\textsuperscript{158} Id. pmbl., at CL4-118 to C14-119.\textsuperscript{159} Council Regulation 1224/80, pmbl. 1980 O.J. (L 134) 2, reprinted in 2 COMMON MKT. REP. (CCH) ¶ 5852 (1984). One of the primary goals of the MTN was the establishment of a fair, neutral, and uniform customs valuation system to be applied internationally. Id. The application of a uniform system eliminates the uncertainties faced by traders previously subjected to a variety of local customs valuation practices.\textsuperscript{160} For example, the "American Selling Price" (ASP) method, which the United States used to impose duties on certain goods based on the actual selling price within the United States of similar United States-produced goods, has been eliminated. See 19 U.S.C. § 1401a (1988). The ASP method was repealed by the Trade Agreements Act of 1979, Pub. L. No. 96-39.\textsuperscript{161} Id. arts. 2-7, at ¶ 3832C-G.\textsuperscript{162} Id.\textsuperscript{163} Id. art. 3, at ¶ 3832C.
ate. Generally, transaction value is defined as the "price actually paid or payable" for the goods when sold for export within the EC.164 This method must be applied by the customs authorities when several well-defined criteria are met. Transaction value is applied when (1) the seller does not restrict the disposition or use of the goods by the buyer; (2) the sale or price is not subject to conditions of indeterminate value; (3) the seller will not directly accrue proceeds from any subsequent resale, disposal, or use of the goods; and (4) the buyer and the seller are not related, or are dealing at arms length.165 Once the base transaction value is determined, other values may be added to determine the actual value of goods sold to the buyer.166 Generally, however, there are many valuable services and other commissions that are not included in the transaction between buyer and seller.167

The critical issue in determining transaction value is to determine the value placed on the goods by the seller and buyer under the prevailing market conditions.168 A reduced price to the buyer will generally result in a reduced customs value, thereby placing more emphasis on the price negotiation process between related or unrelated sellers and buyers.

Another important issue is whether the parties are related. Parties are related if they are controlled by other persons or companies, are partners, or are related through family.169 Be-

164. Id.
165. Id. art. 3(1), at ¶ 3832C.
166. Id. art. 8, at ¶ 3832H.
167. Id. These include packaging costs, including labor and materials, transport and insurance costs, and production materials such as tools, dies, and molds. Id. art. 8(1)-(5), at ¶ 3832H-J.
168. Id. art. 3(3), at ¶ 3832C. Transaction value is not the invoice price, because that may include other costs (such as insurance and freight) that are not related to the cost of the goods themselves. Id.; see also supra note 162.
169. Id. art. 1(2), at ¶ 3832A. Article 1(2) states:
For the purposes of this regulation, persons shall be deemed to be related only if:
(a) they are officers or directors of one another's businesses;
(b) they are legally recognized partners in business;
(c) they are employer and employee;
(d) any person directly or indirectly owns, controls, or holds 5 percent or more of the outstanding voting stock or shares of both of them;
(e) one of them directly or indirectly controls the other;
(f) both of them are directly or indirectly controlled by a third person;
(g) together they directly or indirectly control a third person; or
(h) they are members of the same family.
Id.
cause many importers purchase goods from related parties, proving that the buyer-seller relationship has not influenced the price is an important element in support of the transaction value. The parties' relationship, however, does not in itself indicate that use of the transaction value is inappropriate.\textsuperscript{170} Although Regulation 1224/80 creates a presumption that transaction values between related parties are not applicable, it also provides that the presumption can be overcome by showing that the parties' relationship has not influenced the selling price.\textsuperscript{171}

An example can help illustrate the problem. Suppose A in France buys industrial diamonds from unrelated B in the United States at $1,000 per kilogram, the going price in the world market. No conditions or other restrictive terms are attached to the sales transaction. Duties would be calculated as a percentage of the $1,000. If, however, A and B were related, or if any of the other threshold requirements of Regulation 1224/80 failed to apply, and the same transaction between unrelated parties would have taken place for more than $1,000, the transaction value would be ignored in favor of the identical or similar goods method of valuation.\textsuperscript{172} The seller could, however, rebuff this determination by showing that the sales price and the market price were equivalent.

