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Abstract

This Note argues that the rules of origin in the U.S.-Israel FTA must be reformed to improve the opportunities for trade between the United States and Israel and to facilitate greater economic cooperation among the countries in the Middle East. Part I discusses the benefits of FTAs, presents the rules of origin that the United States uses in different agreements, including the current U.S.-Israel FTA, and examines the European Community's rules of origin and the rules of origin in the EC-Israel FTA. Part II examines the recently-concluded EC-Israel Association Agreement and compares its rules of origin to those in the EC-Israel FTA. Part II also discusses recent developments related to the U.S.-Israel FTA, including two disputes regarding the application of the U.S.-Israel FTA's rules of origin. Finally, Part II presents criticisms regarding the U.S. rules of origin in general and the rules of origin in the U.S.-Israel FTA in particular. Part III proposes changes and additions to the U.S.-Israel FTA's rules of origin and argues that these would facilitate extension of the U.S.-Israel FTA to include other parties in the Middle Eastern region, encouraging other countries to enter into FTAs with governments in the Middle East. This Note concludes that changes in the U.S.-Israel FTA's rules of origin would provide a degree of predictability and liberalization of free trade rules that would contribute to Middle Eastern peace and advance international economic cooperation.

NOTES

RESTRUCTURING RULES OF ORIGIN IN THE U.S.-ISRAEL FREE TRADE AGREEMENT: DOES THE EC-ISRAEL ASSOCIATION AGREEMENT OFFER AN EFFECTIVE MODEL?

*Allan S. Galper**

INTRODUCTION

The United States has long been an advocate of free trade.[1] Since 1947, when twenty-three countries[2] created the General Agreement on Tariffs and Trade[3] ("GATT"), the United States has been a leader in the world-wide trend to cut tariffs,[4] quotas,[5] and other barriers[6] to trade between countries.[7] For many years, the typical framework for such free trade measures involved multi-party negotiations which produced multilateral agreements.[8] Recently, the bilateral[9] context has provided a more

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1. Jon Nordheimer, *Buchanan Threatens Longtime Bipartisan Policy, Official Warns*, N.Y. TIMES, Feb. 25, 1996, at 21 (noting that conservative U.S. politician's criticism of free trade agreements ("FTAs") threatened to undo half-century of U.S. support for opening and regulating international trade). Free trade is defined as "[a] situation where all commodities can be freely imported and exported without special taxes or restrictions being levied." BLACK'S LAW DICTIONARY 666 (6th ed. 1990).

2. JOHN H. JACKSON, WORLD TRADE AND THE LAW OF GATT 91 (1969).

3. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. A3, 55 U.N.T.S. 187 (1950) [hereinafter GATT].

4. BLACK'S LAW DICTIONARY, *supra* note 1, at 1456. Tariffs are defined as "[a] series of schedules or rates of duties or taxes on imported goods." *Id.*

5. *Id.* at 755. An import quota is defined as "[a] quantitative restriction on the importation of an article." *Id.*

6. Yoram A. Turbowicz, Israel's Free Trade Agreements with the United States and the EEC 141 (1990) (unpublished J.S.D. thesis, Harvard University). Examples of non-tariff barriers to trade include: standards, import licensing, customs valuation, anti-dumping regulations, and government procurement restrictions. *Id.*

7. JAGDISH BHAGWATI, THE WORLD TRADING SYSTEM AT RISK 71 (1991) (characterizing United States as leading pro-GATT player in postwar period).

8. ORIT FRENKEL, CONSTRAINTS AND COMPROMISES: TRADE POLICY IN A DEMOCRACY: THE CASE OF THE U.S.-ISRAEL FREE TRADE AREA 111 (1990). A multilateral agreement is defined as "[a]n agreement among more than two persons, firms, or governments." BLACK'S LAW DICTIONARY, *supra* note 1, at 1015. Since World War II, gradual world-wide tariff liberalization has taken place in the context of periodic "rounds" of multilateral negotiations under the auspices of the GATT, which achieved lower global tariff levels. FRENKEL, *supra*, at 111. The most recent series of tariff-reducing talks was termed the

popular format for concluding free trade accords.[10] These bilateral agreements create customs unions[11] and free trade areas[12] between countries.[13] To determine which goods are included in a customs union or free trade area, the parties to the agreement establish rules of origin[14] to govern their trade.[15] As a result of the rise in bilateral free trade agreements[16] ("FTAs"), the signifi-

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Uruguay Round, which ended on December 15, 1993, after seven years of negotiations. William J. Aceves, *Lost Sovereignty? The Implications of the Uruguay Round Agreements*, 19 FORDHAM INT'L L.J. 427, 427 (1995). The Uruguay Round Agreements were signed by 108 countries on April 15, 1994, in Marrakesh, Morocco. *Id.* at 427; *see* Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1 (listing countries that participated in Uruguay Round talks). Among other accomplishments, the Uruguay Round Agreements established the World Trade Organization ("WTO"). Aceves, *supra*, at 428. The WTO serves as a common institutional framework for the conduct of international trade, provides a forum for negotiations concerning international trade matters, and establishes a binding dispute settlement process. *Id. See id.* at 432-36 (outlining basic structure and functions of WTO). Prior to the Uruguay Round, there had been seven rounds of negotiations. FRENKEL, *supra*, at 111 n.15. The first was concluded in 1947, when the GATT was drafted. *Id.* The second round ended in 1948, the third in 1950, and the fourth was completed in 1956. *Id.* The fifth, the Dillon Round, took place from 1960 to 1961, the Kennedy Round was conducted from 1964 to 1967, and the Tokyo Round was held from 1973 to 1979. *Id.*

9. JAMES R. FOX, DICTIONARY OF INTERNATIONAL & COMPARATIVE LAW 46 (1992). Bilateral is defined as "between two parties or two groups of parties." *Id.*

10. *The Right Direction?*, ECONOMIST, Sept. 16, 1995, at 23 [hereinafter *Right Direction*]. Accord is defined as "agreement; usually referring to the settlement of a specific dispute or issue." FOX, *supra* note 9, at 4.

11. *See* GATT, *supra* note 3, art. XXIV(8)(a), 61 Stat. at A67, 55 U.N.T.S. at 270-72, *as amended reprinted in* JACKSON, *supra* note 2, at 845 (defining customs union as substitution of single customs territory for two or more customs territories, such that duties and non-tariff barriers are eliminated on substantially all trade between such territories and members of such customs union apply common external tariffs and trade regulations to non-member states).

12. *See id.* art. XXIV(8)(b), 61 Stat. at A67, 55 U.N.T.S. at 270-72, *as amended reprinted in* JACKSON, *supra* note 2, at 845 (defining free trade area as group of two or more customs territories in which duties and non-tariff barriers are eliminated on substantially all trade between such territories).

13. *Right Direction*, *supra* note 10, at 23.

14. U.S. INT'L TRADE COMM'N, PUB. NO. 1976, STANDARDIZATION OF RULES OF ORIGIN, REPORT TO THE COMM. ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES ON INVESTIGATION NO. 332-239 UNDER SECTION 332 OF THE TARIFF ACT OF 1930 2 (1987) [hereinafter STANDARDIZATION REPORT]. Rules of origin are defined as "those laws, regulations, and administrative practices that are applied to ascribe a country of origin to goods in international trade." *Id.*

15. *Right Direction*, *supra* note 10, at 24.

16. ISAAC PAENSON, MANUAL OF THE TERMINOLOGY OF PUBLIC INTERNATIONAL LAW (LAW OF PEACE) AND INTERNATIONAL ORGANIZATIONS 516 (1983). An FTA is defined as an arrangement "providing for the abolition of duties and quantitative restrictions in the mutual trade in . . . goods." *Id.*

cance of rules of origin has increased.[17]

The United States has played a major role in the shift from multilateral to bilateral free trade negotiations.[18] The United States' first comprehensive bilateral FTA[19] was the U.S.-Israel Free Trade Area Agreement[20] ("U.S.-Israel FTA"), which was signed into law on April 22, 1985.[21] With the signing of the U.S.-Israel FTA, the United States strove to challenge the European Union[22] ("EU") as Israel's primary trade partner.[23] Israel had already signed an FTA[24] ("EC-Israel FTA") with the European

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17. Judith Hippler Bello & Alan F. Holmer, *The Growing Importance of Rules of Origin, in* TRADE LAW AND POLICY INSTITUTE 211, 213 (PLI Commercial Law & Practice Course Handbook Series No. 510, 1989).

18. *Right Direction, supra* note 10, at 23.

19. *See* Sandra Ward, Note, *The U.S.-Israel Free Trade Area: Is It GATT Legal?*, 19 GEO. WASH. J. INT'L L. & ECON. 199, 200 (1985) (stating that United States never had full, bilateral FTA before 1985). The United States' first FTA, with Canada, was sectoral and dealt only with trade in auto parts. *Id.* at 199. *See* Agreement on Auto Products, Jan. 16-Mar. 9, 1965, U.S.-Can., 17 U.S.T. 1372, T.I.A.S. No. 6093 (entered into force Sept. 16, 1966) (setting forth U.S.-Canada auto parts agreement). The United States' Caribbean Basin Initiative ("CBI"), designed to foster economic growth in underdeveloped Caribbean nations, was unilateral. Ward, *supra*, at 200. *See* Caribbean Basin Economic Recovery Act, 19 U.S.C. §§ 2701-07 (1994) [hereinafter CBI] (setting forth text of CBI).

20. Israel-United States: Free Trade Area Agreement, Apr. 22, 1985, U.S.-Isr., 24 I.L.M. 653 [hereinafter U.S.-Israel FTA].

21. FRENKEL, *supra* note 8, at 132.

22. Treaty Establishing the European Community, Feb. 7, 1992, [1992] 1 C.M.L.R. 573 [hereinafter EC Treaty], *incorporating changes made by* Treaty on European Union, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 719, 31 I.L.M. 247 [hereinafter TEU]. The TEU, *supra*, amended the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, 1973 Gr. Brit. T.S. No. 1 (Cmd. 5179-II) [hereinafter EEC Treaty], *as amended by* Single European Act, O.J. L 169/1 (1987), [1987] 2 C.M.L.R. 741 [hereinafter SEA], *in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES (EC Off'l Pub. Off. 1987). Until 1995, the twelve European Union ("EU") Member States were Belgium, Denmark, France, Germany, Greece, Spain, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and the United Kingdom. TEU, *supra*, pmbl., O.J. C 224/1, at 2 (1992), [1992] 1 C.M.L.R. at 725-26. On January 1, 1995, Austria, Finland, and Sweden became EU Member States. *Sweden, Finland and Austria Join European Union*, S.F. CHRON., Jan. 2, 1995, at A8. The TEU, which became effective on January 1, 1993, superseded European Community ("EC") treaties and established the European Union. GEORGE A. BERMANN ET AL., CASES AND MATERIALS ON EUROPEAN COMMUNITY LAW 16-19 (1993).

23. FRENKEL, *supra* note 8, at 82-83; Ward, *supra* note 19, at 202. As of November 1995, the European Union was Israel's main trading partner, receiving 35.3% of Israel's total exports. *EU, Israel to Sign Cooperation Deal*, DOW JONES INT'L NEWS, Nov. 20, 1995, *available in* WESTLAW, News Library, AllNewsPlus database [hereinafter *Cooperation Deal*]. The United States accounted for 32.1%. *Id.*

24. Agreement between the European Economic Community and the State of Israel, Council Regulation No. 1274/75, O.J. L 136/1 (1975) [hereinafter EC-Israel

Community[25] ("EC") in 1975, leaving U.S. producers at a significant trading disadvantage to the European Community.[26] Israel's status as the only country that was a party to both U.S. and EC bilateral FTAs offered U.S. firms the unique opportunity to use Israel as a springboard to reach the European Community's markets.[27]

On January 1, 1995, the United States and Israel implemented the final tariff reductions in the U.S.-Israel FTA.[28] Declaring 1995 the "Year of U.S.-Israel Free Trade,"[29] the two coun-

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FTA]. Israel also signed an FTA with the European Free Trade Association ("EFTA") countries in 1992. *EFTA Agrees Free Trade Accord with Israel*, REUTER NEWS SERVICE, July 16, 1992, *available in* LEXIS, Nexis Library, News File. At that time, when the EFTA consisted of Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, and Switzerland, the EFTA countries accounted for 11% of Israel's imports and four percent of Israeli exports. *Id.* With the accession of Austria, Finland, and Sweden to the European Union on January 1, 1995, the EFTA now consists of Norway, Switzerland, Iceland, and Liechtenstein. Robert Evans, *Free Trade Group to Survive Despite Losses to EU*, REUTER EUR. BUS. REP., Dec. 13, 1994, *available in* LEXIS, Nexis Library, News File. The EFTA was founded in 1960. *Id.* The EFTA's treaty with the European Community created a vast common market called the European Economic Area ("EEA") that came into being in January 1993. *Id.*

25. BERMANN, *supra* note 22, at 2. The European Community preceded the European Union. *Id.* The European Community consisted of several Communities, including: the European Coal and Steel Community, the European Economic Community, the European Defense Community, and the European Political Community. *Id.* at 2-7.

26. Ward, *supra* note 19, at 202. According to U.S. exporters who traded with Israel and who complained to the U.S. International Trade Commission ("ITC"), the U.S. goods that were disadvantaged by the European Community's preferential tariff treatment included: fiberglass products, slide fasteners, wire, culture mediums for beverages, food additives, compactors, x-ray equipment, film and graphic art processors, computer discs, and cellophane. *Id.* at 202 n.23.

27. Ira Nikelsberg, Note, *The Ability to Use Israel's Preferential Trade Status with Both the United States and the European Community to Overcome Potential Trade Barriers*, 24 GEO. WASH. J. INT'L L. & ECON. 371, 407-13 (1990). *See, e.g.*, Mike Unger, *The Israeli Connection: Local Companies Find Expertise, Cost Savings in Research, Engineering and Manufacturing*, NEWSDAY, July 17, 1995, at C1 (stating that Israel can be gateway to Europe for U.S. and Canadian companies by virtue of Israel's FTAs with European Union and EFTA). *But see* Turbowicz, *supra* note 6, at 42 (questioning whether production presence in Israel would be tantamount to presence in both Europe and United States due to difficulty in satisfying rules of origin in both EC-Israel FTA and U.S.-Israel FTA).

28. AGENCE FRANCE PRESSE, Feb. 6, 1995 *available in* WESTLAW, News Library, AllNewsPlus database [hereinafter *Final Tariff Reductions*].

29. Paul Thanos, *Expanding U.S.-Israel Commercial Relationship Broadens Prospects for U.S.-Israeli Partnerships*, BUS. AM., Mar. 1995, at 9 [hereinafter *U.S.-Israeli Partnerships*]. The United States and Israel declared 1995 the "Year of U.S.-Israel Free Trade" in a Joint Declaration signed by U.S. Secretary of Commerce Ronald H. Brown and Israeli Minister of Industry and Trade Micha Harish in Jerusalem on February 6, 1995. *Id.*; *Final Tariff Reductions*, *supra* note 28.

tries celebrated the full implementation of the U.S.-Israel FTA[30] and the fact that U.S. exports to Israel had nearly tripled from 1985 to 1994[31] while exports from Israel to the United States had more than doubled during the same period.[32] Nineteen-ninety-five, however, was also a year in which new questions arose concerning the interpretation of the U.S.-Israel FTA,[33] particularly its rules of origin provision,[34] an aspect of the agreement that Israel unsuccessfully attempted to amend in order to gain greater access to U.S. markets.[35]

In contrast, 1995 marked the completion of negotiations between the European Community and Israel to replace the EC-Israel FTA with a Euro-Mediterranean Association Agreement ("EC-Israel Association Agreement").[36] This Agreement rede-

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30. *U.S.-Israeli Partnerships*, *supra* note 29, at 9.

31. *Id.* U.S. exports to Israel increased from US$1.68 billion in 1985 to US$5.0 billion in 1994. *Id.* U.S. exports to Israel that benefited from the U.S.-Israel FTA included: high-technology products, paper products, aircraft and other transportation equipment, grains, tobacco, and some processed foods. Nikelsberg, *supra* note 27, at 375-76 n.28.

32. *U.S.-Israeli Partnerships*, *supra* note 29, at 9. Exports from Israel to the United States grew from US$2.14 billion in 1985 to US$5.3 billion in 1994. *Id.* Principal Israeli exports to the United States include: cut diamonds, resistors, internal combustion engines, electrical articles, and high fashion apparel. Nikelsberg, *supra* note 27, at 374 n.22.

33. Telephone Interviews with Chris Day, Office of the U.S. Trade Representative and Rachel Hirschler, Assistant Economic Minister in the Embassy of Israel, Washington, D.C. (Jan. 5, 1995) (stating that two of main U.S.-Israel FTA issues that would be addressed in 1995 would be: (1) conflict between Israel's quotas for U.S. agricultural products, which are permitted under U.S.-Israel FTA, and Israel's commitment to replace quotas with tariffs pursuant to Uruguay Round of GATT and (2) lack of certainty in U.S.-Israel FTA's rules of origin, which led to U.S. Customs' determination that Israeli ethanol did not qualify for preferential treatment under U.S.-Israel FTA).

34. *See* Gary G. Yerkey, *U.S. Involved in Two Dozen Disputes Under Existing Trade Pacts, Report Says*, 12 INT'L TRADE REP. (BNA) 1597, 1597 (Sept. 27, 1995) [hereinafter *Two Dozen Disputes*] (discussing U.S.-Israel trade dispute concerning qualification of Israeli-manufactured ethanol for duty-free status under U.S.-Israel FTA).

35. *U.S., Israel Agree to Negotiate Greater Access for Farm Products*, 12 INT'L TRADE REP. (BNA) 1783, 1783 (Oct. 25, 1995) [hereinafter *Farm Products*] (reporting that Clinton Administration agreed to delay making unilateral changes in U.S.-Israel FTA's rules of origin that would have excluded some Israeli-assembled exports to United States).

36. *Cooperation Deal*, *supra* note 23; *See* Commission of the European Communities, Proposal for a Decision of the Council and the Commission on the Conclusion of a Euro-Mediterranean Agreement Establishing an Association between the European Communities and their Member States, of the One Part and the State of Israel, of the Other Part, SEC (95) 1719 Final (Nov. 1995) [hereinafter EC-Israel Association Agreement] (setting forth proposed Association Agreement between European Community and Israel).

fined the method for determining the country of origin of goods traded between the European Community and Israel, and granted Israeli goods greater duty-free access to the European Community.[37] Finally, progress in the Middle East peace process[38] and the signing of trade accords between Israel and the Palestinians[39] and Israel and her Arab neighbors[40] propelled many countries to enter trade talks with the parties in the region,[41] a development that raised questions regarding the rules

37. *Peres's Economic Agenda*, JERUSALEM POST, Nov. 21, 1995, at 6 [hereinafter *Economic Agenda*]; *Cooperation Deal*, *supra* note 23. *See* EC-Israel Association Agreement, *supra* note 35, Protocol No. 4, SEC (95) 1719 Final, at 65-201 (containing rules of origin provisions in EC-Israel Association Agreement).

38. *See* David P. Fidler, *Foreign Private Investment in Palestine: An Analysis of the Law on the Encouragement of Investment in Palestine*, 19 FORDHAM INT'L L.J. 529, 547 (1995) (discussing economic opportunities created by Israel's peace deals with Palestine Liberation Organization ("PLO") and Jordan). A main feature of the recent progress in the Middle East peace process was Israel's signing of the Declaration of Principles with the PLO on September 13, 1993, in Washington, D.C. Fidler, *supra*, at 535. *See* Declaration of Principles on Interim Self-Government Arrangements, Sept. 13, 1993, 32 I.L.M. 1525 (establishing Palestinian Council as interim self-governing authority having jurisdiction over most of West Bank and Gaza). For an analysis of the Declaration of Principles, see generally Katherine W. Meighan, *The Israel-PLO Declaration of Principles: Prelude to a Peace?*, 34 VA. J. INT'L L. 435 (1994).

39. *See* Israel-PLO Agreement on the Gaza Strip and Jericho Area, May 4, 1994, 33 I.L.M. 622 (transferring political and economic authority from Israel to Palestinian National Authority ("PNA") in Gaza Strip and Jericho Area). *See also* Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip (1995) (on file with the *Fordham International Law Journal*) (stating that, once elected, Palestinian Council would assume PNA's powers and obligations). Both of the preceding agreements contain the Protocol on Economic Relations between Israel and the PLO. Fidler, *supra* note 38, at 536. With some exceptions, the Economic Protocol states that industrial and agricultural goods may move freely between Israel and the Palestinian Territories without customs duties, import taxes, and other restrictions. *Id.* at 537. The Economic Protocol creates an economic relationship between Israel and the Palestinian Territories that combines elements of an FTA and a customs union. *Id.* at 537 n.27. For an analysis of the Economic Protocol, see generally Ephraim Kleiman, *The Economic Provisions of the Agreement Between Israel and the PLO*, 28 ISR. L. REV. 347 (1994).

40. *See, e.g.*, Israel-Jordan: Common Agenda for the Bilateral Peace Negotiations, Sept. 14, 1993, 32 I.L.M. 1522 (establishing framework for negotiations to conclude peace treaty between Israel and Jordan).