2. Identical or Similar Goods

If the customs value cannot be determined on the basis of the transaction value method, it may alternatively be determined on the basis of the transaction value of “identical goods” or of “similar goods” sold for export to the same country of importation at or about the same time as the goods being valued.\textsuperscript{173} Identical goods are goods produced in the same country that are the same in all respects.\textsuperscript{174} Similar goods are goods with like characteristics and component parts that make

\textsuperscript{170} Id. art. 3(2), at ¶ 3832C.

\textsuperscript{171} See id. The transaction value may be used in a sale between related persons provided that the importer can demonstrate that the value of the goods closely approximates the transaction value of sales between unrelated buyers and sellers of identical or similar goods for export to the EC or the customs value of identical or similar goods, as determined under articles 6 or 7. Id. art. 3(2)(b), at ¶ 3832C.

\textsuperscript{172} Id. arts. 4-5, at ¶ 3832D.

\textsuperscript{173} Id. art. 4, at ¶ 3832D.

\textsuperscript{174} Id. art. 1(1)(c), at ¶ 3832A.
them interchangeable with the goods to be valued. The preferred method of determining value is to compare the sale to identical goods that have been accepted previously under the transaction value. In the alternative, similar goods will be used to determine value. Thus, the identical or similar goods method looks to sales by third parties, not sales involving the actual buyer and seller.

3. Deductive Value

If the transaction value and identical goods or similar goods values are inappropriate, then the customs value should be determined on the basis of the deductive value. The deductive value is the price at which the greatest number of units of the item are sold to unrelated persons at or about the time the goods are to be sold. If no unit price can be determined at the time of importation, the unit price should be determined by the earliest valuation of goods that are imported within the next ninety days. If the imported and identical or similar goods are not sold as imported, the importer may request a valuation based on the unit price at which the goods are sold for further processing.

4. Computed Value

The fourth valuation method is the "computed value" method. The computed value is calculated as the sum of the costs of production, raw materials, shipping, handling, insurance, and general expenses reflected in sales of the same class or kind of goods. The computed value also includes a mark-

175. Id. art. 1(1)(d), at ¶ 3832A.
176. See id. art. 5, at ¶ 3832E, 3833.07.
177. Id.
178. See id. art. 6, at ¶ 3832F.
179. Id.
180. Id. art. 6(1)(b), at ¶ 3832F, 3833.08. "For the purposes of paragraph 1(b), the 'earliest date' shall be the date by which sales of the imported goods or of identical or similar imported goods are made in sufficient quantity to establish the unit price." Id. art. 6(5), at ¶ 3832F.
181. Id. art. 6(2), at ¶ 3832F. A further requirement is that the valuation is determined by goods sold in the greatest aggregate quantity in the community to persons who are unrelated. Id. Allowance is made for the value added by the processing. Id.
182. See id. art. 7, at ¶ 3832G.
183. Id. art. 7(1), at ¶ 3832G. "General expenses" cover direct and indirect costs of producing or selling the goods for export. Id. art. 7(5), at ¶ 3832G.
up for profits.\textsuperscript{184}

Computed value is usually applied in cases where the buyer and seller are related and the use of identical or similar goods valuation is not available.\textsuperscript{185} Determining computed value requires that producers disclose information related to the production costs of the goods being supplied.\textsuperscript{186} However, customs may not compel the production of such information.\textsuperscript{187} The computed value may not be acceptable for determining valuation if the producer supplies information that does not accord with accepted accounting principles or is inconsistent with "profit and general expense" of the same class of goods.\textsuperscript{188} This is especially true when the producer is unable to justify its figures with valid commercial reasons.\textsuperscript{189}

\section*{5. Residual Valuation Method}

Finally, if none of the above-described methods is appropriate, the customs value is determined using reasonable means consistent with the principles and general provisions of the GATT and on the basis of data available in the country of importation.\textsuperscript{190} Admittedly, this last method reintroduces a measure of uncertainty into corporate planning and pricing policies. It is not intended, however, to be applied unless the first four methods cannot be applied to the particular transaction.\textsuperscript{191}

\section*{B. Charges Excluded from the Customs Value}

The EC's customs rules exclude certain costs and expenses related to the purchase transaction to ensure that goods are not overvalued in calculating the value of the transaction.\textsuperscript{192}

\begin{itemize}
\item \textsuperscript{184} \textit{Id.} art. 7, at § 3832G.
\item \textsuperscript{186} Snyder, \textit{supra} note 168, at 93.
\item \textsuperscript{187} Council Regulation 1224/80, art. 7(2), 1980 O.J. (L 134), \textit{reprinted in} Common Mkt. Rep. (CCH) § 3832.
\item \textsuperscript{188} See Snyder, \textit{supra} note 168, at 93-94. If the profit is inconsistent with the normal figures under such circumstances, the customs authority may choose to base the amount of profit and general expenses on other relevant information. \textit{Id.}
\item \textsuperscript{189} \textit{Id.}
\item \textsuperscript{190} Council Regulation 1224/80, art. 2(3), 1980 O.J. (L 134) 1, \textit{reprinted in} 2 Common Mkt. Rep. (CCH) § 3832B.
\item \textsuperscript{191} \textit{See id.}
\item \textsuperscript{192} \textit{Id.} art. 3, at § 3832C.
\end{itemize}
Because this rule gives added significance to transaction value, it has provoked corporations to reassess their pricing policies. 193

Regulation 1224/80 excludes several specific transaction costs from the customs value calculation. For example, transportation costs are not included in the customs value if they can be clearly distinguished from the price of the imported goods. 194 In addition, the buyer's advertising, promotional and marketing expenses undertaken for its own account are excluded from customs value, even if the seller is aware of and benefits from the expense. 195

The costs of construction, assembly, maintenance, and technical assistance provided by the seller to the buyer after importation are not included in the customs value, provided that such costs are separately identified and distinguished from the price of the imported products themselves. 196 Duties and taxes paid upon importation or sale of the products are also excluded from the customs value. 197 The costs of research, preliminary design, development, and engineering work performed by the buyer but used in the manufacture of the products may also be excluded from the customs value. 198

Significantly, in the area of data processing equipment, the customs value of the carrier medium does not include the value of software, data, or instructions imported with the equipment. 199 Thus, only the value of the carrier medium itself is taken into account. 200 In contrast, royalties or license fees paid by the buyer as a condition of purchase are included in the customs value. 201 This rule does not apply to royalties and license fees that are not due as a condition of the sale and are distinguished from the price of the goods. 202

193. In addition, article 8 of Regulation 1224/80 provides for various additions or "up-lifts" to be made to the customs value whereas other provisions allow for certain exclusions from the customs value. Id. art. 8, at ¶ 3832H.
194. Id. art. 15(1), at ¶ 3832Q.
195. Id. art. 3(3)(b), at ¶ 3832C.
196. Id. art. 3(4)(a), at ¶ 3832C.
197. Id. art. 3(4)(b), at ¶ 3832C.
198. Id. art. 8(1)(b)(iv), at ¶ 3832H.
199. Id. art. 8A, at ¶ 3832H-1.
200. Id.
201. Id. art. 8(1)(c), at ¶ 3832H.
202. Id. art. 8(5)(a), (b), at ¶ 3832H.
VII. SPECIAL CUSTOMS PROCEDURES

In modern-day commerce, the manufacture of goods may take place in a number of different countries. Goods may cross numerous customs frontiers from the raw material stage to the final product. In order to lessen the burden of customs duties on international processing activities, special rules have been adopted.

The EC has enacted legislation that permits goods to enter the EC for working or storage without the imposition of customs duties. Similarly, the EC has special procedures governing goods sent from the EC for working in a third country. Some of the relevant EC framework rules are briefly outlined below. These concern "inward processing," "outward processing," customs warehouses, free zones, and transit procedures.

A. Inward Processing

"Inward processing" refers to customs arrangements that allow goods imported into the EC for processing to avoid payment of customs duties.\textsuperscript{203} Goods of any kind or origin may qualify.\textsuperscript{204} The principal condition for the application of this exemption is that such imported goods must be intended for re-export outside the EC, wholly or partly in the form of "compensating products."\textsuperscript{205}

This term covers goods that have been brought into the EC not for consumption, but for processing into another product.\textsuperscript{206} For example, a product may enter as Indian yarn and leave as EC-origin fabric. While in the EC, the yarn was transformed; it leaves the EC in a different form than when it entered.