41. *See Canada, Israel to Negotiate Free Trade Agreement*, AGENCE FRANCE PRESSE, Nov. 23, 1994, *available in* LEXIS, Nexis Library, News File (reporting that Canada and Israel had begun to negotiate FTA); *Mexican-Israeli Talks*, HOUS. CHRON., May 25, 1995, at 8 (noting that Mexico and Israel planned to open trade talks for negotiation of FTA); *Israel, Canada Plan to Sign Trade Pact*, UPI, Sept. 1, 1995, *available in* LEXIS, Nexis Library, News File (reporting that Israel has been working to conclude FTAs with Czech Republic, Hungary, Poland, and Turkey); *Israel May Lower Duties on Goods from New Markets*, 12 INT'L TRADE REP. (BNA) 1238, 1238-39 (July 19, 1995) (reporting that Far East nations, particularly Japan and Korea, would open markets to Israeli exports in return

of origin that such agreements could contain.[42]

This Note argues that the rules of origin in the U.S.-Israel FTA must be reformed to improve the opportunities for trade between the United States and Israel and to facilitate greater economic cooperation among the countries in the Middle East. Part I discusses the benefits of FTAs, presents the rules of origin that the United States uses in different agreements, including the current U.S.-Israel FTA, and examines the European Community's rules of origin and the rules of origin in the EC-Israel FTA. Part II examines the recently-concluded EC-Israel Association Agreement and compares its rules of origin to those in the EC-Israel FTA. Part II also discusses recent developments related to the U.S.-Israel FTA, including two disputes regarding the application of the U.S.-Israel FTA's rules of origin. Finally, Part II presents criticisms regarding the U.S. rules of origin in general and the rules of origin in the U.S.-Israel FTA in particular. Part III proposes changes and additions to the U.S.-Israel FTA's rules of origin and argues that these would facilitate extension of the U.S.-Israel FTA to include other parties in the Middle Eastern region, encouraging other countries to enter into FTAs with governments in the Middle East. This Note concludes that changes in the U.S.-Israel FTA's rules of origin would provide a degree of predictability and liberalization of free trade rules that would contribute to Middle Eastern peace and advance international economic cooperation.

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for lower Israeli import duties on their products); *Kantor to Offer Concessions to Palestinians*, UPI, Oct. 12, 1995, *available in* LEXIS, Nexis Library, News File [hereinafter *Concessions to Palestinians*] (reporting that United States extended U.S.-Israel FTA to include goods produced in Palestinian-controlled territory). *But see* Jose Rosenfeld & Bill Hutman, *Exports from Areas to U.S. Won't Say 'Made in Israel,'* JERUSALEM POST, May 5, 1995, at 13 [hereinafter *Made in Israel*] (stating that European Community considered extending EC-Israel FTA to include goods produced in Palestinian-controlled territory but decided to wait until Israel and Jordan reached trade agreement of their own).

42. *See, e.g.*, Neville Nankivell, *Canadian Companies See Big Opportunities in Israel: Free Trade Deal Is under Negotiation*, FIN. POST, Aug. 19, 1995, at 18 (reporting that Canada and Israel were disagreeing as to how liberal rules of origin should be in future FTA); Judith Sudilovsky, *Little Effect on Metals Seen in Israel-EU Pact*, AM. METAL MARKET, Aug. 2, 1995, at 16 (noting that "[t]he main sticking point in [Israel's] negotiations with Canada is the issue of substantial transformation of the imported material").

I. *RULES OF ORIGIN AND THEIR IMPLEMENTATION IN THE U.S.-ISRAEL FTA AND THE EC-ISRAEL FTA*

A. *Rules of Origin and the Goals of FTAs*

1. Purposes of FTAs

Nations form free trade areas by agreeing to eliminate duties[43] and other trade barriers that govern commerce between them.[44] The economic argument in support of free trade area agreements characterizes these agreements as efforts to improve efficiency in international trade.[45] FTAs allow participating countries to take advantage of economies of scale[46] by concentrating their production efforts in their most efficient areas, while trading with other participating countries for their remaining needs.[47] A successful free trade area maximizes trade creation[48] and minimizes trade diversion.[49]

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43. *See* BLACK'S LAW DICTIONARY, *supra* note 1, at 386 (defining customs duties as "[t]he tariff or tax assessed upon merchandise, imported from, or exported to a foreign country").

44. GATT, *supra* note 3, art. XXIV(8)(b), 61 Stat. at A67, 55 U.N.T.S. at 270-72, *as amended reprinted in* JACKSON, *supra* note 2, at 845. *See supra* note 12 and accompanying text (defining FTA). A free trade area should not be confused with a customs union, such as the union formed by the European Union. Turbowicz, *supra* note 6, at 257. A free trade area is not as comprehensive as a customs union, because members of a free trade area only strive to eliminate tariffs between themselves and do not apply common external tariffs to non-member countries. GATT, *supra* note 3, art. XXIV(8)(b), 61 Stat. at A67, 55 U.N.T.S. at 270-72, *as amended reprinted in* JACKSON, *supra* note 2, at 845. *See supra* note 11 and accompanying text (defining customs union).

45. Jonathan M. Cooper, Comment, *NAFTA's Rule of Origin and Its Effect on the North American Automotive Industry*, 14 NW. J. INT'L L. & BUS. 442, 445 (1994). Fundamental differences among nations, such as climate, raw material endowment, and labor force, give each country a comparative advantage in certain types of goods. Turbowicz, *supra* note 6, at 70. Countries gain by exporting their products of comparative advantage to pay for low-cost imports from foreign countries. *Id.* at 70-71.

46. *Id.* at 11. Economies of scale refer to "the possibility that increasing the scale of production [will] lead[ ] to lower average costs per unit." *Id.*

47. *Id.* at 70-71. Benefits from achieving economies of scale have a particularly positive impact on small countries, such as Israel. *Id.* at 12-14.

48. *Id.* at 72-73. As countries that are members of a free trade area reduce tariffs on each other's products, new trade is created. *Id.* at 72; *Right Direction*, *supra* note 10, at 24. As a result, some goods previously bought from domestic producers are purchased from the lower cost partner country. Turbowicz, *supra* note 6, at 72; *Right Direction*, *supra* note 10, at 24. Such trade creation improves efficiency. Turbowicz, *supra* note 6, at 72; *Right Direction*, *supra* note 10, at 24.

49. Turbowicz, *supra* note 6, at 72-73. As countries that are members of free trade areas remove tariffs with respect to other free-trade-area members' goods, but not with respect to the goods of non-member countries, a preference to purchase goods from within the free trade area develops. *Id.* at 72; *Right Direction*, *supra* note 10, at 24. Such

Since the mid-1980's, there have been a proliferation of bilateral and regional FTAs,[50] triggered by the United States' reversal of its long-standing policy opposing such agreements.[51] In

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trade diversion reduces efficiency when it represents a switch from an efficient source outside the free trade area to a less efficient producer within the free trade area. Turbowicz, *supra* note 6, at 72; *Right Direction*, *supra* note 10, at 24.

50. Ernest H. Preeg, *The Post-Uruguay Round Free Trade Debate*, 19 WASH. Q. 223, 226 (1996) [hereinafter *Post-Uruguay Round*]. According to the WTO, countries notified GATT of 109 regional FTAs between 1948 and the end of 1994. *Right Direction*, *supra* note 10, at 23. Nearly one-third of those agreements were signed between 1990 and 1994. *Id.* The United States negotiated bilateral free trade deals with Israel in 1985 and Canada in 1988. *Id.* The United States, Canada, and Mexico entered into the North American Free Trade Agreement ("NAFTA") in 1993. *Id.* *See* North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 289 (entered into force Jan. 1, 1994) [hereinafter NAFTA] (setting forth NAFTA between Canada, Mexico, and United States). In 1994, the United States reached agreement to achieve free trade in the Western Hemisphere by 2005, beginning with Chile and a "NAFTA-parity" agreement with the Caribbean Basin countries. *Post-Uruguay Round*, *supra*, at 226. *But see* Robert S. Greenberger & Jonathan Friedland, *Latin Nations, Unsure of U.S. Motives, Make Their Own Trade Pacts*, WALL ST. J., Jan. 9, 1996, at A1 (reporting that Chile signed FTA with Mexico and is discussing one with Canada because domestic political concerns have prevented United States from extending NAFTA to Chile). A similar approach was taken to the Asia-Pacific region, where the Asia-Pacific Economic Cooperation ("APEC") forum plans to have free trade in place by 2020, with a 2010 date for the more developed countries, including the United States and Japan. *Post-Uruguay Round*, *supra*, at 226; *Right Direction*, *supra* note 10, at 23. *But see* Andrew Pollack, *Asian Nations and U.S. Plan Freer Trade*, N.Y. TIMES, Nov. 17, 1995, at A9 (noting that APEC has no means of enforcement and that its guidelines are non-binding, do not eliminate tariffs, and do not define what is meant by free trade). APEC includes the United States, Japan, China, Taiwan, Malaysia, Australia, and a dozen other countries with Pacific coastlines. *Right Direction*, *supra* note 10, at 23. The European Community has also been broadening its regional free trade affiliations. *Post-Uruguay Round*, *supra*, at 226. Since Austria, Finland, and Sweden joined the European Union in 1995, the European Community has reached FTAs with several East European countries, and concluded a customs union between the European Community and Turkey. *Id.* Other regional FTAs involve Australia and New Zealand; the Association of Southeast Asian Nations ("ASEAN"), which includes Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam; and Mercosur, which consists of Argentina, Brazil, Paraguay, and Uruguay. *Id.* at 226-27. The Transatlantic Free Trade Agreement ("TAFTA") is a recent proposal that would eliminate some quotas and tariffs and harmonize regulatory standards between the European Community and the NAFTA countries. *Id.* at 227; Kyle Pope & Robert S. Greenberger, *Europe Seeks Trade Pact with U.S. Similar to Nafta*, WALL ST. J., Nov. 27, 1995, at A14. *But see* Nathaniel C. Nash, *Showing Europe that U.S. Still Cares*, N.Y. TIMES, Dec. 3, 1995, at 20 (reporting that United States and Europe signed document creating Trans-Atlantic Marketplace that reduces tariffs and non-tariff barriers to U.S.-Europe trade but that no enthusiasm existed to negotiate more comprehensive agreement such as TAFTA).

51. *Post-Uruguay Round*, *supra* note 50, at 226. In 1982, the United States became frustrated by other countries' refusals to agree to a new round of GATT talks. *Right Direction*, *supra* note 10, at 23; FRENKEL, *supra* note 8, at 112-13. U.S. trade negotiators were also disappointed with the GATT's regulation of trade and its inability to adapt to the World's new commercial needs. Turbowicz, *supra* note 6, at 53. By negotiating

terms of trade coverage, FTAs are approaching a majority position within the overall world trading system.[52] The Clinton Administration, for example, has concluded more than 180 trade agreements over the past three years.[53]

Studies suggest that free trade areas achieve more trade creation than diversion[54] and lead to reduced trade barriers not only to free trade area members but also to non-member nations.[55] An advantage of bilateral FTAs over multilateral agreements is the equal treatment that developing countries receive in the bilateral context, where both parties are expected to provide fully reciprocal access to each other's markets.[56] In addition, bilateral negotiations, because they involve fewer countries, are more flexible than multilateral talks.[57] Changes are easier to achieve.[58] Bilateral and regional FTAs are also well-suited to address broad ranges of issues that are more easily negotiated between fewer parties, allowing accords to go beyond mere elimination of tariffs and quotas and achieve greater degrees of harmonization[59] of nations' policies.[60]

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bilateral agreements, the United States hoped to motivate other nations to expand trade on a global basis. *Id.* at 54; FRENKEL, *supra* note 8, at 113, 117.

52. *Post-Uruguay Round*, *supra* note 50, at 227. Trade within the European Community and NAFTA countries alone accounts for close to 40% of world exports. *Id.* Implementation of future FTAs, which are currently being negotiated, including TAFTA, would increase FTAs' share of world exports to more than 70%. *Id.*, *See supra* note 50 and accompanying text (listing planned FTAs currently in the negotiation stage).

53. Gary G. Yerkey, *Special Report: 1996 Trade Outlook*, 13 INT'L TRADE REP. (BNA) 125, 125 (Jan. 24, 1996). Columbia University economist Jagdish Bhagwati, a critic of free trade areas, derides the Clinton Administration for its "infatuation" with FTAs. *Right Direction*, *supra* note 10, at 23.

54. *Right Direction*, *supra* note 10, at 24. Stanford University economist Paul Krugman argues that free trade areas usually divert little trade because neighboring nations, in general, conduct significant levels of trade with one another and free trade areas are typically formed by neighboring countries. *Id.*

55. *Id.* While intra-regional trade in Western Europe has increased dramatically since the creation of the European Community, trade barriers to outside countries have also fallen. *Id.* (citing *Regionalism and the World Trading System*, WTO Report, April 1995).

56. *Post-Uruguay Round*, *supra* note 50, at 227. Mexico, for example, gets special treatment under the Uruguay Round, where it maintains reduced tariffs on only 10 to 20% of its imports, and is treated as an equal in NAFTA, whereby Mexico eliminates virtually all border restrictions on 70% of its imports. *Id.* at 227-28.

57. *Right Direction*, *supra* note 10, at 27.

58. *Id.*

59. BLACK'S LAW DICTIONARY, *supra* note 1, at 718. Harmonization refers to the act of bringing something into "agreement, conformity, or accordance with" something else. *Id.* Harmonization efforts aim to unify laws and standardize customs. JOHN H.

Critics argue that free trade areas threaten to undermine the multilateral framework for global free trade that the GATT established almost fifty years ago.[61] Free trade areas are a major exception to GATT's most-favored-nation[62] ("MFN") principle of non-discriminatory trade that compels each member to treat the other trading members in the same manner as it treats its most favored trading partners.[63] The GATT founders allowed the free-trade-area exception because they recognized that free trade areas liberalize trade, in conformity with the GATT's primary goal.[64] Supporters of free trade areas contend that FTAs

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JACKSON ET. AL, LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 45 (3d ed. 1995). Such efforts may take the forms of conventions signed by nations that agree to apply the conventions' rules, model laws that are drafted by international organizations for adoption by individual countries, and statements of practice that nations can include in their agreements. *Id.*

60. *Post-Uruguay Round*, *supra* note 50, at 229. The European Community, for example, has established the goals of a single integrated market and monetary union. *Id.* NAFTA addresses investment policy, intellectual property rights, financial services, transportation, and contains side agreements on labor and environmental standards. *Id.*

61. BHAGWATI, *supra* note 7, at 58-79. Politicians frequently benefit from blaming FTAs for economic problems. *See* John Holusha, *Squeezing Textile Workers*, N.Y. TIMES, Feb. 21, 1996, at D1 (reporting that Patrick Buchanan, like Ross Perot in 1992, enjoyed surge in polls by attacking NAFTA and other U.S. FTAs). In his recent campaign speeches, Buchanan supported a 10% tariff on imports from Japan, a 40% tariff on Chinese goods, a quality-of-life tax on Mexico and other developing nations, and U.S. withdrawal from NAFTA and the WTO. Jim McTague, *Can Trade Stand Pat?*, BARRON'S, Feb. 26, 1996, at 17. Such calls for protectionism are effective with voters more due to workers' anxieties about a changing economy than actual problems in international FTAs. Richard L. Berke, *Some Republicans Hoping for a Way to Stop Buchanan*, N.Y. TIMES, Feb. 22, 1996, at A1, B7 (quoting retired Chairman of U.S. Joint Chiefs of Staff, Gen. Colin L. Powell).

62. GATT, *supra* note 3, art. I(1), 61 Stat. at A12, 55 U.N.T.S. at 198.

63. *Id.*; *Id.* art. XXIV(5), 61 Stat. at A67, 55 U.N.T.S. at 272, *as amended reprinted in* JACKSON, *supra* note 2, at 843-44. Free trade areas do not comply with the MFN principle because the free trade area's trade concessions are accorded only among the parties to the FTA and not to the rest of the GATT contracting parties. Turbowicz, *supra* note 6, at 67. In order to avoid dilution of the MFN principle and abuse of the exception, use of free trade areas is restricted. *Id.* As a result, FTAs must satisfy three basic criteria in order to be valid under GATT. GATT, *supra* note 3, art. XXIV(5)(b)-(c), (8)(b), 61 Stat. at A67, 55 U.N.T.S. at 270-72, *as amended reprinted in* JACKSON, *supra* note 2, at 844-45. *See* Ward, *supra* note 19, at 204-07 (discussing FTA criteria under GATT that include elimination of duties on substantially all trade, prohibition of raising new trade barriers to non-member states, and requirement to implement accord within reasonable length of time). The three FTA requirements, however, are not strongly enforced. Turbowicz, *supra* note 6, at 74-75. In practice, of the 69 GATT working parties established to examine the consistency of free trade areas and customs unions with the Article XXIV criteria, only six reached a conclusion. *Right Direction*, *supra* note 10, at 27.

64. Ward, *supra* note 19, at 204. *See* GATT, *supra* note 3, art. XXIV(4), 61 Stat. at

will actually help achieve the goal of global free trade[65] by continuing the free-trade momentum at a time when global negotiations are languishing.[66]

2. Rules of Origin

Rules of origin are the laws, regulations, and practices that determine the country of origin of goods in international trade.[67] In FTAs, rules of origin determine when goods qualify for tariff-free treatment.[68] FTA members utilize rules of origin to prevent trade deflection[69] and, thus, to capture most of the benefits of the FTA.[70] Some criticize the continued use of rules of origin in a globalized economy where goods are manufactured from components that originated in many different countries.[71]

Yet, it is this growing globalization of trade, characterized by multiple-country manufacturing, that has increased the significance of rules of origin in recent years.[72] The need to distinguish between goods of different countries has grown with the rise in the number of reciprocal trade agreements[73] and country-

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A67, 55 U.N.T.S. at 270-72, *as amended reprinted in* JACKSON, *supra* note 2, at 843 (acknowledging that voluntary agreements between countries increases freedom of trade by developing countries' economic integration).

65. *See, e.g.*, Malcolm Rifkind, *Practical Steps to Take toward Global Free Trade*, WALL. ST. J., Nov. 30, 1995, at A20 (arguing that regional integration does not hinder, but promotes, broader liberalization because European common market has oriented European countries toward free trade and stimulated their economic growth, thus, increasing size of European market for other countries' exports).

66. *Right Direction*, *supra* note 10, at 24. Enthusiasm for future multilateral trade talks has ebbed following completion of the seven-year Uruguay Round. *Id.* *See supra* note 8 and accompanying text (defining Uruguay Round negotiations).

67. N. David Palmeter, *Rules of Origin or Rules of Restriction? A Commentary on a New Form of Protectionism*, 11 FORDHAM INT'L L.J. 1, 2 (1987); C. Edward Galfand, Comment, *Heeding the Call for A Predictable Rule of Origin*, 11 U. PA. J. INT'L BUS. L. 469, 469 (1989).

68. *Right Direction*, *supra* note 10, at 24.

69. Cooper, *supra* note 45, at 452. Trade deflection occurs when countries outside the free trade region perform simple assembly operations on their final products in one area of the free trade region so that these products can qualify for preferential tariff treatment upon export to other areas of the free trade region. *Id.*

70. *Id.*

71. *Right Direction*, *supra* note 10, at 24 (noting criticism of Jagdish Bhagwati).

72. STANDARDIZATION REPORT, *supra* note 14, at 26. Rules of origin are very significant to the operation of a free trade area and they are typically viewed as one of the most contentious topics in the negotiation of an FTA. Turbowicz, *supra* note 6, at 163. Different rules of origin, depending upon their structure and their stringency, produce disparate economic effects. *Id.* at 136-39.

73. BLACK'S LAW DICTIONARY, *supra* note 1, at 1270. A reciprocal trade agreement

specific trade restrictions.[74] These restrictions are embodied not only in preferential tariff[75] schemes that favor goods from certain countries[76] but also in buy national requirements,[77] voluntary restraint agreements[78] ("VRAs"), and antidumping and countervailing duty orders.[79] To be effective, these restrictive programs require specific rules that determine the origin of goods.[80]

Currently, there is no uniform, international rules-of-origin standard.[81] Each country has its particular origin rules and,

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is defined as an "[a]greement between two countries providing for interchange of goods between them at lower tariffs and better terms than exist between one such country and other countries." *Id.*

74. STANDARDIZATION REPORT, *supra* note 14, at 26.

75. BLACK'S LAW DICTIONARY, *supra* note 1, at 1178. A preferential tariff is defined as "[a] tariff which imposes lower rates of duty on goods imported from some countries . . . than on the same goods imported from other countries." *Id.*

76. Palmeter, *supra* note 67, at 2. For example, the U.S. Generalized System of Preferences ("GSP") program, instituted in 1975, allows eligible products from certain developing countries to enter the United States duty-free. Bello & Holmer, *supra* note 17, at 214. *See* Generalized System of Preferences, 19 U.S.C. §§ 2461-66 (1994) [hereinafter GSP] (setting forth text of GSP program).

77. Bello & Holmer, *supra* note 17, at 216. Favoring domestic goods, buy national requirements restrict products eligible for government procurement based on national origin. *Id.*

78. *Id.* at 215. A country signing a voluntary restraint agreement ("VRA") agrees to restrict exports of certain products to a particular destination in order to reduce trade tensions and avoid the imposition of quotas by the importing country. *Id.*

79. *Id.* at 216. Antidumping and countervailing duty laws mandate the imposition of offsetting duties on imports from certain countries when those products are subsidized or sold at less than fair market value, threatening injury to domestic producers of competing products. *Id.*

80. *Id.* at 215. In addition to governing the implementation of preferential and restrictive trade programs, rules of origin serve as the criteria to collect international statistical data on a country-by-country basis. Turbowicz, *supra* note 6, at 130. They are also used for marking purposes to inform consumers of the origin of products, for the calculation of balances of trade and of payments, and for the implementation of health, safety, or other standards. STANDARDIZATION REPORT, *supra* note 14, at 25.