Compensating products are produced by using the imported goods in one or more of the following processes: working the goods,\textsuperscript{207} processing the goods,\textsuperscript{208} repairing the goods,\textsuperscript{209} or

\textsuperscript{203} See Council Regulation 1999/85 On Inward Processing Relief Arrangements, 1985 O.J. (L 188) 1.
\textsuperscript{204} Id. art. 1(2), at 2.
\textsuperscript{205} Id. art. 1(2), (3)(i), at 2.
\textsuperscript{206} Id. art. 1(3)(h)-(i), at 2.
\textsuperscript{207} Id. art. 1(3)(h), at 2. Working includes fitting, assembling, or adapting the goods to other goods. Id.
\textsuperscript{208} Id.
\textsuperscript{209} Id. Repair includes restoration. Id.
using the goods as agents. The concept of compensating products thus refers to those products that incorporate and transform the originally imported goods.

The inward processing exemption for qualifying goods may be made either by suspension or deposit. An exemption by suspension simply means the import duties are suspended while the goods are being processed. The suspension is made final upon the re-export of the goods in the form of compensating products. An exemption by deposit, on the other hand, calls for the appropriate amount of customs duties to be deposited with the customs authorities when the goods are imported for processing. The duties are then reimbursed at the time the goods, in the form of compensating products, are exported from the EC. The suspension system is the one adopted by all EC member states.

Local customs authorities are obliged to grant authorization for inward processing in all cases where the processing arrangements "may contribute towards creating favorable conditions for exporting compensating products," provided certain economic conditions are met to avoid harming essential economic interests of Community manufacturers. The conditions are defined by the nature of the goods intended to be processed and the processing operations involved.

Local customs authorities are permitted to grant inward

210. Id. Using goods as agents means the goods allow or facilitate the production of compensating products, although the goods are partially or entirely used up in the process. Id. The term "agent" encompasses catalysts, accelerators and retarders of chemical reactions, which disappear entirely or partially when employed in the course of production and later cannot be distinguished within the goods produced. The term agent does not apply to use of sources of energy, lubricants, equipment, or tools. Id. art. 1(3)(h)-(i).
211. Id. art. 14, at 4-5.
212. Id. art. 18(1), at 5.
213. Id. art. 16, at 5.
214. Id. art. 27(1), at 7.
215. Court of Auditors, Special Report on the Community Inward Processing System, 1982 O.J. (C 286) 4, 8. In some countries, the deposit system is applied at the discretion of the customs officials. But other countries allow for no discretion. In Denmark, for example, the deposit system is mandatory for industrial products. Id.
217. Article 6 states that the economic conditions are fulfilled when:
   1. The goods which are intended to be processed:
      (a) are not produced in the Community;
      (b) are not produced in the Community in sufficient quantity;
      (c) cannot be made available to the operator within a suitable time by producers established in the Community;
processing authorizations only to natural or legal persons "established" within the Community.\(^\text{219}\) For example, an independent branch office of a U.S. company that operates in Belgium should qualify as a Community establishment for inward processing purposes.\(^\text{220}\) Furthermore, authorizations can be granted only when it is possible to determine that imported goods will be incorporated into re-exported compensating products.\(^\text{221}\)

Upon application, inward processing authorizations are granted either by special authorization or automatically pursuant to certain generally applicable provisions.\(^\text{222}\) Authorizations normally specify the exemption method (suspension or deposit),\(^\text{223}\) the maximum duration of the inward processing activities,\(^\text{224}\) and the method for determining the quantity of

- (d) are produced in the Community but cannot be used because their price is such as to make the proposed commercial operation economically impracticable;
- (e) are produced in the Community but do not have the quality or characteristics necessary for the operator to produce the required compensating products;
- (f) are produced in the Community but cannot be used because they do not conform to the expressly stated requirements of the third-country purchaser of the compensating products;
- (g) are produced in the Community but cannot be used since the compensating products must be obtained from import goods in order to ensure that the provisions concerning the protection of industrial and commercial property are complied with;

2. The goods which are intended to be processed:
- (a) are supplied for the execution of a job-processing contract;
- (b) are imported as part of a transaction of a non-commercial nature

\(\text{Id.} \text{ art. 6, at 3-4.}\)

218. The article 6 processing operations involve:
- (a) repairs to goods, including overhaul and adjustments;
- (b) the usual handling operations to which goods may be subject in pursuance of Community provisions on customs warehousing and free zones;
- (c) operations carried out successively in one or more Member States on the same import goods which have been the subject of an authorization issued after examination of the economic conditions referred to in point 1

\(\text{Id.} \text{ art. 6, at 4.}\)

219. \(\text{Id.} \text{ art. 4, at 3.}\)