81. Bello & Holmer, *supra* note 17, at 218. In preparatory work that preceded completion of the GATT in 1947, the document's drafters declared that each member country had the authority to determine its own rules governing the origin of goods. JACKSON, *supra* note 2, at 468. A 1952 recommendation by the International Chamber of Commerce that the GATT parties adopt a common definition of origin was met with significant opposition and was abandoned. *Id.* at 466-68. The International Convention on the Simplification and Harmonization of Customs Procedures, known as the Kyoto Convention, was signed on May 18, 1973 under the auspices of the Customs Cooperation Council, an international organization that provides technical assistance to its members in the sphere of customs matters. Edurne N. Varona, *Rules of Origin in the GATT, in* RULES OF ORIGIN IN INTERNATIONAL TRADE: A COMPARATIVE STUDY 355, 359-60 (Edwin Vermulst et al. eds., 1994). Annex D.1, the portion of the Kyoto Convention

within each country, different standards apply for different programs.[82] Goods that are wholly produced in one country do not pose a problem and are considered originating in that country.[83] Similarly, if almost no processing occurred in a given country, it is understood that origin will not be conferred there.[84] Rather, a discrepancy arises when a country assembles a product from components that originated both inside and outside its territory.[85] In that case, the aim is to attribute origin to the country whose economy is sufficiently connected to the exported product.[86] This determination can be made using a general standard such as the substantial transformation test[87] or by using more specific criteria such as a change of tariff heading test,[88] a value added content standard,[89] a critical process requirement,[90] or a

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that addresses rules of origin, is reproduced in O.J. L 166/3 (1977). As of November 1991, 23 countries, in addition to the European Community, had ratified the annex of the Kyoto Convention dealing with rules of origin. *Id.* at 360. The United States partially ratified the Kyoto Convention in 1983 but did not accept the annex covering rules of origin. *Id.* While the Kyoto Convention established criteria for determining types of products that are wholly obtained in a given country and simple operations that do not constitute substantial manufacturing or processing, it did not propose a single approach to the more controversial origin issues, instead presenting the various options and leaving ultimate decisions up to individual countries. *Id.* at 361-62. The Kyoto Convention did not, therefore, set forth a uniform international origin system. *Id.* at 361.

82. STANDARDIZATION REPORT, *supra* note 14, at 7-24. *See* U.S. INT'L TRADE COMM'N, PUB. NO. 1695, THE IMPACT OF RULES OF ORIGIN ON U.S. IMPORTS AND EXPORTS, REPORT TO THE PRESIDENT ON INVESTIGATION NO. 332-192 UNDER SECTION 332 OF THE TARIFF ACT OF 1930 19-108 (1985) [hereinafter IMPACT REPORT] (presenting rules of origin of United States and major trading nations).

83. Turbowicz, *supra* note 6, at 131-32.

84. *Id.* at 133. All origin systems specify certain minor processes, such as simple packaging operations, labelling, simple mixing, and assembly of parts, that are insufficient to confer origin status. Jacques Nusbaumer, *Origin Systems and the Trade of Developing Countries*, 13 J. WORLD TRADE L. 34, 36 (1979).

85. Turbowicz, *supra* note 6, at 132.

86. Ian S. Forrester, *EEC Customs Law: Rules of Origin and Preferential Duty Treatment, Part I*, 5 EUR. L. REV. 167, 173 (1980).

87. Turbowicz, *supra* note 6, at 134. The substantial transformation test provides, generally, that a product produced in more than one country is considered a product of the country in which it last underwent a substantial transformation. Galfand, *supra* note 67, at 470.

88. Cooper, *supra* note 45, at 452. The change of tariff heading test is one of the basic standards employed by the European Community, particularly for textile products and for goods from countries receiving preferential tariff treatment. STANDARDIZATION REPORT, *supra* note 14, at 21-22.

89. Cooper, *supra* note 45, at 452. The United States used value added content standards for certain aspects of its origin requirements in the U.S.-Israel FTA, the U.S.-Canada Free Trade Agreement ("U.S.-Canada FTA"), and the NAFTA. *Id.* at 453 n.79.

combination of one or more of these schemes.[91] When an FTA involves a group of nations and a product undergoes manufacturing in more than one member country, the FTA may confer origin based upon a cumulation of the product's successive transformations in the various countries.[92]

Various initiatives have attempted to formulate a single origin standard to govern international trade.[93] In 1983, the Office of the United States Trade Representative[94] ("USTR") suggested two possible ways to achieve harmonization of world origin rules: use of the change in tariff heading test based upon the internationally accepted Harmonized Commodity Description and Coding System[95] ("Harmonized System") or adoption of a common value-added criterion.[96] In 1987, the U.S. International Trade

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See U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 1(c), 24 I.L.M. at 669-70 (containing 35% value added rule in U.S.-Israel FTA); Canada-United States: Free Trade Agreement, Dec. 22, 1987-Jan. 2, 1988, U.S.-Can., Annex 301.2, ¶ 4(a), 27 I.L.M. 281, 297 [hereinafter U.S.-Canada FTA] (presenting 50% domestic content requirement in U.S.-Canada FTA); NAFTA, *supra* note 50, art. 402, 32 I.L.M. at 349 (discussing regional value content in NAFTA).

90. Cooper, *supra* note 45, at 453. The European Community uses the critical process requirement for some products, allowing certain operations to confer origin even where no change in tariff heading occurs. STANDARDIZATION REPORT, *supra* note 14, at 23.

91. Cooper, *supra* note 45, at 453. Japan, for example, requires that some products satisfy the change in tariff heading test as well as contain a minimum level of domestic added value. STANDARDIZATION REPORT, *supra* note 14, at 21.

92. Turbowicz, *supra* note 6, at 134-36. *See* Nusbaumer, *supra* note 84, at 43-44 (discussing benefits of cumulation in FTAs between industrialized and developing countries).

93. Bello & Holmer, *supra* note 17, at 218.

94. FRENKEL, *supra* note 8, at 105. The Office of the U.S. Trade Representative ("USTR"), situated in the Executive Office of the President, is the lead agency for U.S. trade negotiations and trade policy. *Id.*

95. JACKSON, *supra* note 59, at 394. The Harmonized Commodity Description and Coding System ("Harmonized System") entered into force on January 1, 1988. *Id.* It established an internationally accepted classification system that makes tariff nomenclature uniform worldwide. *Id.*; Galfand, *supra* note 67, at 489-90. The Harmonized System is composed of 21 sections which are divided into 99 chapters that are further divided into headings. Galfand, *supra* note 67, at 490. It classifies nearly 10,000 different items that are traded among nations. *Id.* The Harmonized System is based upon an earlier international classification system, the Brussels Tariff Nomenclature, that was approved by the Customs Cooperation Council in 1950. *Id.* at 489 n.171; JACKSON, *supra* note 59, at 394.

96. *USTR Report Says U.S. Getting Ready to Formulate Rules of Origin Stance*, 8 INT'L TRADE REP. (BNA) 536, 536 (July 6, 1983). The common value-added criterion would confer origin upon the country in which a given percentage of a product's value was added. *Id.* This standard resembles the value-added requirement in many U.S. agree-

Commission[97] ("ITC") proposed the adoption of an international rule of origin for customs purposes that would confer origin based upon the performance of specific industrial processes in the situs country.[98] In its proposal, the ITC suggested that the tariff nomenclature could be utilized to segregate product sectors and determine some of the processes to be enumerated in the rule.[99] Due to extensive disagreement over the nature of an international rule of origin, however, the ITC limited its proposal to determining origin for statistical purposes.[100]

Finally, in 1989, during the Uruguay Round negotiations of the GATT, the United States proposed that the GATT adopt a uniform rule of origin to govern international trade.[101] The proposal was based upon the change of tariff heading test, using the Harmonized System nomenclature, and was modeled after the rules of origin in the U.S.-Canada Free Trade Agreement ("U.S.-Canada FTA").[102] Some commentators criticized the proposal because the Harmonized System tariff nomenclature was not designed to determine origin of goods[103] and because the proposal suggested that countries would be permitted to maintain

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ments. *Id.* *See supra* note 89 and accompanying text (discussing value-added standards in U.S.-Israel FTA, U.S.-Canada FTA, and NAFTA).

97. FRENKEL, *supra* note 8, at 108. The U.S. Congress established the International Trade Commission ("ITC") in 1916 to provide Congress and the President with expert and impartial information in the formulation of trade policy. *Id.* The ITC, an independent and quasi-judicial agency, consists of six commissioners appointed by the President and is supported by a professional staff. *Id.* The ITC conducts studies at the request of the Executive or Legislative branches concerning the impact of trade policies. *Id.*

98. STANDARDIZATION REPORT, *supra* note 14, at 5-6.

99. *Id.* at 6.

100. *Id.* at 7.

101. Turbowicz, *supra* note 6, at 156. The U.S. proposal to the GATT Negotiating Group on Non-Tariff Measures is reprinted in N. David Palmeter, *The U.S. Rules of Origin Proposal to GATT: Monotheism or Polytheism?*, 24 J. WORLD TRADE 25, 34-36 (1990). Hong Kong also proposed a uniform, international rule of origin, but its proposal was less ambitious and focused upon harmonization that could be achieved with less negotiation over a shorter span of time. Turbowicz, *supra* note 6, at 158; *Canada Offers Compromise on Reducing Tariffs in Uruguay Round Negotiations*, 6 INT'L TRADE REP. (BNA) 1266, 1267 (Oct. 4, 1989).

102. Palmeter, *supra* note 101, at 26. *See* U.S.-Canada FTA, *supra* note 89, art. 301, 27 I.L.M. at 295 (presenting rules of origin in U.S.-Canada FTA).

103. Palmeter, *supra* note 101, at 26. Because not all tariff heading changes are considered significant enough to produce a change in origin, use of the Harmonized System nomenclature would necessitate the drafting of additional specifications to indicate which changes in tariff classification must occur to change the origin of imported materials. *Id.* This determination could be achieved by reviewing the tariff list product-

several different systems of origin as long as consistency is maintained within each system.[104] In response to the U.S. proposal, the GATT parties drafted an Agreement on Rules of Origin[105] that initiated a three-year World Trade Organization[106] ("WTO") investigation to harmonize non-preferential rules of origin for goods in trade.[107] The WTO is considering use of the change in Harmonized System tariff classification standard as a way to determine when substantial transformation has occurred.[108] The WTO will publish the results of its investigation in an annex to the GATT's Uruguay Round Agreement on Rules of Origin.[109]

B. *The U.S.-Israel FTA*

In 1984,[110] the U.S. Congress authorized President Ronald

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by-product or by utilizing a different standard where the change in tariff heading is inappropriate. *Id.* at 26, 28.

104. *Id.* at 29.

105. Agreement on Rules of Origin, *in* JOHN H. JACKSON ET. AL, 1995 DOCUMENTS SUPPLEMENT TO LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 235 (1995).

106. Aceves, *supra* note 8, at 428. The WTO was created as a result of the recently concluded Uruguay Round trade talks. *Id.* *See supra* note 8 and accompanying text (discussing Uruguay Round and role of WTO). The concept of an international organization such as the WTO that would regulate the multilateral trading system is not a new one. Aceves, *supra* note 8, at 432 n.20. The first such institution, the International Trade Organization, was discussed in the original GATT agreement. *Id.*

107. *Also in the News*, 12 INT'L TRADE REP. (BNA) 707, 707 (Apr. 19, 1995) (stating that ITC will prepare report to WTO's Committee on Rules of Origin and Customs Cooperation Council's Technical Committee on Rules of Origin, bodies that are developing harmonized standards). *But see* Rossella Brevetti, *Crane Says Trade Panel Hopes to Finish Origin Rule Guidelines by End of the Year*, 12 INT'L TRADE REP. (BNA) 1174, 1174 (July 12, 1995) (predicting that it will be at least five years before harmonized rules take effect). Despite the WTO's current work to harmonize rules of origin, the U.S. Treasury Department, citing the immediate need for uniform country of origin rules, proposed that all countries adopt the interim marking rules that are contained in the NAFTA. *Id.*

108. *Comments Sought by ITC on Harmonization of Origin Rules*, 12 INT'L TRADE REP. (BNA) 1112, 1112-13 (June 28, 1995) [hereinafter *ITC Harmonization*].

109. *Id.* at 1112.

110. Ward, *supra* note 19, at 213. Israel first proposed the idea of an FTA with the United States in the early 1970's when Israel was negotiating its FTA with the European Community. FRENKEL, *supra* note 8, at 113. The United States rejected the proposal, declaring disinterest in any bilateral arrangements. *Id.* at 113-14. Israel proposed the concept again in 1981, in the context of a possible three-way free trade area between the United States, Israel, and Egypt or two bilateral FTAs between the United States and Israel and the United States and Egypt. *Id.* at 114-15. Out of concern for affecting U.S. relations with Arab countries, the United States contacted Egypt and Saudi Arabia and asked whether the two countries were interested in bilateral FTAs with the United

Reagan to negotiate a comprehensive FTA with Israel.[111] One of the United States' goals was to undercut the trade advantage that

States. *Id.* at 115. Both countries declined the U.S. offer and indicated that they would not oppose a U.S.-Israel FTA. *Id.* President Ronald Reagan approved the negotiation of the U.S.-Israel FTA in June 1982 and announced the U.S.-Israel agreement to negotiate the FTA on November 29, 1983, during Israeli Prime Minister Yitzhak Shamir's visit to the United States. *Id.* at 116, 120. Formal U.S.-Israel FTA negotiations commenced in Washington on January 17, 1984. Nikelsberg, *supra* note 27, at 375 n.23.

111. Trade and Tariff Act of 1984 § 401(a)(1)-(2), 19 U.S.C. § 2112(b) (1994). The Trade and Tariff Act of 1984, signed into law on October 30, 1984, authorized the President to negotiate the FTA with Israel as well as FTAs with other interested countries, provided that the other country requested the negotiations and the U.S. President submitted the proposal to the House Ways and Means and Senate Finance committees for early approval. Ward, *supra* note 19, at 213-14. *See* Trade and Tariff Act of 1984 § 401(a)(2), 19 U.S.C. § 2112(b)(4)(A) (1994) (containing framework for future FTA negotiations with other countries). New FTA-negotiating legislation was necessary because, although nontariff barrier negotiating authority was extended until January 3, 1988, in the Trade Agreements Act of 1979, the tariff-cutting authority in the Trade Act of 1974 expired on January 2, 1980, and had not been renewed. FRENKEL, *supra* note 8, at 121; Ward, *supra* note 19, at 213 n.127. *See* Trade Act of 1974 § 101, 19 U.S.C. § 2112 (1994) (granting President tariff-cutting authority); Trade Act of 1974 § 102, 19 U.S.C. § 2112 (1994) (granting President nontariff-cutting authority). Congress passed the Trade Act of 1974 to provide the President with authority to proclaim tariff reductions under the Tokyo Round of multilateral negotiations. FRENKEL, *supra* note 8, at 102; Ward, *supra* note 19, at 213 n.127. *See supra* note 8 and accompanying text (discussing Tokyo Round and other rounds of GATT-sponsored negotiations). The Trade and Tariff Act of 1984 amended § 102 of the Trade Act of 1974 to allow negotiation of the U.S.-Israel FTA. Ward, *supra* note 19, at 213. *See* Trade and Tariff Act of 1984 § 401(a)(1)-(2), 19 U.S.C. § 2112(b) (1994) (providing authority to negotiate U.S.-Israel FTA).

In the United States, the President must submit all FTAs to Congress for approval. Ward, *supra* note 19, at 214. This procedure requires that the President give Congress at least 90 days notification of his intention to enter into an agreement. Trade Act of 1974 § 102(e)(1), 19 U.S.C. § 2112(e)(1) (1994). After entering into the agreement, the President must submit it to the House Ways and Means Committee and the Senate Finance Committee. *Id.* § 102(e)(2), 19 U.S.C. § 2112(e)(2) (1994). Under the "fast-track" procedure, each committee has 45 days to approve or reject the proposed agreement. *Id.* § 151(e)(1), 19 U.S.C. § 2191(e)(1) (1994). If approved, the agreement is submitted for a final vote before each house of Congress, where the bill must be passed without amendment within 15 days. *Id.* If either committee rejects the agreement or if either house of Congress fails to pass the measure, the President may resubmit the bill under the normal legislative process. Ward, *supra* note 19, at 215.

In addition to the President and Congress, several Executive-branch agencies are involved in the FTA-negotiation and implementation process. *See* FRENKEL, *supra* note 8, at 104-08 (detailing relationships between different bodies in trade negotiation process). The USTR handles the actual negotiation of the FTA. *Id.* at 105; *see supra* note 94 and accompanying text (discussing USTR's responsibilities). The Commerce Department represents the interests of U.S. industry in the trade policy process and is responsible for U.S. trade operations in manufactured goods. FRENKEL, *supra* note 8, at 106. The Customs Service, an agency of the Treasury Department, is responsible for the collection of duties. *Id.* In addition, trade policy recommendations are sought

the European Community enjoyed with Israel as a result of the 1975 EC-Israel FTA.[112] Although Israel did not represent a main source of U.S. imports[113] or a significant market for U.S. exports[114] relative to the United States' other trading partners, the Reagan Administration felt the U.S.-Israel FTA negotiations were significant[115] because, in addition to remedying the comparative

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from the ITC, an independent agency. *Id.* at 108; *see supra* note 97 and accompanying text (outlining ITC's duties).

112. Ward, *supra* note 19, at 201-03; FRENKEL, *supra* note 8, at 82. U.S. exporters complained to the ITC that their trade with Israel had been disadvantaged by the EC-Israel FTA. Ward, *supra* note 19, at 202. Indeed, the European Community's market share of Israeli imports rose from 33.7% in 1980 to 40.9% in 1983 and would only increase as the EC-Israel FTA reached full implementation by 1989. *Id.* at 202; FRENKEL, *supra* note 8, at 82-83. *See supra* note 23 and accompanying text (discussing U.S. motivation to challenge European Community as Israel's primary trade partner).

113. FRENKEL, *supra* note 8, at 3-4. In 1983, only 0.5% of U.S. imports came from Israel and 93% of these imports already entered the United States duty-free. *Id.* at 3. Israeli exports enjoyed such preferential status in the United States either because of Israel's MFN or GSP status. Nikelsberg, *supra* note 27, at 374; *see supra* notes 62, 76 and accompanying text (defining MFN principle and GSP program). As a result, prior to implementation of the U.S.-Israel FTA, 35% of Israeli exports under the GSP and 55% of Israeli exports under GATT tariff reductions already entered the United States duty-free. Ward, *supra* note 19, at 201 n.14. The economic significance of the U.S.-Israel FTA to the United States was therefore relatively inconsequential. FRENKEL, *supra* note 8, at 3-4.

114. FRENKEL, *supra* note 8, at 56. In 1983, U.S. exports to Israel were valued at US$1.6 billion, "with approximately 60% already entering Israel duty-free on either an MFN or temporary duty-free basis." W. Charles Sawyer & Richard L. Sprinkle, *U.S.-Israel Free Trade Area: Trade Expansion Effects of the Agreement*, 20 J. WORLD TRADE L. 526, 531 (1986).

115. Telephone interview with Colin MacKinnon, Middle East Executive Reports (Aug. 31, 1994) (stating that Reagan Administration viewed U.S.-Israel FTA more as symbolic gesture than economic necessity). The negotiators' initial goal was to complete the U.S.-Israel FTA by early September 1984. FRENKEL, *supra* note 8, at 120. This would allow the Reagan Administration to demonstrate its pro-Israel position before the 1984 presidential election. Turbowicz, *supra* note 6, at 57. The final U.S.-Israel FTA negotiating session, in fact, occurred on January 23, 1985. FRENKEL, *supra* note 8, at 131. Both countries initialed the FTA on March 7, 1985. *Id.* Initialing of an agreement is official indication that negotiations are concluded, but that technical changes must be made before formal signing. *Id.* at 131 n.44. Israel and the United States formally signed the FTA on April 22, 1985, and both houses of the U.S. Congress passed the FTA's implementing legislation on June 11, 1985. *Id.* at 132. *See* United States-Israel Free Trade Area Implementation Act of 1985 § 8(b)(1), 19 U.S.C. § 2112(b)(3) (1994) (providing that reduction of U.S. duties under U.S.-Israel FTA would not apply to other nations that trade with United States). The Israeli Cabinet voted to implement the FTA on August 18, 1985, and the FTA entered into force the next day after the parties notified the GATT. FRENKEL, *supra* note 8, at 132. It is widely agreed that the U.S.-Israel FTA satisfied the GATT requirements for free trade areas. Ward, *supra* note 19, at 223-28; Turbowicz, *supra* note 6, at 100; Guy T. Petrillo, Note, *Free Trade Area Agreements and U.S. Trade Policy*, 18 N.Y.U. J. INT'L L. & POL. 1281, 1314 (1986). *See*

disadvantage of U.S. exports to Israel as compared to EC exports after implementation of the EC-Israel FTA, the United States wished to use the U.S.-Israel FTA as a means to encourage other countries to join new multilateral trade talks.[116]

1. U.S. Rules of Origin

a. The Substantial Transformation Test

The substantial transformation test is the traditional rule-of-origin standard in the United States.[117] This test indicates that a product produced in more than one country is considered a product of the country in which it last underwent a substantial transformation.[118] While no statutes or regulations specifically define substantial transformation, court decisions and administrative rulings have given this phrase meaning.[119] When the Supreme Court first articulated this standard,[120] it defined substantial transformation as a manufacturing process that produced a new and different article with a distinctive name, character, or use.[121] After this initial Supreme Court interpretation,

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supra note 63 and accompanying text (presenting GATT requirements for free trade areas).

116. Sawyer & Sprinkle, *supra* note 114, at 526; FRENKEL, *supra* note 8, at 116-19. *See supra* note 51 and accompanying text (discussing U.S. shift to bilateral trade agreements due to frustration with countries' refusals to enter new multilateral negotiations). The U.S.-Israel FTA was also consistent with longstanding U.S. foreign policy and a desire to improve Israel's economic situation, thus, reducing Israel's dependence on U.S. foreign aid. Nikelsberg, *supra* note 27, at 376; Sawyer & Sprinkle, *supra* note 114, at 528-29. In any event, the small size of the Israeli economy in relation to the U.S. market insured that the United States would not seriously be harmed even if the agreement proved to be a failure. Nikelsberg, *supra* note 27, at 376 n.31. Israel greatly desired the U.S.-Israel FTA because it feared that the GSP would expire and Israel would, thus, lose a substantial source of its trade privileges with the United States. Nikelsberg, *supra* note 27, at 374; *see supra* note 76 and accompanying text (defining GSP program). The GSP was, in fact, renewed for a period of 8.5 years, commencing January 4, 1985, under the Trade and Tariff Act of 1984 §§ 505, 508, 19 U.S.C. § 2465 (1994). Nikelsberg, *supra* note 27, at 375 n.23. Notwithstanding the program's renewal, it was still in Israel's interest to replace the GSP as a major source of trade benefits, because the 1984 GSP amendments made the program more restrictive. *Id.*

117. Palmeter, *supra* note 67, at 3.

118. Galfand, *supra* note 67, at 470.

119. *Id.*

120. Anheuser-Busch Brewing Ass'n v. United States, 207 U.S. 556, 562 (1908).

121. *Anheuser-Busch*, 207 U.S. at 562. In *Anheuser-Busch*, the Supreme Court held that corks imported from Spain did not qualify for duty drawback, because the corks were not manufactured in the United States of imported materials, but were chemically and physically treated in the United States to make them fit for use in bottling beer for export. *Id.* at 558-62. The drawback statute allowed a U.S. importer to collect a refund

courts interpreted the substantial transformation test in disparate ways, depending upon the court and the product under consideration.[122] Different courts have considered various factors when determining whether a product has satisfied the substantial transformation test, including whether the imported material lost its original identity,[123] whether the manufacturing process transformed the product from one used by producers to one used by consumers,[124] whether processing operations added

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of the U.S. duties it paid on imported materials if the imported materials were used in the manufacture of a product that was exported from the United States. *Id.* at 559. In *Anheuser-Busch*, the Supreme Court found that the exported product was beer, not cork, so the duties paid on the imported cork were not subject to drawback. *Id.* at 563.

122. Cooper, *supra* note 45, at 454; Galfand, *supra* note 67, at 480-84.

123. United States v. Gibson-Thomsen Co., 27 C.C.P.A. 267, 273 (1940). In *Gibson-Thomsen*, the court held that wood brush blocks and toothbrush handles from Japan that were fitted with bristles in the United States to form hairbrushes and toothbrushes, respectively, lost their original identity and became new articles, each having a new name, character, and use. *Gibson-Thomsen*, 27 C.C.P.A. at 273. Consequently, the U.S. marking statute did not require the U.S. importer to print "Made in Japan" on the hairbrushes and toothbrushes, as the Japanese material was substantially transformed in the United States. *Id.* *See* Chemo Puro Mfg. Corp. v. United States, 146 F. Supp. 178, 181 (Cust. Ct. 1954) (holding that nutgalls grown in China for production of tannic acid in United Kingdom had lost their original identity, resulting in new product with new name, use, and tariff status). *See also* Uniroyal, Inc. v. United States, 542 F. Supp. 1026, 1029 (Ct. Int'l Trade 1982), *aff'd per curiam*, 702 F.2d 1022 (Fed. Cir. 1983) (holding that substantial transformation did not occur for purpose of marking statute because attachment of outsoles in United States to leather uppers imported from Indonesia did not change identity of uppers that were essence of completed shoes); National Juice Prods. Ass'n v. United States, 628 F. Supp. 978, 991 (Ct. Int'l Trade 1986) (holding that, for purpose of marking statute, U.S. orange juice processors did not substantially transform juice concentrate from oranges grown and processed abroad by adding water, orange essences, and oils in United States, because foreign concentrate was very essence of U.S.-produced orange juice).

124. Midwood Indus., Inc. v. United States, 313 F. Supp. 951, 957 (Cust. Ct. 1970), *appeal dismissed*, 57 C.C.P.A. 141 (1970). In *Midwood*, the court held that steel forgings imported from West Germany, England, and Italy only had value for producers of flanges and fittings and the forgings were transformed into different articles having a new name, character, and use once they were processed to form fittings and flanges useable by consumers. *Midwood*, 313 F. Supp. at 957. As a result, the U.S. marking statute did not require the U.S. importer of the forgings to mark the fittings and flanges as foreign goods. *Id.* *See* Torrington Co. v. United States, 764 F.2d 1563, 1571 (Fed. Cir. 1985) (holding that sewing needles imported from Portugal qualified for duty-free treatment under U.S. GSP program because two substantial transformations occurred in Portugal, second of which resulted from manufacturing process that converted needle blanks, useable by producers, into finished needles, useable by consumers). *But see Uniroyal*, 542 F. Supp. at 1026 (ignoring change from producer to consumer good that resulted from post-importation manufacturing process in determining whether substantial transformation occurred in United States).

significant value to the product,[125] whether the production process was complex,[126] and whether the manufacturing operations produced a change in the imported material's tariff classification.[127]

b. Application of the Substantial Transformation Test

In the United States, rules of origin and the substantial transformation test are used in several contexts and do not always involve a preferential duty treatment determination.[128] A determination of origin often influences country of origin marking, government procurement, entitlement to drawback, countervailing and antidumping duties, and statistical information-gathering.[129] Additionally, country of origin decides whether a

125. United States v. Murray, 621 F.2d 1163, 1170 (1st Cir.), *cert. denied*, 449 U.S. 837 (1980). In *Murray*, the court held that the defendant made false statements to U.S. authorities by asserting that the glue he had imported originated in Holland, not China, where the glue was originally manufactured. *Murray*, 621 F.2d at 1170. The court held that the glue did not originate in Holland because the rebagging of the glue in Holland did not increase the glue's value and, thus, did not substantially transform the glue in Holland. *Id.* *See Uniroyal*, 542 F. Supp. at 1030 (finding that imported leather uppers were not substantially transformed by attachment of outsoles in United States because, in part, outsoles constituted small portion of cost of completed shoes); *National Juice*, 628 F. Supp. at 990 (holding that U.S. orange juice processors did not substantially transform foreign orange juice concentrate by adding water, orange essences, and oils to it in United States because foreign concentrate constituted majority of value of end product, orange juice, and contents added in United States contributed minor value to juice).

126. Texas Instruments, Inc. v. United States, 681 F.2d 778, 785 (C.C.P.A. 1982). In *Texas Instruments*, the court held that integrated circuits assembled in Taiwan from U.S. materials were substantially transformed into new and different articles of commerce in Taiwan because the U.S. materials underwent extensive manufacturing operations in Taiwan. *Texas Instruments*, 681 F.2d at 785. As a result, the circuits qualified as products produced in Taiwan for purposes of the 35% value-added requirement under the U.S. GSP program. *Id.* at 784. *See Uniroyal*, 542 F. Supp. at 1029-30 (holding that substantial transformation of imported leather uppers did not occur because attachment of outsoles to uppers in United States was minor assembly operation, requiring small fraction of time and skill necessary to produce uppers).

127. Belcrest Linens v. United States, 741 F.2d 1368, 1373 (Fed. Cir. 1984). In *Belcrest*, the court held that pillowcases that were manufactured in Hong Kong from Chinese bolts of cloth should not, upon importation into the United States, be assessed the duty rate for products from China because the processes performed in Hong Kong substantially transformed the Chinese cloth by changing its character, identity, and use. *Belcrest*, 741 F.2d at 1374. In dicta, the court noted that change in tariff classification as a result of the manufacturing process was a factor to consider in determining whether imported material underwent a substantial transformation. *Id.* at 1373.

128. Galfand, *supra* note 67, at 472.

129. Turbowicz, *supra* note 6, at 168.

good is entitled to preferential duty treatment for the purposes of MFN preferences, the Generalized System of Preferences[130] ("GSP") program, the Caribbean Basin Initiative[131] ("CBI"), products of U.S. insular possessions, U.S. exports returned from abroad, U.S. textile import regulations, the U.S.-Canada FTA, the North American Free Trade Agreement[132] ("NAFTA"), and the U.S.-Israel FTA.[133]

[1] Country of Origin Marking

All foreign goods imported into the United States must be marked such that the ultimate purchaser in the United States is aware of the goods' origin.[134] While the ultimate purchaser is usually a U.S. consumer,[135] the importer may be considered the ultimate purchaser if he substantially transforms the material through a manufacturing process following importation.[136] In that case, the material becomes a product originating in the United States and the importer would not be required to mark

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130. GSP, 19 U.S.C. §§ 2461-66 (1994).

131. CBI, 19 U.S.C. §§ 2701-07 (1994).

132. NAFTA, *supra* note 50, 32 I.L.M. at 289.

133. Turbowicz, *supra* note 6, at 168; Palmeter, *supra* note 67, at 7-21, 26-32; Cooper, *supra* note 45, at 456.

134. Tariff Act of 1930, 19 U.S.C. § 1304(a) (1994). The marking statute provides ultimate purchasers with the knowledge of the good's country of origin in case the product's origin would influence purchaser's decision to buy the product. *National Juice*, 628 F. Supp. at 988 n.14. Congress presumed that U.S. consumers would prefer U.S.-made goods. *Id. See generally* Robert F. Ruyak, Note, *United States Country of Origin Marking Requirements: The Application of a Nontariff Trade Barrier*, 6 LAW & POL'Y INT'L BUS. 485 (1974) (analyzing country-of-origin marking statute).

135. *See* 19 C.F.R. § 134.1(d) (1995) (stating that ultimate purchaser is last person in United States who receives article in its imported form). When the product is sold in its imported form, the retail buyer is the ultimate purchaser. *Id.* § 134.1(d)(3).

136. *See id.* § 134.1(d)(1) (noting that U.S. manufacturer is ultimate purchaser if he substantially transforms imported material even though processing operation does not produce new or different article). The fact that the processing can result in a substantial transformation without producing a new or different article distinguishes the substantial transformation test for marking purposes from its application in other contexts. Turbowicz, *supra* note 6, at 169 n.344. *See also supra* notes 123-24 and accompanying text (discussing *United States v. Gibson-Thomsen Co.*, 27 C.C.P.A. 267 (1940), *Uniroyal, Inc. v. United States*, 542 F. Supp. 1026, 1029 (Ct. Int'l Trade 1982), *aff'd per curiam*, 702 F.2d 1022 (Fed. Cir. 1983), *Midwood Indus., Inc. v. United States*, 313 F. Supp. 951 (Cust. Ct. 1970), *appeal dismissed*, 57 C.C.P.A. 141 (1970), and *National Juice*, 628 F. Supp. at 991, cases where courts considered whether U.S. importer substantially transformed imported material for purpose of marking statute). For U.S. Customs Service administrative rulings dealing with U.S. importers' substantial transformation of goods for marking purposes, see Palmeter, *supra* note 67, at 7 n.15.

the manufactured good with the imported material's country of origin.[137] The substantial transformation test also governs country of origin marking for a non-domestic product manufactured in more than one country prior to importation into the United States.[138] Specifically, a non-domestic product originates in the country of its manufacture, production, or growth and any further work performed on the product in a second country must cause a substantial transformation of the product in order for the second country to be the product's country of origin.[139]

[2] Government Procurement

The Buy American Act[140] requires the U.S. Government to grant preferences to domestic goods and manufacturers for government purchases.[141] This requirement is waived, however, for the products of countries that signed the International Agreement of Government Procurement.[142] Country of origin determinations are necessary to assess both whether a good is of U.S. origin[143] and whether a non-domestic good originated in a signatory to the International Agreement of Government Procurement.[144] In the latter case, the substantial transformation test is

137. Galfand, *supra* note 67, at 472. *See generally* David Silverstein, *Country-of-Origin Marking Requirements Under Section 304 of the Tariff Act: An Importer's Map Through the Maze*, 25 AM. BUS. L.J. 285 (1987) (explaining case law and regulations dealing with country-of-origin marking requirements in order to clarify U.S. tariff law for importers).

138. *See* 19 C.F.R. § 134.1(b) (1995) (addressing products of non-domestic origin that enter United States).

139. *Id. See, e.g.*, Parodi Erminio & Co. v. United States, 6 Cust. Ct. 288, 290 (1941) (holding that olive oil produced in Spain and then filtered and packed in France should be marked product of Spain upon exportation to United States, because no substantial transformation of olive oil occurred in France).

140. 41 U.S.C. § 10(a)-(b) (1994).

141. *Id.*

142. Palmeter, *supra* note 67, at 23. *See* AGREEMENTS REACHED IN THE TOKYO ROUND OF THE MULTILATERAL TRADE NEGOTIATIONS, H.R. DOC. NO. 153, 96th Cong., 1st Sess., pt. 1, at 67-189 (1979) (setting forth GATT Agreement on Government Procurement). *See generally* Morton Pomeranz, *Toward a New International Order in Government Procurement*, 11 LAW & POL'Y INT'L BUS. 1263 (1979) (analyzing Agreement on Government Procurement).

143. Palmeter, *supra* note 67, at 23. Determining whether a product is of U.S. origin does not involve use of the substantial transformation test. *Id.* at 23 n.87. For purposes of government procurement, an unmanufactured product is of U.S. origin if it was mined or produced in the United States and a manufactured product is of U.S. origin if it was produced substantially from materials manufactured in the United States. 41 U.S.C. § 10(a) (1994).

144. Palmeter, *supra* note 67, at 23. For the purpose of determining whether a good is the product of a country that signed the International Agreement on Govern-

used.[145]

[3] Entitlement to Drawback

Drawback refers to the refund of duties paid by a U.S. importer on imported material that is used to manufacture a product in the United States for export.[146] Statutes and regulations do not explicitly define when incorporation of imported material results in the manufacture of a new product in the United States.[147] Relevant cases,[148] however, indicate that the substantial transformation test is used to determine when the addition of U.S. products or manufacturing to imported material produces a new article that is considered to originate in the United States.[149]

[4] Countervailing and Antidumping Duties

The United States imposes countervailing duties on imported products that are heavily subsidized by non-domestic governments.[150] In addition, the United States assesses antidump-

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ment Procurement, a product is considered to originate in a country if it was wholly produced there or, if the product consists of materials from a second country, if the product was substantially transformed there into a new and different article of commerce with a new name, character, or use. 19 U.S.C. § 2518(4)(B) (1994).

145. Palmeter, *supra* note 67, at 23. The substantial transformation test in this context, 19 U.S.C. § 2518(4)(B) (1994), differs slightly from the version contained in most court cases and administrative regulations. *Id.*

146. 19 U.S.C. § 1313(a) (1994). The statute mandates full refund, less one percent of the total, of duties levied on imported materials that are used to manufacture exported products. *Id.* Developing U.S. exports and assisting U.S. industries are the underlying goals of the U.S. drawback regulations. United States v. International Paint Co., 35 C.C.P.A. 87, 90 (1948).

147. Palmeter, *supra* note 67, at 22; Galfand, *supra* note 67, at 478. The U.S. drawback regulations define a drawback product as "a finished or partially finished product manufactured in the United States under a drawback contract." 19 C.F.R. § 191.2(g) (1995).

148. *International Paint*, 35 C.C.P.A. at 87; *Anheuser-Busch*, 207 U.S. at 562.

149. *International Paint*, 35 C.C.P.A. at 93 (holding that change in name, character, or use as result of processing indicated manufacture of product in United States for drawback purposes); *see supra* note 121 and accompanying text (articulating same principle in *Anheuser-Busch*).

150. Turbowicz, *supra* note 6, at 179. Countervailing duties are intended to equalize the benefit of subsidies given by foreign governments. *Id.* *See* 19 U.S.C. § 1671 (1994) (setting forth U.S. countervailing duty law). *See, e.g.*, Negev Phosphates, Ltd. v. United States, 699 F. Supp. 938, 945 (Ct. Int'l Trade 1988) (affirming countervailing duty order against industrial phosphoric acid imported into United States from Israel as result of Israeli Government payments to Israeli exporter to compensate exporter for effects of inflation and exchange rate fluctuations).

ing duties on goods produced abroad that are sold at U.S. prices substantially less than the prices charged in the producing country.[151] In order to assess whether either of the above punitive measures should be taken and which country produced the goods in question, a country-of-origin determination is necessary.[152] While the substantial transformation test typically decides origin in these circumstances,[153] merchandise from the producing country that is completed or assembled in the United States or in a second foreign country in an attempt to circumvent the countervailing and antidumping duties may also be subject to the imposition of such duties.[154]

[5] Statistical Purposes

The U.S. Government collects data concerning imports into the United States and requires importers to provide statistical information to document the flow of goods entering and leaving the United States.[155] No U.S. statute or regulation addresses rules of origin expressly for statistical purposes.[156] The regulations of the U.S. Census Bureau apply to the collection of statisti-

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151. Turbowicz, *supra* note 6, at 179. Antidumping duties are intended to counter price discrimination by foreign firms that flood U.S. markets with cheap goods. *Id.* *See* 19 U.S.C. § 1673 (1994) (setting forth U.S. antidumping law). *See, e.g., Negev Phosphates*, 699 F. Supp. at 949 (affirming antidumping duty order against industrial phosphoric acid imported into United States from Belgium and Israel as result of acid being sold in United States for less than fair value).

152. Turbowicz, *supra* note 6, at 179. *See generally* Judith Hippler Bello & Alan F. Holmer, *The Trade and Tariff Act of 1984: Principal Antidumping and Countervailing Duty Provisions*, 19 INT'L L. 639 (1985) (analyzing 1984 amendments to antidumping and countervailing duty laws).

153. Turbowicz, *supra* note 6, at 179.

154. *Id.* at 180. *See* Omnibus Trade and Competitive Act of 1988 § 1321(a), 19 U.S.C. § 1677j (1994) (containing measures to prevent circumvention of countervailing and antidumping duty orders). Merchandise from the producing country that is completed or assembled in the United States or a second foreign country in an attempt to circumvent countervailing and antidumping duties may be subject to the imposition of such duties against the products originating in the producing country if three conditions are satisfied: the merchandise that is sold in the United States is of the same class or kind as merchandise that is subject to a countervailing or antidumping duty order, is assembled or completed in the United States or another foreign country from materials that are subject to a countervailing or antidumping duty order, and is similar in value to the imported materials that are used to assemble the merchandise in the United States. *Id.* § 1677j(a)(1), (b)(1).

155. Turbowicz, *supra* note 6, at 175. *See* 15 C.F.R. § 30.70 (1993) (requiring statistical information on importation documents).

156. Turbowicz, *supra* note 6, at 175.

cal information regarding U.S. imports.[157] These regulations[158] indicate that the determination of country of origin for U.S. imports is governed by the substantial transformation test as it is applied in the context of marking the origin of goods.[159]

[6] Most Favored Nation Preferences

The United States generally applies the same tariff rate, the MFN duty rate,[160] to a given product, regardless of the product's country of origin.[161] This is not the case, however, for products that either entered the United States on a claim of preference[162] or originated in a Communist country.[163] To determine an import's country of origin and, thus, the tariff rate that should be applied, the substantial transformation test is used.[164]

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157. *Id.*

158. 15 C.F.R. § 30.70(f)(1)-(2) (1993).

159. Turbowicz, *supra* note 6, at 175. *See supra* notes 134-39 and accompanying text (discussing rules of origin for country-of-origin marking purposes).

160. Galfand, *supra* note 67, at 478. *See supra* note 62 and accompanying text (defining MFN principle).

161. Galfand, *supra* note 67, at 478. The MFN rate for each product is set forth in column one of the Harmonized Tariff Schedule of the United States ("HTSUS"). Turbowicz, *supra* note 6, at 182. *See* U.S. INT'L TRADE COMM'N, PUB. NO. 2690, SUPPLEMENT ONE TO HARMONIZED TARIFF SCHEDULE OF THE UNITED STATES, General Note 3(a)(ii), at 3 (1995) [hereinafter HTSUS SUPPLEMENT] (stating that United States applies column-one rates to products of nations that receive MFN status). The reduced rates in column one are the result of many rounds of tariff-cutting trade negotiations. Palmeter, *supra* note 67, at 16. *See supra* note 8 and accompanying text (discussing eight rounds of GATT negotiations). The United States adopted the HTSUS on January 1, 1989. JACKSON, *supra* note 59, at 395. *See* U.S. INT'L TRADE COMM'N, PUB. NO. 2030, HARMONIZED TARIFF SCHEDULE OF THE UNITED STATES (1990) [hereinafter HTSUS] (containing schedule of U.S. tariffs). The HTSUS is based upon the internationally accepted Harmonized System of tariff nomenclature. JACKSON, *supra* note 59, at 395. *See supra* note 95 and accompanying text (discussing Harmonized System).

162. Galfand, *supra* note 67, at 478. Claims of preference generally afford products lower rates than those in column one of the HTSUS and apply, for example, to products entering the United States from U.S. insular possessions, under the GSP and CBI programs, and under FTAs that the United States has concluded. *Id.* at 478 n.72. *See supra* note 63 and accompanying text (discussing FTAs as major exception to GATT's MFN principle).

163. Galfand, *supra* note 67, at 478-79. The rates applicable to products from Communist countries are set forth in column two of the HTSUS. Turbowicz, *supra* note 6, at 182. *See* HTSUS SUPPLEMENT, *supra* note 161, General Note 3(b), at 4 (providing column-two rates that United States applies to products of communist countries). Currently, the Communist countries that receive column-two tariff treatment are Afghanistan, Cuba, Kampuchea, Laos, North Korea, and Vietnam. *Id.* The tariff rates in column two are the highest import duties levied by the United States. Palmeter, *supra* note 67, at 15-16.

164. Galfand, *supra* note 67, at 479. The HTSUS does not specify a method to

[7] Generalized System of Preferences

The GSP program[165] was created in 1974 to provide nonreciprocal duty-free treatment to eligible products of developing countries[166] in order to foster economic development and diversification of exports in the beneficiary developing countries ("BDCs").[167] The GSP's rules of origin determine a product's eligibility for the program and apply both the substantial transformation test and the value-added test to ensure that the product receiving favorable treatment actually originated in the BDC and that its production created a minimum amount of economic activity in the BDC.[168] Specifically, the GSP's rules of origin require that products be imported directly from the BDC into the United States[169] and that the sum of the cost of materials pro-

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determine the origin of goods for tariff schedule purposes. Turbowicz, *supra* note 6, at 182; HTSUS SUPPLEMENT, *supra* note 161, General Note 3, at 3-5. It does, however, refer to the Trade Expansion Act of 1962 that defines the product of a nation as an article that is the "growth, produce, or manufacture of such area." Turbowicz, *supra* note 6, at 182 (quoting Belcrest Linens v. United States, 741 F.2d 1368, 1370 (Fed. Cir. 1984)); HTSUS SUPPLEMENT, *supra* note 161, General Note 3(a)(iv)(A), at 3. *See* 19 U.S.C. §§ 2431, 2481(8) (1994) (presenting §§ 401 and 601 of Trade Act of 1974 that retained requirements of § 231 of Trade Expansion Act of 1962 and definition of product's origin given in Trade Expansion Act of 1962). This is the language of the substantial transformation test, and cases have confirmed that the substantial transformation test governs the determination of origin for tariff schedule purposes. Turbowicz, *supra* note 6, at 182. *See* Chemo Puro Mfg. Corp. v. United States, 146 F. Supp. 178, 181 (Cust. Ct. 1954) (holding that nutgalls grown in China for production of tannic acid in United Kingdom became new product in United Kingdom with new name, use, and tariff status and were thus subject to MFN tariff rate, not communist country rate, upon importation into United States); *Belcrest*, 741 F.2d at 1372 (finding that pillowcases manufactured in Hong Kong from Chinese bolts of cloth should, upon importation into United States, be subject to 34% duty rate as product of Hong Kong and not 90% duty rate as product of China, because cutting and sewing operations performed in Hong Kong substantially transformed Chinese cloth by changing its character, identity, and use from bolt of woven fabric into pillowcase).