220. Case 111/79, Caterpillar Overseas v. Belgium, 1980 E.C.R. 773, 801. The concept of community establishment is not elaborated in Council Regulation 1999/85. In \textit{Caterpillar}, the court focused on the need to have a genuine place of business in the EC. 1980 E.C.R. at 801. The records of the business must also be subject to verification by the relevant national authorities. \(\text{Id.}\)

221. Council Regulation 1999/85, art. 4(c), 1985 O.J. (L 188) 3.

222. \(\text{Id.} \text{ arts. 7-8, at 4.}\)

223. \(\text{Id.} \text{ art. 16, at 5.}\)

224. \(\text{Id.} \text{ art. 14, at 4-5.}\) Specific time limits may be established pursuant to the
imported goods deemed incorporated in the compensating products.\textsuperscript{225}

Once an authorization has been granted, the national customs authorities of the relevant member state must inform the EC Commission, which, in turn, informs the other member states.\textsuperscript{226} The latter may object to an authorization within a limited time period after notification, on the grounds that the inward processing does not meet the economic conditions noted above.\textsuperscript{227}

B. Outward Processing

Under “outward processing” regulations, goods may be exported outside the EC for “processing, working or repair” and then re-imported back into the EC either wholly or partially free of import duties.\textsuperscript{228} Under the outward processing regulations, only “persons” within the EC will be granted outward processing authorization.\textsuperscript{229} Also, the goods must be compensating products.\textsuperscript{230} To qualify for this treatment, the goods to be processed must be of EC origin or be in free circulation within the EC with total or partial relief from import duties.\textsuperscript{231} In addition, outward processing authorization\textsuperscript{232} is granted only when it is possible to establish that the compensating products have been manufactured from EC goods.\textsuperscript{233}

procedure in article 31. \textit{Id.} art. 14(4), at 5. Also, according to article 8, an initial authorization period of up to nine months may be issued to those operations not specifically fitting the economic conditions set forth in article 6. \textit{Id.} art. 8, at 4.

225. \textit{Id.} art. 15, at 5.
226. \textit{Id.} art. 8, at 4.
227. \textit{Id.} Objections are handled on a case-by-case basis pursuant to the general procedures of article 31. \textit{Id.} art. 31, at 8.
229. \textit{Id.} art. 1(3), at 2. “Persons” is defined as: (1) a natural person; (2) a legal person; (3) as association of persons having legal capacity but each legal status of being a “legal person.” \textit{Id.} This requirement is the same as that required for inward processing.
230. \textit{Id.} art. 2, at 2. In outward processing, the notion of compensating products is the same as in inward processing, except that the fourth criterion, the use of certain goods as agents, does not apply. \textit{See} Commission Regulation 2473/86, art. 1(3)(e), 1986 O.J. (L 212) 1, \textit{as implemented by} Commission Regulation 2458/87, 1987 O.J. (L 230) 1.
232. \textit{Id.} art. 4(1), at 3. The authorization is issued by the customs authority of the member state in which the goods for temporary export are located. \textit{Id.}
233. \textit{Id.} art. 5(1)(c), at 3.
In general, outward processing authorization will be denied only when the use of export processing causes serious economic damage to EC processors. Once the authorization is granted, a time limit is set within which the compensating products must be re-imported back into the EC.

In calculating the amount of the duty exemption, it is important to note that in outward processing, only that part of the re-imported good consisting of the EC origin goods is exempted from customs duties. This amount is calculated on the basis of the differential taxation system, which considers both the added value and changes in the rates of duty as a result of the processing undertaken outside the EC.

The calculations are rather complicated, but annex III of Regulation 2458/87 provides examples of how to determine the proportion of imported goods incorporated in the compensating products. A simple illustration of the differential tax system: Fabric valued at $10,000 is exported for processing into shirts. A customs duty of 5% is imposed on the fabric. The shirts, worth $20,000, will be subject to 10% customs duties upon re-importation into the EC. Under the outward processing system, the shirts will be taxed as follows:

1. Customs duties on the fabric exported for outward processing: \( ($10,000 \times 5\%) = 500 \)
2. Customs duties on the reimported shirts: \( ($20,000 \times 10\%) = 2,000 \)
3. Net EC customs duties to be collected on the shirts: \( ($2,000 - 500) = 1,500 \)

The rate of duty applicable to the temporarily exported goods is the rate in force as of the date the compensating products are re-imported. As an exception to the foregoing, a total customs duty exemption is granted for cost-free repairs by the EC.