165. 19 U.S.C. §§ 2461-66 (1994).

166. Galfand, *supra* note 67, at 473. *See generally* D. Robert Webster & Christopher P. Bussert, *The Revised Generalized System of Preferences: "Instant Replay" or a Real Change?*, 6 NW. J. INT'L L. & BUS. 1035 (1985) (analyzing U.S. GSP program); Thomas R. Graham, *The U.S. Generalized System of Preferences for Developing Countries: International Innovation and the Art of the Possible*, 72 AM. J. INT'L L. 513 (1978) (discussing evolution and administration of U.S. GSP program); Barry H. Nemmers & Ted Rowland, *The U.S. Generalized System of Preferences: Too Much System, Too Little Preference*, 9 LAW & POL'Y INT'L BUS. 855 (1977) (commenting on U.S. GSP requirements and suggesting possible improvements).

167. Galfand, *supra* note 67, at 473 n.29.

168. Palmeter, *supra* note 67, at 7-8.

169. 19 U.S.C. § 2463(b)(1)(A) (1994). *See* 19 C.F.R. §§ 10.174-75 (1995) (defin-

duced in the BDC plus the direct costs of processing equals at least thirty-five percent of the product's value at the time of its importation into the United States.[170] The substantial transformation test is used to determine whether materials imported into the BDC are considered products of the BDC for the purposes of eligibility in the GSP program.[171] To include such imported materials in the BDC's thirty-five percent added-value requirement, a dual substantial transformation test[172] must be met: (1) the material imported into the BDC must be substantially

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ing direct shipment). *See also* 19 C.F.R. § 10.173(a) (1995) (requiring that exporter in beneficiary developing country ("BDC") submit declaration of origin to U.S. customs official when exported product was partially manufactured outside BDC).

170. 19 U.S.C. § 2463(b)(1)(B) (1994). A product that is imported directly into the United States from a BDC will be eligible for duty-free treatment if:

> [T]he sum of (i) the cost or value of the materials produced in the beneficiary developing country or any two or more countries which are members of the same association of countries which is treated as one country under section 2462(a)(3) of this title, plus (ii) the direct costs of processing operations performed in such beneficiary developing country or such member countries is not less than 35 percent of the appraised value of such article at the time of its entry into the customs territory of the United States.

Id. Countries associated through either a customs union or FTA are treated as one customs territory for the purpose of satisfying the 35% value-added requirement. *Id.*; Turbowicz, *supra* note 6, at 186. It makes no difference, however, whether exports were manufactured in the BDC from materials that were imported from another BDC. *Id.* The GSP program, therefore, allows limited horizontal cumulation. *Id.* Using material imported from the United States in the production of exports in the BDC does not lend any particular benefit to such exports upon their importation into the United States, thus, excluding vertical cumulation. *Id.*

171. 19 C.F.R. § 10.177(a) (1995). The regulation states that products of the BDC are those composed of materials that are either wholly grown, produced, or manufactured in the BDC or substantially transformed in the BDC into a new and different article of commerce. *Id.* *See supra* note 126 and accompanying text (discussing *Texas Instruments*, where court held material imported from United States into Taiwan was substantially transformed in Taiwan and could, thus, be included in Taiwan's 35% value-added requirement for GSP purposes). *But see* Madison Galleries v. United States, 870 F.2d 627, 631-32 (Fed. Cir. 1989) (refusing to find that substantial transformation of material imported from Taiwan to Hong Kong was necessary before counting material in Hong Kong's 35% value-added requirement). In *Madison*, porcelainware items were manufactured in Taiwan, a non-BDC, and sent to Hong Kong, a BDC, where they were decorated. *Madison*, 870 F.2d at 629. The decoration process in Hong Kong did not substantially transform the porcelainware but did contribute more than 35% of its value at the time of its importation into the United States. *Id.* The court held that the GSP statute's plain language and legislative history only required that 35% of an eligible article's value be added in the BDC and not that an article be substantially transformed by becoming a "product of" the BDC. *Id.* at 631-32. *See also* Turbowicz, *supra* note 6, at 201 (criticizing court's decision in *Madison* for ignoring substantial transformation requirement and allowing pass-through operation to receive GSP benefits).

172. Galfand, *supra* note 67, at 473. Use of non-BDC materials and the dual sub-

transformed into a new article of commerce in the BDC and, thus, become a product of the BDC; and (2) this material must be substantially transformed a second time, into the product that is exported to the United States.[173]

[8] Caribbean Basin Initiative

The CBI,[174] enacted in 1983, designates certain Caribbean countries' exports eligible to receive duty-free treatment upon importation into the United States.[175] Like the GSP,[176] CBI rules of origin require direct importation of the product from a beneficiary country into the United States,[177] thirty-five percent added value in the beneficiary country,[178] use of the substantial transformation test to determine when materials imported from a non-CBI beneficiary country become the product of a beneficiary country,[179] and dual substantial transformation of non-CBI-

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stantial transformation test are only necessary when materials that are wholly produced in the BDC do not comprise at least 35% of the exported product's value. *Id.*

173. 19 C.F.R. § 10.177(a) (1995); Palmeter, *supra* note 67, at 9. *See* Torrington Co. v. United States, 764 F.2d 1563, 1568-72 (Fed. Cir. 1985) (holding that Portuguese sewing needles, manufactured from wire that was imported from non-BDC into Portugal, qualified for duty-free treatment upon exportation to United States under U.S. GSP program because two substantial transformations occurred in Portugal, from wire to needle blanks and from needle blanks to finished needles, and inclusion of value of needle blanks allowed needles to meet Portugal's 35% value-added requirement). *See generally* Thomas P. Cutler, *The United States Generalized System of Preferences: The Problem of Substantial Transformation*, 5 N.C. J. INT'L L. & COM. REG. 393 (1980) (discussing complexity of GSP's substantial transformation requirements).

174. CBI, 19 U.S.C. §§ 2701-07 (1994).

175. *Id.* CBI, intended to foster economic growth in underdeveloped countries, authorized the U.S. President to designate 27 Central American and Caribbean nations as eligible to receive unilateral duty-free treatment for most of their exports to the United States. Turbowicz, *supra* note 6, at 202; Galfand, *supra* note 67, at 474. Products excluded from duty-free treatment under CBI include: textile products that are subject to textile agreements, footwear, handbags, luggage, canned tuna, petroleum products, and watches. 19 U.S.C. § 2703(b) (1994).

176. *See supra* notes 168-73 and accompanying text (discussing rules of origin in GSP program).

177. 19 U.S.C. § 2703(a)(1)(A) (1994). The CBI legislation contains a cumulation provision that allows a product to be transported to the United States directly from any of the designated CBI countries, not just from the CBI country that manufactured and exported the product. *Id.* § 2703(a)(1)(A)-(B) (1994).

178. 19 U.S.C. § 2703(a)(1)(B) (1994).

179. 19 C.F.R. § 10.196(a)(2) (1995). Duty-free treatment applies to a product that is wholly manufactured or grown in the CBI-beneficiary country. 19 U.S.C. § 2703(a)(1) (1994). CBI explicitly provides that a substantial transformation is necessary whenever material that was imported from a non-beneficiary country is used in a beneficiary country to produce an export eligible for CBI treatment. 19 C.F.R.

beneficiary material that is imported into a beneficiary country in order to include the imported material in the beneficiary country's thirty-five percent value-added requirement.[180] The CBI's rules are more liberal, however, in their provision for cumulation of value among the CBI-beneficiary countries[181] and their requirement that only one substantial transformation of imported material is necessary in the beneficiary country when that transformation adds at least thirty-five percent of the final product's value.[182]

[9] Products of U.S. Insular Possessions

The United States has granted preferential tariff treatment to imports from its insular possessions[183] since 1954.[184] Prior to the CBI,[185] products from U.S. insular possessions could enter

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§ 10.195(a)(1) (1995). This avoids the possibility of a case like *Madison*, 870 F.2d 627, in the CBI context. Turbowicz, *supra* note 6, at 205. *See supra* note 171 and accompanying text (discussing court's decision in *Madison* to allow imported material to count toward BDC's 35% value-added requirement for GSP purposes even though no substantial transformation of imported material occurred).

180. 19 C.F.R. § 10.196(a)(2), Example 3 (1995).

181. Palmeter, *supra* note 67, at 12. In calculating a product's 35% value-added requirement, CBI allows cumulation of the value added by all of the beneficiary countries. 19 U.S.C. § 2703(a)(1)(B) (1994). *Compare id.* (permitting horizontal cumulation among all CBI beneficiary countries) *with* 19 U.S.C. § 2463(b)(1)(B) (1994) (permitting such cumulation only among members of customs union or FTA). In addition, costs incurred in the United States may account for up to 15% of the beneficiary country's 35% value-added requirement and material that is imported from the United States into a beneficiary country and used to manufacture an export eligible for CBI treatment may comprise up to 15% of the beneficiary country's 35% value-added requirement. 19 U.S.C. § 2703(a)(1) (1994); Turbowicz, *supra* note 6, at 203-04. *See supra* note 170 and accompanying text (noting that GSP does not contain such vertical cumulation provision). *See also supra* note 177 and accompanying text (discussing CBI's direct shipment provision that allows products to be imported into United States from any CBI country).

182. 19 C.F.R. § 10.196(a), Example 2 (1995); Palmeter, *supra* note 67, at 13.

183. 19 C.F.R. § 7.8 n.5 (1995). U.S. insular possessions include Guam, Wake Island, Midway Islands, Kingman Reef, Johnston Island, and American Samoa. *Id.* They also include the Commonwealth of the Northern Mariana Islands. Palmeter, *supra* note 67, at 14 n.38.

184. Yuri Fashions Co. v. United States, 632 F. Supp. 41, 44 (Ct. Int'l Trade 1986). The Customs Simplification Act of 1954 stated that any product that was wholly a growth or manufacture of a U.S. insular possession or that was manufactured from materials from either a U.S. insular possession or the United States and did not derive more than 50% of its value from foreign materials could enter the United States duty-free. *Yuri Fashions*, 632 F. Supp. at 44-45.

185. *See supra* notes 174-82 and accompanying text (discussing CBI and its rules of origin).

the United States duty-free as long as fifty percent of their value was not derived from foreign content.[186] After passage of the CBI, the United States afforded duty-free entry to products of CBI-beneficiary countries as long as sixty-five percent of their value was not derived from foreign content.[187] To allow products from insular possessions to retain their advantage over goods from CBI-beneficiary countries, this value-added standard for products of U.S. insular possessions was changed so that products from U.S. insular possessions receive duty treatment that is at least as favorable as that received by products from CBI-beneficiary countries.[188]

[10] U.S. Exports Returned from Abroad

When a U.S. product is exported abroad and subsequently returned to the United States, it may be treated for tariff purposes in three possible ways.[189] The returned product may receive duty-free treatment,[190] preferential treatment,[191] or standard treatment as a product of another country.[192] The substan-

186. *See* 19 C.F.R. § 7.8(a) (1995) (referring to certificate of origin that must accompany products from insular possessions containing less than 50% foreign content in order for such products to enter United States duty-free). Watches and watch movements could derive up to 70% of their total value from foreign materials. *Id.* For the purposes of this preference, foreign materials were defined as materials originating outside of the United States and any of its insular possessions. *Id.*

187. *See supra* note 178 and accompanying text (providing CBI's 35% value-added requirement).

188. HTSUS SUPPLEMENT, *supra* note 161, General Note 3(a)(iv)(D), at 4; Palmeter, *supra* note 67, at 14. Products from U.S. insular possessions that would also be eligible for duty-free treatment as products from CBI-beneficiary countries can derive up to 70% of their value from foreign materials, thus maintaining a five percent advantage over products from CBI-beneficiary countries. HTSUS SUPPLEMENT, *supra* note 161, General Note 3(a)(iv)(A), at 3. Products from U.S. insular possessions that are not also eligible for duty-free treatment under the CBI retain the 50% foreign value standard. *Id.*

189. Palmeter, *supra* note 67, at 17-18.

190. *Id.* at 9. A returned product receives duty-free treatment upon entry into the United States if the product's value or condition was not improved abroad. *Id.*

191. *Id.* at 18. U.S. products that were exported abroad for alteration or repair are only subject, upon re-entry into the United States, to duties on the value of the repairs or alterations performed abroad. *Id.*; 19 C.F.R. § 10.8(a) (1995). Metal products that are manufactured in the United States and exported abroad for processing must require further processing after their return to the United States in order to be dutiable, upon their return, only on the value added abroad. Palmeter, *supra* note 67, at 20; 19 C.F.R. § 10.9(a) (1995).

192. Palmeter, *supra* note 67, at 17. If foreign processing exceeds the scope of repair and alteration, the U.S. product is considered to have been substantially trans-

tial transformation test is used to determine the extent to which the returned product has retained its U.S. origin.[193]

To receive duty-free treatment[194] upon reimportation into the United States, a returned good must still be a product of the United States and cannot have been substantially transformed abroad into a new product.[195] To receive preferential treatment[196] upon returning to the United States, a U.S. product can have been subject to repairs or alterations abroad, but must not have been substantially transformed into a new product.[197] A

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formed abroad, thus, becoming a product of a foreign country, subject to the regular U.S. duty on goods from that country. *Id.* at 19.

193. *Id.* at 19. Because products that are assembled abroad from U.S. materials and that are then imported into the United States are not subject to duties on the value of the U.S. materials, the substantial transformation test is also used to determine which materials in imported products are of U.S. origin. *Id.* at 20; 19 C.F.R. §§ 10.12(e), 10.14(b) (1995). *But see* General Motors Corp. v. United States, 976 F.2d 716, 717-18 (Fed. Cir. 1992) (denying tariff reduction on motor vehicles manufactured in Mexico and imported into United States for portion of vehicles that contained U.S. sheet metal components, sent to Mexico for topcoat painting, because painting advanced vehicles in value and condition and was not incidental to assembly process).

194. *See supra* note 190 and accompanying text (discussing duty-free treatment for reimported products whose value or condition was not improved abroad).

195. IMPACT REPORT, *supra* note 82, at 34. *See* 19 C.F.R. § 10.12(e) (1995) (using substantial transformation test to define "product of the United States"). *See also* United States v. John V. Carr & Son, Inc., 69 Cust. Ct. 78, 93 (1972), *aff'd* 496 F.2d 1225 (C.C.P.A. 1974) (holding that fishhooks produced in United States, exported in bulk, and assembled and packaged abroad were not advanced in value or improved in condition abroad and were, thus, entitled to duty-free entry upon return to United States); Border Brokerage Co. v. United States, 314 F. Supp. 788, 792 (Cust. Ct. 1970) (finding that tomatoes grown in United States and exported for sorting, grading, and packaging qualified for duty-free treatment upon return to United States). *Cf.* Target Sportswear, Inc. v. United States, 70 F.3d 604, 607 (Fed. Cir. 1995) (finding that mens suits that were imported into United States from U.S. Virgin Islands after being cut and joined in Virgin Islands, sewn together in Dominican Republic, and finished upon return to Virgin Islands were subject to quota restriction on Dominican Republic textiles and did not receive duty-free treatment as products of U.S. insular possession because regulation states that textile products exported from U.S. insular possession and advanced in value or assembled in foreign country cannot be treated as products of insular possession upon their return there).

196. *See supra* note 191 and accompanying text (stating that U.S. products that were exported for alterations or repairs are subject upon reimportation to duties only on the value of the alterations or repairs performed abroad).

197. Palmeter, *supra* note 67, at 18. *See, e.g.*, Royal Bead Novelty Co. v. United States, 342 F. Supp. 1394, 1400 (Cust. Ct. 1972) (finding that uncoated glass beads that were reimported after being coated abroad for use as costume jewelry were only subject to duty on value of alterations performed abroad); Amity Fabrics, Inc. v. United States, 43 Cust. Ct. 64, 68 (1959) (holding that already-died fabric that was sent abroad for redyeing was only subject upon reimportation to duty on value of alterations performed abroad). *But see* Dolliff & Co. v. United States, 455 F. Supp. 618, 622 (Cust. Ct. 1978),

U.S. product that is returned to the United States from another country is assessed the duty applicable to that other country[198] when the U.S. product was substantially transformed in that country into another product.[199]

[11] U.S. Textile Import Regulations

In 1985, the U.S. Customs Service promulgated new country of origin regulations for textile and apparel products.[200] These new rules added a substantial manufacturing component to the traditional substantial transformation test.[201] As a result, more

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aff'd 599 F.2d 1015 (C.C.P.A. 1979) (finding that dyeing and finishing of fabric abroad produced new and different article that was subject upon reimportation to duty on full value of merchandise, not only on value of alterations performed abroad).

198. *See supra* note 192 and accompanying text (stating that U.S. product that was processed in another country, not merely repaired or altered there, is subject to standard tariff treatment afforded to goods from that country).

199. Palmeter, *supra* note 67, at 19. *See, e.g.*, Guardian Indus. Corp. v. United States, 3 Ct. Int'l Trade 9, 16 (1982) (holding that performance abroad of tempering of annealed glass for use in patio doors was not mere alteration but transformation of product into new and different article of commerce subject to full duty upon reimportation into United States); A.F. Burstrom v. United States, 44 C.C.P.A. 27, 31 (1956) (holding that steel ingots produced in United States that were converted abroad into steel slabs were subject to processing, not mere alteration, outside United States and were therefore subject to full duty upon reimportation).

200. 19 C.F.R. § 12.130 (1995). *See* Craig R. Giesse & Martin J. Lewin, *The Multifiber Arrangement: 'Temporary' Protection Run Amuck*, 19 LAW & POL'Y INT'L BUS. 51, 129-42 (1987) (discussing motivation for new textile regulation and problems it caused). *See generally* David Stepp, Note, *The 1984 "Country of Origin" Regulations for Textile Imports: Illegal Administrative Action Under Domestic and International Law?*, 14 GA. J. INT'L & COMP. L. 573 (1984) (discussing legality of President Reagan's country-of-origin regulations for textile products).

201. 19 C.F.R. § 12.130(b) (1995). The regulation states that a "textile or textile product will be considered to have undergone a substantial transformation if it has been transformed by means of substantial manufacturing or processing operations into a new and different article of commerce." *Id.* The regulation provides criteria that may be used to assess whether a product was subject to substantial manufacturing or processing operations. *Id.* § 12.130(d)(2). These criteria include the physical change in the product as a result of the processing operations, the time involved in the manufacturing operations, the complexity of the manufacturing process, the level of skill and technology required in the processing operations, and the value added to the product in each foreign country as compared to the product's value at the time of its importation into the United States. *Id.* § 12.130(d)(2)(i)-(v). The regulation also specifies operations that usually do or do not confer origin upon the country where such operations take place. *Id.* § 12.130(e). Operations that usually confer origin include: dyeing or printing of fabric when accompanied by further processing of the fabric, spinning fibers into yarn, weaving or knitting fabric, cutting fabric into parts and assembling those parts into the completed article, and sewing or tailoring cut pieces of apparel into a completed garment. *Id.* § 12.130(e)(1)(i)-(v). Operations that do not usually confer origin include: simple combining, labeling or cleaning operations, cutting fabrics that are

textile products were deemed to originate in countries that had filled their U.S. import quotas and textile imports into the United States were restricted.[202]

[12] U.S.-Canada FTA

The United States and Canada signed an FTA[203] in 1988 that eliminates tariffs and other barriers to trade between the two countries.[204] Canada's rejection of the United States' traditional substantial transformation test prompted the parties to establish a three-part rules-of-origin regime.[205] First, any product

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intended for commercial use, joining together completed knit-to-shape component parts, finishing operations such as bleaching or shrinking, and dyeing or printing of fabrics or yarns. *Id.* § 12.130(e)(2)(i)-(v).

202. Turbowicz, *supra* note 6, at 236. *See Yuri Fashions*, 632 F. Supp. at 49 (denying duty-free entry to sweaters that were processed in Commonwealth of Northern Mariana Islands from components manufactured in Korea, because sweaters originated in Korea according to rules of origin in 1985 textile regulations). A large volume of sweaters that were manufactured through knitting operations in China and looping operations in Hong Kong were affected by the 1985 textile regulations. Giesse & Lewin, *supra* note 200, at 134. Hong Kong had always been considered the origin of these sweaters because the looping operation was a process in which knit panels were attached to one another to form a complete sweater. *Id.* at 134 n.492; *see supra* note 127 and accompanying text (discussing *Belcrest Linens v. United States*, 741 F.2d 1368, 1374 (Fed. Cir. 1984), where court held that Hong Kong was origin of pillowcases manufactured in Hong Kong from Chinese bolts of cloth). Because final assembly operations occurred in China, however, the substantial manufacturing test that was adopted by the 1985 regulations considered the sweaters to originate in China, which had a smaller quota for sweaters in its agreement with the United States than Hong Kong did in its agreement with the United States. Giesse & Lewin, *supra* note 200, at 135. Significant numbers of these sweaters were, thus, prevented from entering the United States as imports. *Id.* Restriction of textile imports in such a manner was the primary goal of the 1985 textile regulations. *Id.* at 140-41. *See also* Patrick D. Gill, *The Implementation of the Country of Origin Regulations: A Case Study*, 10 B.C. INT'L & COMP. L. REV. 275, 276 (1987) (stating that new rules achieved U.S. objective to reduce imports of sweaters that were assembled in Hong Kong from Chinese components); Christopher T. Griffith, Recent Development, *The Inability of "Marginal Processes" to Affect Country of Origin Determinations in the Textile Industry Under the 1985 Customs Service Regulations: Mast Industries, Inc. v. United States*, 9 HOUS. J. INT'L L. 355, 356-57 (1987) (noting that Congress authorized new country-of-origin regulations for textiles due to increasing number of textile products that were entering United States).

203. U.S.-Canada FTA, *supra* note 89, 27 I.L.M. at 281.

204. Paul Asker, Note, *Changes in the Rules of Origin in the United States-Canada Free Trade Agreement: A Preliminary Evaluation*, 36 WAYNE L. REV. 1545, 1545 (1990).

205. *Id.* at 1552. *See generally* N. David Palmeter, *The Canada-U.S. Free Trade Agreement Rule of Origin and a Multilateral Agreement*, 16 INT'L BUS. LAW. 513 (1988) (discussing U.S.-Canada FTA's rule-of-origin provisions); Tom Greig & Rosemary Anderson, *The Canada-U.S. Free Trade Agreement's Rules of Origin*, 36 CANADIAN TAX J. 700 (1988) (explaining rules of origin in U.S.-Canada FTA).

that is wholly grown or manufactured in one or both of the parties to the FTA and contains no materials from third countries is considered to be a product of the United States or Canada and, thus, receives preferential treatment under the FTA.[206] Second, in order to be considered a product of the United States or Canada and, thus, receive preferential treatment under the FTA, material that is imported into the United States or Canada from a third country must undergo specific types of processing in the United States or Canada that produce a change in the material's tariff heading.[207] The specific transformations for each product that cause the product to be classified under a different tariff heading are listed in an annex to the U.S.-Canada FTA.[208] Third, products that are assembled in the United States or Canada from imported parts receive preferential treatment under the U.S.-Canada FTA only if more than fifty percent of the completed product's value is attributable to the costs of assembly in

206. U.S.-Canada FTA, *supra* note 89, art. 301, ¶ 1, 27 I.L.M. at 295. Materials from both the United States and Canada are treated as being from the same country for the purposes of the U.S.-Canada FTA's rules of origin. Turbowicz, *supra* note 6, at 212. The agreement, thus, provides for total horizontal cumulation. *Id.* at 212 n.448. The U.S.-Canada FTA also states that products of the United States or Canada that undergo further processing in a third country will not qualify for preferential treatment. *Id.* at 219-20; Asker, *supra* note 204, at 1553 n.46; U.S.-Canada FTA, *supra* note 89, Annex 301.2, ¶¶ 2, 4(b), 27 I.L.M. at 297. Products that are traded between the United States and Canada under the U.S.-Canada FTA must be accompanied by written declarations of origin. *Id.* Annex 406(A), 27 I.L.M. at 313.

207. U.S.-Canada FTA, *supra* note 89, art. 301, ¶ 2, 27 I.L.M. at 295. The specific transformations are based upon changes in the product's classification under the Harmonized System's tariff nomenclature. Asker, *supra* note 204, at 1553. *See supra* note 95 and accompanying text (discussing Harmonized System that is used by leading trading nations and that applies to virtually every product involved in world trade).

208. Asker, *supra* note 204, at 1553. *See* U.S.-Canada FTA, *supra* note 89, Annex 301.2, 27 I.L.M. at 298-307 (listing specific transformations applicable to each product under U.S.-Canada FTA). For example, a product initially classified under Section IV, "Prepared Foodstuffs; Beverages, Spirits and Vinegar; Tobacco and Manufactured Tobacco Substitutes," would qualify for preferential treatment if it was transformed into a product under a different heading, such as heading 1806.00.00, "Chocolate and other food preparations containing cocoa." Asker, *supra* note 204, at 1553 n.51; U.S.-Canada FTA, *supra* note 89, Annex 301.2, § IV, ¶ 3, 27 I.L.M. at 298. While there is no generally applicable domestic content requirement under the U.S.-Canada FTA, some products, in addition to undergoing a change in Harmonized System classification, must also contain a minimum level of material, usually 50% of the finished product's value, that originated in either the United States or Canada. Asker, *supra* note 204, at 1554. Finally, a specific transformation that results from either simple packaging operations, dilution with water, or any process that is meant to circumvent the FTA's rules of origin does not afford preferential treatment to the product that underwent such transformation. U.S.-Canada FTA, *supra* note 89, art. 301, ¶ 3, 27 I.L.M. at 295.

the United States or Canada.[209]

[13] North American Free Trade Agreement

The United States, Canada, and Mexico signed the NAFTA[210] in 1992[211] and, in so doing, created the World's largest free trade area.[212] The rules of origin in the NAFTA resemble those in the U.S.-Canada FTA but also include significant changes.[213] A product that is wholly obtained or manufactured in one or more of the parties to the NAFTA originates in the free trade region.[214] For a product that is produced in a NAFTA-country from materials that are imported from a non-NAFTA-country, the non-NAFTA materials must be processed in the NAFTA region so that they undergo a specific change in tariff

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209. U.S.-Canada FTA, *supra* note 89, Annex 301.2, ¶ 4(a), 27 I.L.M. at 297. Assembly costs include the value of materials from the United States or Canada that are used to assemble the product as well as the direct costs of assembly. *Id.* Direct costs of assembly include labor, energy, machine maintenance and depreciation, testing and inspecting, rent, and royalty or licensing fees. *Id.* art. 304(a)-(f), 27 I.L.M. at 296. Unlike the GSP and CBI, the U.S.-Canada FTA does not allow promotional costs and other business expenses, aside from direct costs, to be included in the agreement's value-added requirement. Asker, *supra* note 204, at 1555-56; U.S.-Canada FTA, *supra* note 89, art. 304(g)-(m), 27 I.L.M. at 296. For the purposes of the U.S.-Canada FTA's value-added standard, the domestic content of automotive parts that are assembled from foreign materials is calculated using the roll up method. Cooper, *supra* note 45, at 456. The roll up method considers a product to originate in the country that accounts for the majority of its contents. *Id.* While this method appears to produce results that are identical to the standard 50% value-added requirement, divergences can occur when the product that is computed using the roll up method is combined with other materials to form another product abroad. *Id.* Due to political pressure, textile and apparel products were excluded from the category of goods that can receive preferential treatment by fulfilling the U.S.-Canada FTA's value-added standard. Palmeter, *supra* note 205, at 513; U.S.-Canada FTA, *supra* note 89, Annex 301.2, ¶ 5, 27 I.L.M. at 298. Instead, textile and apparel products must satisfy a double transformation in the United States or Canada in order to receive preferential treatment under the U.S.-Canada FTA. Turbowicz, *supra* note 6, at 213; U.S.-Canada FTA, *supra* note 89, Annex 301.2, § XI, 27 I.L.M. at 301-02.

210. NAFTA, *supra* note 50, 32 I.L.M. at 289.

211. Cooper, *supra* note 45, at 448.

212. *Id.* at 442. *See generally* C. O'Neal Taylor, *Fast Track, Trade Policy, and Free Trade Agreements: Why the NAFTA Turned into a Battle*, 28 GEO. WASH. J. INT'L L. & ECON. 1 (1994) (discussing negotiation of NAFTA).

213. Cooper, *supra* note 45, at 457. *See supra* notes 203-09 and accompanying text (discussing rules of origin in U.S.-Canada FTA).

214. NAFTA, *supra* note 50, art. 401(a), 32 I.L.M. at 349. Products that are traded between the NAFTA parties must be accompanied by certificates of origin. *Id.* art. 501, 32 I.L.M. at 358.

classification.[215] In the NAFTA, the value-added requirement applies only to products that are connected to the automotive trade.[216] Specifically, the minimal level of materials from the NAFTA-countries, the United States, Canada, and Mexico, that products must contain is sixty-two and one-half percent for passenger automobiles and light trucks[217] and sixty percent for other vehicles.[218]

2. Rules of Origin and the Substantial Transformation Test in the U.S.-Israel FTA

The drafters of the U.S.-Israel FTA adopted the rules of origin that exist in the CBI.[219] To be defined as an exporting country's product under the U.S.-Israel FTA, therefore, a product

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215. *Id.* art. 401(b), 32 I.L.M. at 349. The specific change of tariff classification requirements are listed in Annex 401 of the NAFTA. Cooper, *supra* note 45, at 457 n.106. *See* NAFTA, *supra* note 50, Annex 401, 32 I.L.M. at 397-456 (listing specific rules of origin for products traded between NAFTA countries). Annex 401 may require a product to undergo a specific change that does not produce a change in tariff classification. *Id.* art. 401(b), 32 I.L.M. at 349.

216. Cooper, *supra* note 45, at 458; NAFTA, *supra* note 50, arts. 402, ¶ 3, 403, 32 I.L.M. at 349, 352. *See supra* note 209 and accompanying text (stating that, under U.S.-Canada FTA, products that are assembled in United States or Canada from imported parts must satisfy 50% domestic content requirement).

217. NAFTA, *supra* note 50, art. 403, ¶ 5(a), 32 I.L.M. at 351.

218. *Id.* art. 403, ¶ 5(b), 32 I.L.M. at 351. Unlike the U.S.-Canada FTA, domestic value content in the NAFTA is calculated using the net-cost method for automobiles and the trace-through method for automotive parts. Cooper, *supra* note 45, at 458; NAFTA, *supra* note 50, arts. 402, ¶ 5(d)(i), 403, ¶ 1(a), 32 I.L.M. at 350, 351. The U.S.-Canada FTA calculated domestic value content using the direct cost method for automobiles and the roll up method for automotive parts. Cooper, *supra* note 45, at 458. *See supra* note 209 and accompanying text (defining direct cost and roll up methods for purposes of U.S.-Canada FTA). Calculating an automobile's domestic value content using the net cost method involves subtracting the costs of the automobile's marketing, royalties, shipping, packing, and certain interest costs from the total cost of the automobile. NAFTA, *supra* note 50, arts. 402, ¶ 8, 415, 32 I.L.M. at 350, 354. The resulting figure is the automobile's net cost. *Id.* art. 415, 32 I.L.M. at 355. In order to qualify for preferential treatment, the automobile's net cost minus the value of foreign materials that were incorporated into the automobile in the NAFTA region must exceed 62.5% of the automobile's net cost. Cooper, *supra* note 45, at 458. In order to calculate the domestic content of automotive parts that originated outside the NAFTA region, the trace-through method is used, and it defines the amount of foreign materials in the automobile as the sum of the values of the foreign materials at the time that they were received by the first person in the territory of a party who takes title to them. NAFTA, *supra* note 50, art. 403, ¶ 1, 32 I.L.M. at 351.

219. Nikelsberg, *supra* note 27, at 385. *See* CBI, 19 U.S.C. § 2703(a) (1994) (containing CBI's rules of origin). The drafters of the U.S.-Israel FTA were required to adopt the CBI rules of origin by the legislation that authorized negotiation of the U.S.-Israel FTA. Ward, *supra* note 19, at 215.

must satisfy three requirements.[220] First, it must be either wholly grown or manufactured in the exporting country,[221] or manufactured into a new product in the exporting country from non-domestic materials.[222] Second, the product must be transported directly from one country to the other.[223] Third, the product must have at least thirty-five percent of its appraised value added in the exporting country.[224] Up to fifteen percent of this thirty-

220. U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 1(a)-(c), 24 I.L.M. at 669-70.

221. *Id.* Annex 3, ¶ 1(a), 24 I.L.M. at 669. The growth product phrase applies to an article that originated entirely in the exporting country, i.e., none of its materials were imported from a nonparticipating country. *Id.* Annex 3, ¶ 3, 24 I.L.M. at 670. *See* Nikelsberg, *supra* note 27, at 385 n.87 (explaining provision that all materials must originate in exporting country).

222. U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 1(a), 24 I.L.M. at 669. Materials do not become a new product by undergoing, in the exporting country, "(1) simple combining or packaging operations or (2) mere dilution with water or with another substance that does not materially alter the characteristics of the article or material." *Id.* Annex 3, ¶ 2, 24 I.L.M. at 670. *See* Nikelsberg, *supra* note 27, at 385 n.89 (explaining ineligibility of materials that undergo simple operations).

223. U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 1(b), 24 I.L.M. at 669; Nikelsberg, *supra* note 27, at 385. Direct importation means:

> (a) direct shipment from one party into the other party without passing through the territory of any intermediate country; or (b) if shipment is through the territory of an intermediate country, the articles in the shipment do not enter into the commerce of any intermediate country and the invoices, bills of lading, and other shipping documents, show the other party as the final destination; or (c) if shipment is through an intermediate country and the invoices and other documents do not show the other party as the final destination, then the articles in the shipment, upon arrival in that party, are imported directly only if they (i) remain under the control of the customs authority in an intermediate country; (ii) do not enter into the commerce of an intermediate country except for the purpose of a sale other than at retail, provided that the articles are imported as a result of the original commercial transaction between the importer and the producer or the latter's sales agent; (iii) have not been subjected to operations other than loading and unloading, and other activities necessary to preserve the article in good condition; and (iv) comply with the origin requirements for articles exported to a party from the other party under this agreement as stated in the documents required under the certification procedure.

U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 8, 24 I.L.M. at 671-72. *See id.* Annex 3, ¶ 9, 24 I.L.M. at 672-73 for certification procedure (outlining certificate of origin requirements).

224. U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 1(c), 24 I.L.M. at 669-70; Nikelsberg, *supra* note 27, at 385. The 35% domestic content requirement can consist of "(i) the cost or value of materials produced in the exporting party, plus (ii) the direct costs of processing operations performed in the exporting party." U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 1(c), 24 I.L.M. at 669-70. The phrase "cost or value of materials" produced in the exporting party includes the manufacturer's actual cost for the materials as well as: the additional costs for freight, insurance, packing, transportation, actual cost of waste or spoilage less the value of recoverable scrap, and taxes or duties imposed

five percent added value may be produced in the country of import.[225]

When imported material is used to manufacture the final exported product, the question arises whether the value of the imported material can be included in the thirty-five percent domestic content requirement.[226] To do so, the exporting country must first substantially transform the imported material into a new and different article of commerce and then this converted material must be substantially transformed into a new and different article of commerce.[227] Only after this two-stage process has occurred may the value of the imported material be included in the thirty-five percent value-added requirement.[228]

3. Dispute Resolution in the U.S.-Israel FTA

The U.S.-Israel FTA provides a mechanism to settle trade disputes between parties to the agreement, including disputes over origin.[229] This dispute resolution forum is only available to

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on the materials by a party. *Id.* Annex 3, ¶ 6(a), 24 I.L.M. at 670. If the manufacturer receives the material at less than fair market value, the cost is computed by adding: (1) the expenses incurred in the growth, production, or manufacture of the material; (2) a profit amount; and (3) the costs of freight, insurance, packing and all other transportation costs. *Id.* Annex 3, ¶ 6(b), 24 I.L.M. at 670-71. The phrase "direct costs of processing operations" includes the cost of: (1) all labor, (2) the allocable portion of dies, molds, tooling and depreciation on machinery, (3) research and development, and (4) inspection and testing. *Id.* Annex 3, ¶ 7, 24 I.L.M. at 671. Direct costs do not include profits and general expenses. Nikelsberg, *supra* note 27, at 385 n.91.

225. U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 5, 24 I.L.M. at 670. "This provision allows a product that has at least 20% of added value of Israeli origin to satisfy the 35% added value requirement when the remaining value required to meet the 35% threshold is of U.S. origin, or vice versa." Nikelsberg, *supra* note 27, at 388 n.106. Because Israel does not have many natural resources, this provision creates an incentive for Israeli manufacturers to buy raw materials from the United States. *United States-Israel Free Trade Area Agreement: Hearing before the House Comm. on Ways and Means*, 99th Cong., 1st Sess. 21 (1985) (statement of Philip Opher, Executive Vice President, American-Israel Chamber of Commerce and Industry Inc.).

226. Nikelsberg, *supra* note 27, at 387-88.

227. U.S.-Israel FTA, *supra* note 20, Annex 3, ¶ 4, 24 I.L.M. at 670. For an example of such a double transformation, see *supra* note 124 and accompanying text (discussing *Torrington Co. v. United States*, 764 F.2d 1563 (Fed. Cir. 1985), where Portugal imported wire from another country, turned wire into needle blanks, and then converted needle blanks into industrial sewing machine needles).

228. Nikelsberg, *supra* note 27, at 388.

229. U.S.-Israel FTA, *supra* note 20, art. 19, 24 I.L.M. at 664-65. The U.S.-Israel FTA's dispute settlement mechanism has jurisdiction to deal with almost any dispute between the United States and Israel, except the imposition of antidumping and countervailing duties by one party. *Id.* art. 19, ¶ 1(a), 24 I.L.M. at 664-65; Avraham Azrieli,

the governments of the United States and Israel, not private parties.[230] In the event of a disagreement between the governments, the first step in the dispute settlement process is the convening of consultations,[231] in which the U.S.-Israel FTA encourages the parties to arrive at a mutually agreeable solution.[232] If consultations are unsuccessful, disputes are then referred to the Joint Committee,[233] which supervises the implementation of the U.S.-Israel FTA.[234] If the Joint Committee is unable to resolve a dispute within sixty days, or within a longer period established by the Joint Committee, either party can refer the matter to a three-member conciliation panel.[235] If, within three months from the

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Improving Arbitration Under the U.S.-Israel Free Trade Agreement: A Framework for a Middle-East Free Trade Zone, 67 ST. JOHN'S L. REV. 187, 218-19 (1993).

230. Azrieli, *supra* note 229, at 219, 255; *see* U.S.-Israel FTA, *supra* note 20, arts. 1, 19, 24 I.L.M. at 657, 664-65 (stating that dispute settlement is available to Parties, defined as governments of United States and Israel). A private party facing injury from the U.S.-Israel FTA may, however, request that government officials overseeing implementation of the U.S.-Israel FTA take action on its behalf. Azrieli, *supra* note 229, at 260. If the officials fail to initiate the U.S.-Israel FTA's dispute resolution process on behalf of the private party, the party may be able to obtain judicial scrutiny of the government's decision not to act. *Id.* at 261.

231. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(b), 24 I.L.M. at 665. While the U.S.-Israel FTA does not specify the procedure for consultations, trade officials in both countries would most likely have on-going communications in which such disagreements could be raised. Azrieli, *supra* note 229, at 219.

232. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(b), 24 I.L.M. at 665.

233. *Id.* art. 19, ¶ 1(c), 24 I.L.M. at 665.

234. *Id.* art. 17, 24 I.L.M. at 663-64. The Joint Committee reviews the trade relationship between the United States and Israel and is charged with considering ways to improve the U.S.-Israel FTA. *Id.* art. 17, ¶¶ 1, 2(c), 24 I.L.M. at 663-64. The Joint Committee is headed by the USTR and the Israeli Minister of Industry and Trade. *Id.* art. 17, ¶ 3(a), 24 I.L.M. at 664. It meets at least once a year in regular sessions that alternate between the United States and Israel. *Id.* art. 17, ¶ 4, 24 I.L.M. at 664. While the U.S.-Israel FTA authorizes the Joint Committee to establish its own rules of procedure, it has never published such rules. *Id.*; Azrieli, *supra* note 229, at 220. Other than stating that the Joint Committee "shall endeavor to resolve the dispute," the U.S.-Israel FTA does not specify the format for the Joint Committee's attempts to resolve a dispute. *See* U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(c), 24 I.L.M. at 665 (indicating when matter should be referred to Joint Committee).

235. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(d), 24 I.L.M. at 665. Within 15 days of the date of referral of the dispute to the conciliation panel, each party must appoint one member to the conciliation panel. *Id.* Within 45 days of the date of referral, these two panel members must appoint a third member who will serve as the panel's chairman. *Id.* The U.S.-Israel FTA does not provide guidelines for selection of the panelists. Azrieli, *supra* note 229, at 223. Use of "conciliation" in the panel's name, as opposed to "dispute resolution" or "arbitration," reflects the U.S.-Israel FTA's drafters' desire to deprive the panel of any potent authority and to encourage the parties to resolve their disputes through amicable settlement. *Id.* at 227.

date that the first panelist was appointed, the panel is unable to resolve the dispute by mutual agreement of the parties, the panel must issue a report to the parties that contains findings of fact, a determination of either party's failure to carry out its obligations under the agreement, and a proposal for settling the dispute.[236] The report is non-binding[237] and the panel's findings are not published.[238] The U.S.-Israel FTA entitles the parties to take appropriate measures after the conciliation panel has presented its report.[239] The U.S.-Israel FTA does not provide a further enforcement mechanism that conclusively resolves a dispute between the parties.[240]

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236. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(e), 24 I.L.M. at 665. The U.S.-Israel FTA does not require the conciliation panel to state the reasoning that supports its proposed settlement. Azrieli, *supra* note 229, at 235. Without the benefit of sound reasoning, the report may be less able to withstand accusations that it was influenced by partiality. *Id.* at 237-38.

237. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(e), 24 I.L.M. at 665. Israel's FTA negotiators desired a binding dispute resolution mechanism, but U.S. officials felt that such a measure was unacceptable. Turbowicz, *supra* note 6, at 362-63. The U.S.-Israel FTA provides the conciliation panel with exclusive jurisdiction over disputes that are referred to it by the parties. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(f), 24 I.L.M. at 665. Alternatively, the U.S.-Israel FTA affords exclusive jurisdiction to "any other applicable international dispute settlement mechanism [that] has been invoked by either Party with respect to any matter." *Id.* It is not clear whether the findings of a different dispute settlement forum could, unlike the conciliation panel, be binding upon the parties. Azrieli, *supra* note 229, at 228. While the United States and Israel are free to use the GATT's dispute settlement mechanism, they intended the dispute settlement process in the U.S.-Israel FTA to be an improvement of the alternative system in the GATT. Turbowicz, *supra* note 6, at 326.