234. \textit{Id.} art. 6, at 3.
236. \textit{Id.} art. 13, at 4. For inward processing, customs duties are completely exempted for "compensated" goods.
239. \textit{Id.}
manufacturer or seller of previously imported products, and for goods re-imported without ever having undergone processing outside the EC.

Regulation 636/82 contains special outward processing rules for textile and clothing products. These rules apply to processing arrangements of certain textile and clothing products that are re-imported into the Community after working or processing in certain third countries. To qualify, the EC exporter must manufacture in its own EC factory "products which are similar to and at the same stage of manufacture as the compensating products in respect of which the application for the arrangements is made." The EC exporter may manufacture the compensating products in a third country up to the annual limits fixed by the member state where the application is made. The legislation implementing Regulation 636/82 further provides that the amounts of compensating products shall be charged against any such quantitative limits.

The rules also require that the goods initially exported from the EC be in "free circulation" and of EC origin. In addition, the compensating products can be re-imported only into the EC member state where the authorization for export was granted. Finally, the regulation requires that the authorization for the processing arrangement "lay down the conditions under which the processing operation itself is to take place."

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240. Id. art. 14, at 6. This applies provided that customs duties were actually paid when due at the moment of original importation. For this reason, defective products on which duties were paid do not qualify.
244. Id. art. 2(a), at 2 (emphasis added). "Compensating products" refers to products that have undergone the processing operations carried out in third countries. See id. art. 1(4)(a), 2(2)(d), at 2.
245. See id. art. 2(b), at 2.
247. Council Regulation 636/82, art. 2(2)(c), 1982 O.J. (L 76) 2. Derogations from this provision may be granted by EC member state authorities only for goods of which EC production is insufficient. Id.
248. Id. art. 8(2), at 3.
249. Id. art. 5(3), at 3. The authorization should address, for example, the quantities of goods to be exported and quantities of products to be reimported, procedures for identifying the temporarily exported goods in the compensating products, and the time limit for reimportation. Id.
C. Customs Warehouses

Customs warehouses are places where goods may be stored upon entry into the EC without the collection of customs duties.250 Such goods must still be presented to the customs authorities for approval prior to storage.251 Goods of any kind, regardless of their quantity, country of origin or destination, may be placed in customs warehouses.252

The essential purpose of customs warehouses is to allow storage and handling of goods. Storage is permissible only to ensure the preservation of goods or to improve their packaging or marketable quality.253 To ensure that warehoused goods are not being processed, the EC provides a list of permissible forms of handling called "usual forms of handling."254 Member states can allow only usual forms of handling in their customs warehouse regimes.255

D. Free Zones

A free zone is a limited geographical area or specific location, including a customs warehouse, where the EC or its member states cannot impose custom duties, agricultural levies, quantitative restrictions, or other similar charges.256 As with customs warehouses, free zones are established under national law.257 Many of the conditions and limitations applicable to customs warehouses also apply to free zones. The principal

251. Id. arts. 4, 5(1), at C1-225.
252. Id. art. 3(1), at C1-224. The ability to place goods in customs warehouses is subject, however, to certain restrictions based on public health and safety concerns. Id. art. 3(2), at C-224.
253. Id. art. 11(c), at C1-228.
255. Council Directive 71/235, art. 1(2), 1971 O.J. (L 398), reprinted in CI ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW C1-394 (1975). But see Case 49/82, Commission v. The Netherlands, 1983 E.C.R. 1195. In Commission v. The Netherlands, the Dutch government argued that the working, shaping, and weighing of butter in customs warehouses, rather than simply its repackaging, was permitted by Directive 71/235. The European Court of Justice decided that the operations, which resulted in smaller packs of butter for sale at a different market level, went beyond the purpose of a customs warehouse, namely, the storage of goods. Id.
257. Id. art. 1(1), at C1-231.
difference between free zones and customs warehouses is that free zones eliminate the normal customs procedures that are carried out prior to entering goods into customs warehouses.258

Operations within free zones that qualify as "usual forms of handling" are permitted on goods that originate outside the Community.259 However, any further operations within the EC must be authorized under the rules applying to inward processing arrangements.260 Therefore, goods introduced into the customs territory of the Community under the inward processing arrangements, and products obtained under those arrangements, may be brought into, and may remain in, free zones, provided that the obligations incurred under those arrangements are fulfilled.261