238. Azrieli, *supra* note 229, at 205, 232. Because the conciliation panel is not required to publish its findings, no official record exists regarding the resolution of disputes under the U.S.-Israel FTA. *Id.* at 205. In addition, courts have not heard any cases dealing with disputes under the U.S.-Israel FTA. *Id.* at 205 n.102. *See* Proceedings of the Seventh Annual Judicial Conference of the United States Court of International Trade, 137 F.R.D. 509, 616 (1990) (stating that no cases had been heard pertaining to U.S.-Israel FTA). Because the conciliation panel's report is non-binding, "non-publication deprives the winning party from its sole means of enforcement, namely, public opinion and respect for international law." Azrieli, *supra* note 229, at 234. Where the losing party is politically stronger, it might pressure the winning party not to make the winning award public. *Id.* at 234 n.279.

239. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 2, 24 I.L.M. at 665.

240. Azrieli, *supra* note 229, at 206. Because the conciliation panel has exclusive jurisdiction over disputes that are referred to it by the parties and the panel's findings are neither binding nor published, "there is practically no institution to which the winning party may turn when facing a refusal by the losing party to follow the Panel's Report." *Id.* at 232-33.

C. *The EC-Israel FTA*

The European Community and Israel signed an FTA on May 11, 1975.[241] By January 1, 1989, a free trade zone in the industrial sector had been established between the parties.[242] Products that are traded under the EC-Israel FTA are governed by the FTA's own rules of origin.[243]

1. Historical Relationship between the European Community and Israel

The European Community and Israel signed two major trade agreements before concluding the EC-Israel FTA in 1975.[244] The European Community acknowledged the differences between the two economies and granted Israel more time to eliminate its tariffs under the EC-Israel FTA.[245] Although Israeli officials acknowledged the significance of the EC-Israel FTA, they sought a more comprehensive trade pact with the European Community.[246]

a. From the Treaty of Rome until the EC-Israel FTA

The formal relationship between the European Community and Israel began about a year after the signing of the Treaty of Rome,[247] when, in April 1958, Israel became the third country to request an accredited ambassador to the Community.[248] In October of that year, Israel submitted to the EC Commission[249] a

241. Simon H. Langer, *The Israel-EEC Free Trade Agreement: An Analysis of the Agreement and Its Effect on Investments*, 9 SYRACUSE J. INT'L L. & COM. 63, 77 (1982).

242. *EC/Israel Relations*, Memorandum from the European Community 2 (Aug. 9, 1993) [hereinafter *EC/Israel Relations*] (on file with the *Fordham International Law Journal*).

243. Forrester, *supra* note 86, at 173.

244. TALIA EINHORN, THE ROLE OF THE FREE TRADE AGREEMENT BETWEEN ISRAEL AND THE EEC: THE LEGAL FRAMEWORK FOR TRADING WITH ISRAEL BETWEEN THEORY AND PRACTICE 18 n.11 (1994).

245. Langer, *supra* note 241, at 91-92.

246. *Id.* at 86.

247. EEC Treaty, *supra* note 22, 298 U.N.T.S. 11, 1973 Gr. Brit. T.S. No. 1.

248. *See EC Signs Far-Reaching Agreement with Israel*, European Community Background Information Memorandum 2 (Mar. 2, 1977) [hereinafter Background Note] (on file with the *Fordham International Law Journal)* (citing speech of Mr. Claude Cheysson, member of EC Commission, February 8, 1977). The Israeli delegation to the Common Market was accredited on January 30, 1959. Langer, *supra* note 241, at 64 n.7. Prior to Israel, only the United States and Greece had established diplomatic missions at the European Community's Brussels headquarters. *Id.*

249. A.G. TOTH, THE OXFORD ENCYCLOPAEDIA OF EUROPEAN COMMUNITY LAW 70

memorandum regarding a comprehensive agreement between the European Community and Israel.[250] Those efforts yielded a limited commercial agreement in 1964,[251] which was replaced by a Preferential Trade Agreement in 1970 ("1970 Agreement").[252]

(1990) [hereinafter ENCYCLOPAEDIA OF EC LAW]. The Commission is one of the four main institutions of the European Union. DAVID MEDHURST, A BRIEF AND PRACTICAL GUIDE TO EC LAW 17 (1994). The other three institutions are the Council of Ministers, the European Parliament, and the European Court of Justice ("ECJ"). *Id.* The Commission serves as the European Union's executive body and it implements and enforces EU legislation. ENCYCLOPAEDIA OF EC LAW, *supra*, at 70. The Commission also initiates EU policy and proposes legislation to the Council. *Id.* The Council is the European Union's primary legislative and decision-making body. *Id.* at 137-38. It generally acts upon legislation after receiving a proposal to do so from the Commission. *Id.* at 72. The European Parliament may review the Commission's legislative proposals and make appropriate recommendations. MEDHURST, *supra*, at 17-18. The ECJ interprets EU legislation. ENCYCLOPAEDIA OF EC LAW, *supra*, at 211-17.

250. EINHORN, *supra* note 244, at 18 n.11; Langer, *supra* note 241, at 64.

251. EINHORN, *supra* note 244, at 18 n.11; Langer, *supra* note 241, at 65-66. *See* Council Decision No. 64/357/EEC, 7 J.O. 1517 (1964), O.J. Eng. Spec. Ed. 1974, at 77 (setting forth commercial agreement between European Community and Israel). This limited agreement, signed on June 4, 1964, was for a term of three years and was renewed several times. Background Note, *supra* note 248, at 2-3. It provided for the partial suspension of the EC common external tariff duties on Israeli goods in about 20 industrial and agricultural categories. *Id.* at 2-3; *EC/Israel Relations*, *supra* note 242, at 1. This agreement also removed some of the quantitative restrictions that EC Member States still applied in their trade with Israel. *Id.* at 1. The agreement contained an Israeli pledge to facilitate EC imports and also established a joint committee to promote the implementation of the accord and the development of trade between the parties. Background Note, *supra* note 248, at 2-3; *EC/Israel Relations*, *supra* note 242, at 1. At the time, it was only the second nondiscriminatory commercial agreement that the European Community had concluded with a non-member country. Langer, *supra* note 241, at 66 n.18. The first such agreement was concluded between the European Community and Iran in October 1963. *Id.* *See* Council Decision No. 63/574/EEC, J.O. L 152/2554 (1963), O.J. Eng. Spec. Ed. 1974, at 309 (setting forth trade agreement between European Community and Iran).

252. EINHORN, *supra* note 244, at 18 n.11; Langer, *supra* note 241, at 66-70 (chronicling historical development of EEC-Israel trade negotiations from 1966 to 1970). *See* Council Regulation No. 1526/70, J.O. L 183/1 (1970), O.J. Eng. Spec. Ed. 1974, at 84 (presenting 1970 trade agreement between European Community and Israel). The preferential agreement was signed in Luxembourg on June 29, 1970, for a term of five years. *EC/Israel Relations*, *supra* note 242, at 1. It was negotiated under Article 113 of the Treaty of Rome and granted Israel new and substantially greater tariff advantages. *See* Langer, *supra* note 241, at 86 (discussing European Community's insistence of concluding accords with Israel pursuant to tariff and trade agreements provision of Article 113 of Treaty of Rome instead of association agreements provision of Article 238 as Israel requested); EEC Treaty, *supra* note 22, art. 113, 298 U.N.T.S. at 60, 1973 Gr. Brit. T.S. No. 1, at 42-43 (providing for negotiation of EC trade agreements with non-member states). *See also* EEC Treaty, *supra* note 22, art. 238, 298 U.N.T.S. at 92, 1973 Gr. Brit. T.S. No. 1, at 74 (allowing European Community to conclude agreements with non-member states that establish "association involving reciprocal rights and obligations, common action and special procedures"). Between October 1, 1970, when the

The 1970 Agreement signified the first step toward a free-trade zone between Israel and the European Community.[253]

Several developments, however, led to the renegotiation of trade provisions between Israel and the Community.[254] The European Community's proposed enlargement[255] prompted Israel to call attention to the prospective erosion of the value of its trade preferences once new Member States joined the European Community.[256] The introduction, in 1971, of the European Community's GSP program[257] for developing countries also eroded the value of Israel's trade preferences with the European Community.[258] Finally, in October 1972, the European Community announced that it would pursue a common commercial policy with Mediterranean countries, resulting, in part, in a need to renegotiate Israel's 1970 Agreement with the European Community.[259]

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agreement came into force, and December 31, 1973, the European Community reduced its tariffs on Israeli industrial goods to 50% of the full duty, with some exceptions for sensitive products. *EC/Israel Relations*, *supra* note 242, at 1. In addition, the European Community granted preferential treatment to 80% of its agricultural imports from Israel by reducing its Common Customs Tariff duties from between 30 and 70% on such products. *Id.* Israel, for its part, reduced tariffs by 10 to 30% on 60% of its imports from the European Community. *Id.*; Langer, *supra* note 241, at 71-72 (table showing reduction in Israeli tariffs on imports from European Community).

253. *EC/Israel Relations*, *supra* note 242, at 1.

254. *Id.*

255. *Id.* The enlargement resulted in the accession of the United Kingdom, Ireland, and Denmark to the European Community in 1973. *Id.* at 2.

256. *Id.*; RICHARD POMFRET, MEDITERRANEAN POLICY OF THE EUROPEAN COMMUNITY: A STUDY OF DISCRIMINATION IN TRADE 20-21 (1986). *See, e.g.*, Council Regulation No. 681/73, O.J. L 66/5 (1973) (addressing changes in European Community-Israel trade as result of United Kingdom, Denmark, and Ireland becoming EC Member States). Before joining the European Community, Great Britain's and Denmark's duties on Israeli imports were lower than the European Community's, so tariffs on Israeli exports to the United Kingdom and Denmark increased after those countries became members of the European Community. Nikelsberg, *supra* note 27, at 372; Langer, *supra* note 241, at 72-73; Yaacov Cohen, *Implications of a Free Trade Area Between the EEC and Israel*, 10 J. WORLD TRADE L. 252, 253 (1976) (giving examples of different tariff levels for Israeli imports in European Community and United Kingdom).

257. NICHOLAS A. ZAIMIS, EC RULES OF ORIGIN 179 (1992). *See supra* note 76 and accompanying text (discussing United States' GSP program).

258. POMFRET, *supra* note 256, at 21. Israel was excluded from the arrangement that went into effect in January 1972 in which the European Community granted preferences to the industrial exports of most developing countries. Langer, *supra* note 241, at 73.

259. POMFRET, *supra* note 256, at 16-24. The European Community formally adopted its "global" Mediterranean policy at the Paris Summit Conference on October 19, 1972. *EC/Israel Relations*, *supra* note 242, at 2; Background Note, *supra* note 248, at

b. Conclusion of the EC-Israel FTA

While Portugal, Spain, and Greece would later become full members of the European Community,[260] the first result of the European Community's global Mediterranean approach was the FTA between Israel and the European Community in 1975.[261] This accord was intended to allow Israeli industrial exports to the European Community to compete more freely in EC markets.[262] On July 1, 1977, when the EC-Israel FTA came into force, Israeli exports of industrial goods became fully exempt from EC duties.[263] In return, Israel eliminated tariffs on EC industrial exports by January 1, 1989.[264] On this date, a free trade zone in the industrial sector was thus fully established between

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2. With the policy change, the European Community meant to transcend purely commercial interests and to stimulate general economic development of the Mediterranean region. Background Note, supra note 248, at 2; *EC/Israel Relations*, *supra* note 242, at 1-2. By declaring its policy to be "global," the European Community intended to adopt a uniform policy toward the Mediterranean nations of Albania, Algeria, Cyprus, Egypt, Greece, Israel, Jordan, Lebanon, Libya, Malta, Morocco, Portugal, Spain, Syria, Tunisia, Turkey, and Yugoslavia. Langer, *supra* note 241, at 63 n.2.

260. BERMANN, *supra* note 22, at 11. Greece became a member of the European Community on January 1, 1981. *Id.* Spain and Portugal both became EC members on January 1, 1986. *Id.*

261. Background Note, *supra* note 248, at 3. *See* EC-Israel FTA, *supra* note 24, O.J. L 136/1 (1975) (presenting FTA between European Community and Israel). *See also* Langer, *supra* note 241, at 74-77 (discussing progress of EC-Israel trade negotiations from 1973 to 1975); Cohen, *supra* note 256, at 253-57 (discussing political views of EC Member States during that period and their influence on negotiation of agreement with Israel). The agreement, signed on May 11, 1975, was of unlimited duration. Langer, *supra* note 241, at 77. It was hailed by Israeli officials as the most important economic treaty in Israel's history. *Id.* at 77 n.63. Like previous EC-Israel trade agreements, the EC-Israel FTA was negotiated pursuant to Article 113 of the Treaty of Rome. *Id.* at 86; *see supra* note 252 and accompanying text (discussing European Community's insistence on negotiating 1970 Agreement pursuant to Article 113). Because of the extensive nature, however, of the parties' reciprocal rights and obligations under the EC-Israel FTA, the FTA seems to fall more under the association agreements provision in Article 238 of the Treaty of Rome. Langer, *supra* note 241, at 88; *see supra* note 252 and accompanying text (discussing Article 238). Opposition from EC Member States such as France and Italy that have opposed Israeli association with the European Community may have prevented negotiation of the EC-Israel FTA pursuant to Article 238. Langer, *supra* note 241, at 88-89.

262. EINHORN, *supra* note 244, at 19.

263. *Id.* at 20; Langer, *supra* note 241, at 78 (providing timetable of European Community's elimination of duties on Israeli industrial exports).

264. EINHORN, *supra* note 244, at 20; Langer, *supra* note 241, at 80-81 (detailing gradual elimination of Israeli tariffs in order to protect young and sensitive Israeli industries).

Israel and the European Community.[265]

c. Amendments and Additional Protocols to the EC-Israel FTA

Following the passage of the EC-Israel FTA in 1975, Israel complained that the FTA was creating a growing imbalance of trade between the European Community and Israel because of the difference in size of the parties' economies.[266] In response to this problem, the European Community and Israel signed two protocols[267] in Brussels on February 8, 1977, that supplemented the EC-Israel FTA.[268] The Additional Protocol established wider economic, financial, and technical cooperation between the European Community and Israel.[269] The Financial Protocol required the European Community to invest in Israeli projects that promoted industrialization in Israel.[270] Following the initial provisions signed in February 1977, the European Community and

265. *EC/Israel Relations*, *supra* note 242, at 2. No provision for total free trade in the agricultural sector had been signed. Background Note, *supra* note 248, at 5. However, the European Community reduced its duties by 40 to 50% on 85% of its imports of Israeli agricultural products. EINHORN, *supra* note 244, at 23; Langer, *supra* note 241, at 78-80 (specifying European Community's reduction in duties for different Israeli agricultural products). On a smaller scale, Israel reduced its duties by 15 to 25% on a limited list of agricultural imports from the European Community. EINHORN, *supra* note 244, at 24; Langer, *supra* note 241, at 82.

266. Langer, *supra* note 241, at 89.

267. *See* Council Regulation No. 2217/78, O.J. L 270/1, at 2 (1978) [hereinafter Additional Protocol] (setting forth Additional Protocol to EC-Israel FTA); *Id.* O.J. L 270/1, at 9 (1978) [hereinafter Financial Protocol] (setting forth Financial Protocol to EC-Israel FTA).

268. Langer, *supra* note 241, at 91. These protocols were negotiated pursuant to Article 238 of the Treaty of Rome. *Id.* at 91 n.134; *see supra* note 252 and accompanying text (discussing Article 238). Because the European Community had already negotiated association agreements under Article 238 with several Arab countries, including Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, and Tunisia, the use of Article 238 for the additional protocols with Israel may have been an attempt by the European Community to show its evenhanded approach toward Mediterranean countries. Langer, *supra* note 241, at 87 n.117, 91 n.134. *See supra* note 252 and accompanying text (illustrating Israeli frustration with European Community's refusal to negotiate agreements under Article 238).

269. Additional Protocol, *supra* note 267, arts. 2-4, O.J. L 270/1, at 3-4 (1978). *See* Langer, *supra* note 241, at 91-92 (describing main provisions of Additional Protocol). The Additional Protocol is of unlimited duration. *Id.* at 91.

270. Financial Protocol, *supra* note 267, art. 1, O.J. L 270/9, at 10 (1978). The Financial Protocol provided for EC loans through October 31, 1981, to finance capital projects in Israel. *Id.* art. 2, O.J. L 270/9, at 10 (1978). The European Community renewed its commitment to invest in Israeli projects on several occasions. *See* Council Regulation No. 3354/83, O.J. L 335/7, at 8 (1983) (providing for EC loans through October 31, 1986); Council Decision No. 88/597/EEC, O.J. L 327/51, at 52 (1988)

Israel agreed to several additional protocols that extended Israel's deadline for eliminating duties on EC products[271] and that adjusted Israeli and EC duties once new Member States joined the European Community.[272]

The parties also implemented minor amendments to the EC-Israel FTA's rules of origin in 1977 and 1979 that addressed proof of direct shipment between the parties[273] and determination of origin for products that are shipped as sets containing components from different countries.[274] In addition, the European Community issued several regulations pertaining to EC trade with the Occupied Territories.[275] In 1986, the European Community granted preferential treatment to many products from the Occupied Territories[276] and amended this regulation

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(providing for EC loans through October 31, 1991); Council Decision No. 92/210/EEC, O.J. L 94/45, at 46 (1992) (providing for EC loans through October 31, 1996).

271. *See* Council Regulation No. 1008/81, art. 1, O.J. L 102/1, at 2 (1981) (presenting Second Additional Protocol to EC-Israel FTA that extended timetable from January 1, 1985, to January 1, 1987, for Israeli elimination of all duties on EC products under EC-Israel FTA); Council Regulation No. 3565/84, art. 1, O.J. L 332/1, at 2 (1984) (presenting Third Additional Protocol to EC-Israel FTA that extended timetable from January 1, 1987, to January 1, 1989, for Israeli elimination of all duties on EC products under EC-Israel FTA).

272. *See, e.g.*, Council Decision No. 88/596/EEC, arts. 1-4, O.J. L 327/35, at 36-37 (1988) [hereinafter Fourth Additional Protocol] (presenting Fourth Additional Protocol to EC-Israel FTA that adjusted duties for Israeli and EC goods as result of accession of Spain and Portugal to European Community in 1986).

273. *See* Council Regulation No. 1726/77, art. 5(2)(a)-(c), O.J. L 190/1, at 4-5 (1977) [hereinafter 1977 Origin Amendment] (providing specific means of proving that products satisfied EC-Israel FTA's direct transportation requirement).

274. EINHORN, *supra* note 244, at 29 n.48. *See* Council Regulation No. 560/79, art. 2, O.J. L 80/1, at 2 (1979) [hereinafter 1979 Origin Amendment] (stating that, for products that are shipped as sets, set as whole would be regarded as originating product under EC-Israel FTA if value of non-originating articles in set did not exceed 15% of set's total value).

275. Nikelsberg, *supra* note 27, at 373 n.13. The Occupied Territories are defined as the areas of the West Bank and the Gaza Strip that Israel took over from Jordan and Egypt, respectively, following the June 1967 Six Day War. NADAV SAFRAN, ISRAEL: THE EMBATTLED ALLY 67 (1981).

276. *See* Council Regulation No. 3363/86, arts. 1-2, O.J. L 306/103, at 103 (1986) (reducing or eliminating duties on certain products originating in Occupied Territories that are imported into European Community); Commission Regulation No. 4129/86, O.J. L 381/1 (1986) (presenting rules of origin, much like those in EC-Israel FTA, governing products that are produced in Occupied Territories and that are imported into European Community); Commission Regulation No. 1302/87, art. 1, O.J. L 123/5, at 5 (1987) (modifying monetary values of certain minor provisions in prior regulation dealing with products from Occupied Territories); Commission Regulation 809/88, art. 3, O.J. L 86/1, at 2 (1988) (adjusting rules of origin that govern products from Occupied Territories so that rules comply with Harmonized System of tariff classification).

to allow for bilateral cumulation between the two parties in 1988.[277] In 1994, the European Community initiated a financial and technical cooperation program between the Community and the Occupied Territories.[278]

2. Rule-of-Origin Requirements in the EC-Israel FTA

In 1968, the European Community established a uniform rules of origin standard.[279] The rules of origin in the EC-Israel FTA are based upon this uniform standard, but also contain unique provisions that suit EC-Israel trade.[280] The EC-Israel FTA's rules of origin are largely based upon the change-in-tariff heading test.[281]

a. Rules of Origin in the European Community

Prior to 1968, no common rules-of-origin standard existed to govern European Community trade.[282] In that year, the Council passed Regulation 802/68[283] ("Common Definition") that established criteria to be used throughout the European Community for determining the origin of goods.[284] A common

277. *See* Commission Regulation No. 2774/88, O.J. L 249/5 (1988) (allowing bilateral cumulation between European Community and Occupied Territories such that products originating in European Community that undergo working or processing in Occupied Territories are considered originating in Occupied Territories when determining origin of final products that are imported into European Community).

278. *See* Council Regulation No. 1734/94, O.J. L 182/4 (1994) (establishing five-year program of financial and technical cooperation between European Community and Occupied Territories to aid economic and social development in Occupied Territories); Council Regulation No. 1735/94, art. 1, O.J. L 182/6, at 6 (1994) (including Occupied Territories in five-year program of financial cooperation between European Community and Mediterranean non-member countries); Communication from the Commission to the Council and the European Parliament on future European Union economic assistance to the West Bank and the Gaza Strip, COM (95) 505 Final (Oct. 1995) (presenting plan of action as basis for EC position on future assistance to West Bank and Gaza Strip).

279. Turbowicz, *supra* note 6, at 261.

280. *Id.* at 272.

281. Langer, *supra* note 241, at 83.

282. Forrester, *supra* note 86, at 175. Prior to 1968, each EC Member State applied its own rule-of-origin standard to determine whether goods qualified for preferential treatment under the European Community's trade agreements. *Id. See* Turbowicz, *supra* note 6, at 257-60 (explaining why common rule of origin was necessary for intra-Community trade as well as for European Community's external trade with foreign countries).

283. Council Regulation No. 802/68, J.O. L 148/1 (1968), O.J. Eng. Spec. Ed. 1972, at 165 [hereinafter Common Definition].