E. Transit Procedures

To facilitate trade between member states, the EC has adopted transit procedures that aim to lessen the burden of full customs formalities on goods passing from one member state to another.262 Transit procedures are classified into external and internal transit.263 These procedures do not apply to goods covered by the EC's temporary import procedure,264 or to goods using intra-EC trading systems if the carriage of the goods began outside the EC or will end outside the EC.265

1. External Community Transit

The external community transit procedure applies to goods not originating in, or not in free circulation within, the EC.266

258. Id. art. 8(1), at C1-234.
261. Id. art. 5(2), at C1-233.
263. Id. art. 1, at C10-195.
264. Id. art. 4(2), at C10-197.
265. Id. art. 7, at C10-199.
266. Id. art. 1, at C10-195. External procedures apply to goods that satisfy the conditions of the EC, but have been subject to export formalities for the grant of refunds for export to third countries pursuant to the common agricultural policy. Id.
The system requires the deposit of a guarantee at the customs office of departure\textsuperscript{267} to ensure that delivery is made at a stated destination within a specified time limit. When the goods arrive at the stated destination, the customs formalities necessary for releasing the goods into free circulation are performed.\textsuperscript{268} The guarantee will be released at that time.

2. Internal Community Transit

The basic procedure for goods originating in, or already within, free circulation in the EC is the same as that under the external Community transit procedure. The major difference relates to the provision of a guarantee.\textsuperscript{269} EC residents that regularly use the transit procedure and are financially stable can obtain exemptions from the guarantee obligation.\textsuperscript{270} This exemption does not apply, however, to goods exceeding a specified value, or goods subject to particularly high levels of duties or other charges in one or more member states.\textsuperscript{271}

Special rules apply to the transit procedures for particular modes of transport, notably goods traveling by rail,\textsuperscript{272} sea,\textsuperscript{273} air,\textsuperscript{274} inland waterways (including the Rhine),\textsuperscript{275} pipeline,\textsuperscript{276} postal consignment,\textsuperscript{277} and goods carried by travellers.\textsuperscript{278} Finally, for geographic reasons, special agreements have been adopted with Austria and Switzerland to simplify transit proce-
dures through these countries. \footnote{279. See Council Regulation 2812/72, 1973 O.J. (L 365) 225.}

3. The Single Administrative Document

When goods are imported, whether they originate from another member state or from a third country, an importer must make a formal declaration to national customs authorities for statistical purposes. In addition, import duties will have to be assessed for those products not already in free circulation in the EC. In the past, this procedure required the completion of approximately thirty-five different forms. As of January 1, 1988, the Single Administrative Document has replaced these various forms and standardized the import formality process. Intended primarily as a simplification and standardization of customs declarations for the intra-Community transport of goods, the document is also to be utilized for export and import transactions with third countries. Its use will also be extended to the European Free Trade Agreement countries: Austria, Finland, Iceland, Norway, Sweden, and Switzerland. Nonetheless, other information may be required on other forms, particularly when exporting. For example, export licenses are required for many electric or strategic products. These licenses are granted by the appropriate national authorities, according to the individual member state’s laws, which are generally based on the COCOM arrangements. \footnote{280. The so-called “TIR” consignment system, which delays presentation of the goods for customs clearance until the member state of final destination is reached, was another major step. Council Regulation 3690/86, 1986 O.J. (L 341) 1, as implemented by Commission Regulation 1544/87, 1987 O.J. (L 144) 7. In addition, postal fees for customs presentation have been abolished. Council Regulation 1797/86, 1986 O.J. (L 157) 1. However, member states may impose charges and fees which represent costs of transport and other services relating to the transit. Such charges and fees do not violate the EC’s principles on free movement. Case 266/81, Società Italiana par l'Oleodotto Transalpino (SIOT) v. Ministero dello Finanze, 1983 E.C.R. 731.}

VIII. Conclusion

The EC’s customs rules have important trade implications for U.S. businesses. The rules surrounding product origin and valuation are just two examples of the growing tension between production processes in non-EC countries and the protection of Community economic concerns. The debate within the EC concerning the origin of products using parts exported
from Japan, and the pressure to impose additional special rules in the telecommunications sector, an area dominated by U.S. companies, are two examples of this tension. It remains to be seen how these tensions will be resolved. Perhaps exceptions to the general rules will be developed, or a more fundamental change in the understanding of customs will take place.