284. Turbowicz, *supra* note 6, at 261. The Common Definition must be applied in

definition of origin was necessary to ensure uniform application of the European Community's Common Customs Tariff[285] as well as consistent standards for statistics, marking, quantitative restrictions, and other measures related to the importation and exportation of goods by the European Community and its Member States.[286]

The Common Definition states that goods that are wholly obtained or produced in one country are considered to originate in that country.[287] For goods that are not wholly obtained

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the same manner by the customs service of each EC Member State. *Id.* at 261-62; Common Definition, *supra* note 283, O.J. Eng. Spec. Ed. 1972, at 165. Because the Common Definition is a provision arising exclusively under Community law, EC Member States may not promulgate unilaterally binding rules of interpretation in the sphere covered by the Common Definition. Gesellschaft fur Uberseehandel mbH v. Handelskammer Hamburg, Case 49/76, [1977] E.C.R. 41, 52, [1977-1978 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8407, at 7336.

285. Common Definition, *supra* note 283, art. 1(a), O.J. Eng. Spec. Ed. 1972, at 166. Members of a customs union must apply the same customs duty to all imports. Turbowicz, *supra* note 6, at 260. The European Community first established its Common Customs Tariff in 1968. *Id.*; Council Regulation No. 950/68, J.O. L 172/1 (1968), O.J. Eng. Spec. Ed. 1972, at 275.

286. Turbowicz, *supra* note 6, at 258, 260-61. To certify that products originated in the European Community, they must be accompanied by a certificate of origin. Common Definition, *supra* note 283, arts. 9-10, O.J. Eng. Spec. Ed. 1972, at 166-67. *See id.* Annex II, O.J. Eng. Spec. Ed. 1972, at 169 (outlining detailed provisions concerning preparation and issuance of certificates of origin). Because the EC Member States could not agree on rules to determine the origin of oil products, the Common Definition does not apply to the petroleum products listed in Annex I of the Common Definition regulation. Ian S. Forrester, *EEC Customs Law: Rules of Origin and Preferential Duty Treatment, Part II*, 5 EUR. L. REV. 257, 259 (1980); Common Definition, *supra* note 283, art. 3, O.J. Eng. Spec. Ed. 1972, at 166. *Id.* Annex I, O.J. Eng. Spec. Ed. 1972, at 168 (listing petroleum products excluded from Common Definition). The EC Member States apply their own particular rules of origin to the excluded oil products. Forrester, *supra*, at 260. Accessories, spare parts, or tools that are delivered with a product that form part of the product's standard equipment are deemed to have the same origin as the product with which they are delivered. Common Definition, *supra* note 283, art. 7, O.J. Eng. Spec. Ed. 1972, at 166.

287. Common Definition, *supra* note 283, art. 4(1), O.J. Eng. Spec. Ed. 1972, at 166. The Common Definition explains that the following are considered wholly obtained or produced in one country:

> (a) mineral products extracted within its territory; (b) vegetable products harvested therein; (c) live animals born and raised therein; (d) products derived from live animals raised therein; (e) products of hunting or fishing carried on therein; (f) products of sea-fishing and other products taken from the sea by vessels registered or recorded in that country and flying its flag; (g) goods obtained on board factory ships from the products referred to in (f) originating in that country, if such factory ships are registered or recorded in that country and flying its flag; (h) products taken from the sea-bed or beneath the sea-bed outside territorial waters, if that country has, for the purposes of ex-

in one country, the Common Definition attributes origin to the country in which the last substantial process was performed.[288] The four conditions[289] that confer origin on the country of the last substantial operation are: (1) that the last substantial process or operation must have occurred in that country;[290] (2) that

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ploitation, exclusive rights to such soil or subsoil; (i) waste and scrap products derived from manufacturing operations and used articles, if they were collected therein and are only fit for the recovery of raw materials; (j) goods which are produced therein exclusively from goods referred to in subparagraphs (a) to (i) or from their derivatives, at any stage of production.

Id. art. 4(2)(a)-(j), O.J. Eng. Spec. Ed. 1972, at 166. While origin determinations concerning goods wholly obtained in one country are usually straightforward, difficulties arose, for example, concerning joint fishing operations involving vessels flying the flags of more than one country. Turbowicz, *supra* note 6, at 262-63. In such a case, the product was deemed wholly obtained because of the absence of any processing, even though more than one country was involved in obtaining the final product. *Id.* at 263. The ECJ held that the origin of the fish was attributed to the flag flown by the vessel that performed the essential part of the operation, defined as locating the fish and separating them from the sea by netting them. Commission v. United Kingdom, Case 100/84, [1985] E.C.R. 1169, 1183, [1985] 2 C.M.L.R. 199, 212. For a more detailed discussion of the European Community's treatment of fish for origin purposes, see Forrester, *supra* note 286, at 257-59.

288. Common Definition, *supra* note 283, art. 5, O.J. Eng. Spec. Ed. 1972, at 166. The Common Definition's anti-fraud provision states that work performed on a product where the sole object was to circumvent the European Community's rules of origin standard will not confer origin upon the affected product. *Id.* art. 6, O.J. Eng. Spec. Ed. 1972, at 166.

289. *Id.* art. 5, O.J. Eng. Spec. Ed. 1972, at 166. The four conditions are cumulative and, thus, must all be satisfied in order to confer origin upon the country of the last substantial operation. Turbowicz, *supra* note 6, at 263. *But see* Forrester, *supra* note 86, at 173-74 (suggesting that any one of four conditions alone ought to associate product significantly with exporting country). The additional conditions that were added to the substantial transformation test resulted from the fact that the Common Definition was a conglomeration of the rules of origin of several EC Member States. *Id.* at 174; Turbowicz, *supra* note 6, at 263.

290. Common Definition, *supra* note 283, art. 5, O.J. Eng. Spec. Ed. 1972, at 166. A process is substantial only if the product resulting from the process or operation has its own properties and composition that it did not possess before the operation. *Gesellschaft fur Uberseehandel*, [1977] E.C.R. at 53, ¶ 6, [1977-1978 Transfer Binder] Common Mkt. Rep. (CCH) at 7336. In *Gesellschaft fur Uberseehandel*, the ECJ held that the grinding of a raw material such as raw casein to various degrees of fineness was not a process or operation because it did not bring about a significant qualitative change in the raw material but merely changed the consistency of the product and its presentation for the purposes of its later use. *Id.* at 53, ¶ 7, [1977-1978 Transfer Binder] Common Mkt. Rep. (CCH) at 7336. Operations that alter the presentation of a product for the purposes of its use but that do not cause a significant qualitative change in the product's properties do not affect the origin of the product. Zentralgenossenschaft des Fleischergewerbes e.G. (Zentrag) v. Hauptzollamt Bochum, Case 93/83, [1984] E.C.R. 1095, 1106, [1983-1985 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 14063, at 14897.

the process must have been economically justified;[291] (3) that the process must have involved equipment that was particularly suited for such an operation;[292] and (4) that the process must have resulted in the manufacture of a new product or represented an important stage of manufacture.[293]

The Common Definition does not apply to the European Community's preferential trade agreements[294] that incorporate their own rules of origin.[295] The Common Definition is only used where no specific rule of origin exists with regard to a particular import.[296] As a result, the Common Definition's application is limited to the movement of goods within the European Community and the European Community's non-preferential trade with non-EC countries.[297]

The Common Definition created a Committee on Origin[298] that is empowered to promulgate specific regulations to deter-

291. Common Definition, *supra* note 283, art. 5, O.J. Eng. Spec. Ed. 1972, at 166. A substantial operation will usually be economically justified because without the substantial operation the product would be unfinished or unsuitable for its specific use. Turbowicz, *supra* note 6, at 267.

292. Common Definition, *supra* note 283, art. 5, O.J. Eng. Spec. Ed. 1972, at 166. This condition requires that certain skills and tools be utilized in order for the substantial process to determine the origin of a product. Turbowicz, *supra* note 6, at 267-68.

293. Common Definition, *supra* note 283, art. 5, O.J. Eng. Spec. Ed. 1972, at 166. A new product is defined as a new item of commerce that is different than its constituent elements. Turbowicz, *supra* note 6, at 268. A new product may be produced in a non-substantial process, such as mixing ink powder with water to produce ink, that will not confer origin. *Id.* An important stage of manufacture produces significant qualitative change in the product. *Id.* An important stage of manufacture, such as conducting consumer safety tests on pharmaceuticals, may occur without altering the product's constituents and, thus, will not affect the origin of the product. *Id.*

294. Common Definition, *supra* note 283, art. 2, O.J. Eng. Spec. Ed. 1972, at 166. The Commission may, therefore, apply a rule of origin standard to the European Community's GSP program that is stricter than the standard allowed under the Common Definition. S.R. Industries v. Administration des Douanes, Case 385/85, [1986] E.C.R. 2929, 2942, [1988] 1 C.M.L.R. 378, 385.

295. Forrester, *supra* note 86, at 173; Turbowicz, *supra* note 6, at 272. The European Community generally uses a change-in-tariff-heading standard to determine when a new product was formed and to define country of origin in its trade agreements with other countries. IMPACT REPORT, *supra* note 82, at 16. For a detailed discussion of the rules of origin in the European Community's trade agreements with other countries, see *id.* at 68-97.

296. Forrester, *supra* note 86, at 173; Turbowicz, *supra* note 6, at 272.

297. Turbowicz, *supra* note 6, at 272-73.

298. Common Definition, *supra* note 283, art. 12(1), O.J. Eng. Spec. Ed. 1972, at 167. The Committee on Origin consists of representatives of the EC Member States and is chaired by a representative of the EC Commission. *Id.*

mine the origin of particular products.[299] Products that are subject to specific origin regulations include: eggs,[300] spare parts,[301] radio and television receivers,[302] basic wines intended for the preparation of vermouth,[303] tape recorders,[304] meat of certain domestic animals,[305] ceramic products,[306] grape juice,[307] textile products,[308] ball bearings,[309] integrated circuits,[310] and photocopiers.[311] Although product-specific regulations are intended to clarify the substantial process determination for particular products, they are often used as protectionist measures to restrict imports and force non-EC manufacturers to establish production facilities within the European Community.[312]

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299. Forrester, *supra* note 86, at 174; Common Definition, *supra* note 283, arts. 12-14, O.J. Eng. Spec. Ed. 1972, at 167. The Committee on Origin adopts a regulation when it is difficult to define a substantial process or operation for a particular product. Turbowicz, *supra* note 6, at 274. For instance, when it is impossible to identify the last substantial process or operation, a different rule may be promulgated. Yoshida Nederland B.V. v. Kamer van Koophandel en Fabrieken voor Friesland, Case 34/78, [1979] E.C.R. 115, 134-35, [1979] 2 C.M.L.R. 747, 769 (discussing EC Commission regulation that conferred origin of slide fasteners upon country where certain assembly operations occurred).

300. Commission Regulation No. 641/69, J.O. L 83/15 (1969), O.J. Eng. Spec. Ed. 1972, at 187.

301. Commission Regulation No. 37/70, J.O. L 7/6 (1970), O.J. Eng. Spec. Ed. 1972, at 3.

302. Commission Regulation No. 2632/70, J.O. L 279/35 (1970), O.J. Eng. Spec. Ed. 1972, at 911.

303. Commission Regulation No. 315/71, J.O. L 36/10 (1971), O.J. Eng. Spec. Ed. 1972, at 67.

304. Commission Regulation No. 861/71, J.O. L 95/11 (1971), O.J. Eng. Spec. Ed. 1972, at 243.

305. Commission Regulation No. 964/71, J.O. L 104/12 (1971), O.J. Eng. Spec. Ed. 1972, at 253.

306. Commission Regulation No. 2025/73, O.J. L 206/32 (1973).

307. Commission Regulation No. 2026/73, O.J. L 206/33 (1973).

308. Commission Regulation No. 749/78, O.J. L 101/7 (1978).

309. Commission Regulation No. 1836/78, O.J. L 210/49 (1978).

310. Commission Regulation No. 288/89, O.J. L 33/23 (1989).

311. Commission Regulation No. 2071/89, O.J. L 196/24 (1989).

312. Turbowicz, *supra* note 6, at 278. *See, e.g.*, *Change in Semiconductor Origin Definition Could Signal Revisions for Other Products*, 6 INT'L TRADE REP. (BNA) 72, 72 (Jan. 18, 1989) (indicating that EC Commission's change in specific rule of origin for semiconductors benefits European industry and may lead to further rule of origin changes to gain advantage for European industry and technology). *See generally* Jaap Feenstra, *Rules of Origin and Textile Products: Recent Case-Law of the Court of Justice*, 22 COMMON MKT. L. REV. 533 (1985) (illustrating use of specific textiles rules of origin to protect domestic EC market); J.A. Usher, *The Origin of Slide Fasteners*, 4 EUR. L. REV. 184 (1979) (discussing *Yoshida* cases where EC Commission's specific rule of origin for slide fasteners

b. Rules of Origin in the EC-Israel FTA

Whether a product is eligible for preferential treatment under the EC-Israel FTA is determined by the rules of origin in Protocol Three of that Agreement.[313] Protocol Three states that, in order to be considered a product originating in one of the parties to the Agreement,[314] the good must be produced in one of three specific ways.[315] First, it may be produced from the party's local raw materials.[316] Second, it may be produced by the

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raised question whether slide fasteners manufactured in Netherlands and Germany that contained Japanese component could be of EC origin).

313. EC-Israel FTA, *supra* note 24, art. 2(3), O.J. L 136/1, at 3 (1975); *Id.* Protocol 3, arts. 1-5, O.J. L 136/1, at 126-27 (1975). From 1975 to 1995, only minor amendments were made to Protocol 3. *See supra* notes 273-74 and accompanying text (discussing amendments to rules of origin in EC-Israel FTA).

314. EC-Israel FTA, *supra* note 24, Protocol 3, art. 1, O.J. L 136/1, at 126 (1975). In addition to satisfying the origin requirements, products under the EC-Israel FTA must also be transported directly from the European Community to Israel or vice versa. *Id.* Products whose shipment only passes through the territory of the European Community or Israel are considered to be transported directly under the agreement. *Id.* Protocol 3, art. 5, O.J. L 136/1, at 127 (1975). In addition, goods that originate in the European Community or Israel may pass through the territory of other parties and still be considered "transported directly" as long as the goods constitute a single shipment and are not split up:

> [P]rovided that the crossing of the latter territory is justified for geographical reasons, that the goods have remained under the surveillance of the customs authorities in the country of transit or of warehousing, that they have not entered into the commerce of such countries nor been delivered for home use there and have not undergone operations other than unloading, reloading or any operation designed to preserve them in good condition.

Id. Products receive preferential treatment under the EC-Israel FTA only upon submission of a movement certificate which proves that the goods are "originating products." *Id.* Protocol 3, arts. 6-17, O.J. L 136/1, at 127-30 (1975). *See id.* Annex V, O.J. L 136/1, at 176-79 (1975) (containing example of movement certificate). The products contained in List C were temporarily excluded from the scope of Protocol 3. *Id.* Protocol 3, art. 1, O.J. L 136/1, at 126 (1975). *See id.* Annex IV, List C, O.J. L 136/1, at 175 (1975) (listing excluded products).

315. *Id.* Protocol 3, art. 1, O.J. L 136/1, at 126 (1975).

316. *Id.* Protocol 3, art. 1(1)(a), (2)(a), O.J. L 136/1, at 126 (1975); Langer, *supra* note 241, at 83. Article 2 of the protocol explains that the following are considered "wholly obtained" from the parties' local raw materials:

> (a) mineral products extracted from their soil or from their seabed; (b) vegetable products harvested there; (c) live animals born and raised there; (d) products from live animals raised there; (e) products obtained by hunting or fishing conducted there; (f) products of sea fishing and other products taken from the sea by their vessels; (g) products made aboard their factory ships exclusively from products referred to in subparagraph (f); (h) used articles collected there fit only for the recovery of raw materials; (i) waste and scrap resulting from manufacturing operations conducted there; (j) goods produced there exclusively from products specified in subparagraphs (a) to (i).

party from raw materials imported from the other party.[317] Finally, it may be produced by the party from raw materials imported from a country which is not party to the EC-Israel FTA, so long as such raw materials undergo working or processing in the party's territory[318] so that the end product is classified under a tariff heading that is different from any of the headings covering the materials before they were worked or processed.[319] For example, a diamond ring that is classified under tariff heading 71.12 and that was produced in Israel from the combination of a South African diamond, classified under tariff heading 71.02, and Australian gold, classified under tariff heading 71.07, would qualify for preferential treatment upon exportation to the European Community because the ring was produced from non-Israeli materials that were processed in Israel such that a change

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EC-Israel FTA, *supra* note 24, Protocol 3, art. 2(a)-(j), O.J. L 136/1, at 126 (1975).

317. EC-Israel FTA, *supra* note 24, Protocol 3, art. 1(1)(b), (2)(b), O.J. L 136/1, at 126 (1975); Langer, *supra* note 241, at 83.

318. EC-Israel FTA, *supra* note 24, Protocol 3, art. 1(1)(b), (2)(b), O.J. L 136/1, at 126 (1975); Langer, *supra* note 241, at 83.

319. EC-Israel FTA, *supra* note 24, Protocol 3, art. 3(1)(a), O.J. L 136/1, at 126 (1975); Langer, *supra* note 241, at 83. "Tariff headings" refer to the headings in the Brussels Nomenclature for the Classification of Goods in Customs Tariffs ("CCT"). EC-Israel FTA, *supra* note 24, Protocol 3, art. 3(1), O.J. L 136/1, at 126 (1975). Two exceptions apply to the change-in-tariff-heading rule for non-party raw materials. *Id.* The first concerns goods, described in List A of the agreement, which are not considered originating in the parties to the agreement even though non-party raw materials have been worked or processed enough to produce a change in tariff heading. *Id.* Protocol 3, art. 3(1)(a), O.J. L 136/1, at 126 (1975). *See id.* Annex II, List A, O.J. L 136/1, at 134-67 (1975) (presenting "[l]ist of working or processing operations which result in a change of tariff heading without conferring the status of 'originating products' on the products undergoing such operations, or conferring this status only subject to certain conditions"). List A may, however, contain special conditions under which the working or processing would in fact allow the good to be considered originating in the parties to the agreement. *Id.* Protocol 3, art. 3(1)(a), O.J. L 136/1, at 126 (1975); *id.* Annex II, List A, O.J. L 136/1, at 134-67 (1975). The second exception concerns goods, described in List B of the agreement, which are considered originating in the parties to the agreement even though non-party raw materials have not been worked or processed enough to produce a change in tariff heading. *Id.* Protocol 3, art. 3(1)(b), O.J. L 136/1, at 126 (1975). *See id.* Annex III, List B, O.J. L 136/75, at 168-74 (1975) (presenting "[l]ist of working or processing operations which do not result in a change of tariff heading, but which do confer the status of 'originating products' on the products undergoing such operations"). Certain operations fail to qualify as working or processing that is sufficient to confer the status of originating products, even if a change in tariff heading occurs. *Id.* Protocol 3, art. 3(3), O.J. L 136/1, at 127 (1975). These operations include: insuring preservation of the goods during transport or storage, removing dust, sifting, sorting, classifying, washing, painting, cutting-up, simple packaging, labeling, simple mixing, simple assembly, and animal-slaughtering. *Id.* Protocol 3, art. 3(3)(a)-(h), O.J. L 136/1, at 127 (1975); Langer, *supra* note 241, at 83 n.94.

in their tariff headings occurred.[320] In addition, for some products,[321] the EC-Israel FTA specifies that the value of non-party raw materials worked or processed cannot exceed a given percentage of the value of the end product.[322] This requirement frequently limits the value of non-party imported materials to forty to fifty percent of the final product.[323] For such specified goods, the party-based content requirement is, therefore, fifty to sixty percent of the final product.[324]

3. Dispute Resolution in the EC-Israel FTA

The EC-Israel FTA established a Joint Committee to oversee the implementation of the FTA and to resolve disputes between the European Community and Israel.[325] The Joint Committee consisted of representatives of the European Community and Israel and acted by mutual agreement.[326] In 1978, the Joint Committee was replaced with a Cooperation Council that was empowered to resolve disagreements between the parties and to issue resolutions and opinions in order to achieve the FTA's

320. Forrester, *supra* note 86, at 179-80.

321. *Id.* at 182. For example, knives and cutting blades for machines that are manufactured in Israel or the European Community using non-domestic materials must not only undergo a change in tariff heading during the course of their production, but they may not derive more than 40% of their value from imported materials in order to enjoy originating status under the EC-Israel FTA. *Id.* Similarly, aluminum window frames manufactured from non-domestic materials must undergo a change in tariff heading and cannot derive more than 50% of their value from non-domestic materials. *Id.*

322. EC-Israel FTA, *supra* note 24, Protocol 3, art. 3(2), O.J. L 136/1, at 126 (1975). Percentage rules limiting the value of non-party imported raw materials are given for the applicable goods in Lists A and B. *Id.* To determine the percentage value of non-party raw materials in the value of the finished product, the value of non-party imported raw materials is considered to be their customs value at the time of importation, or, if the materials' origin cannot be determined, the earliest ascertainable price paid for such materials, and the value of the finished product is considered to be the price paid ex-works less local taxes. *Id.* Protocol 3, art. 4, O.J. L 136/1, at 127 (1975); Langer, *supra* note 241, at 83. The "customs value" is defined as the customs value established in the Convention concerning the Valuation of Goods for Customs Purposes signed in Brussels on December 25, 1950. EC-Israel FTA, *supra* note 24, Protocol 3, Annex I, Note 5, O.J. L 136/1, at 132 (1975). The "ex-works price" is defined as the price paid to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all the products used in manufacture. *Id.*

323. Langer, *supra* note 241, at 83.

324. *Id.*

325. EC-Israel FTA, *supra* note 24, art. 19(1), O.J. L 136/1, at 6 (1975).

326. *Id.* art. 20, O.J. L 136/1, at 7 (1975).

objectives.[327] The decisions of the Cooperation Council, unlike the Joint Committee, are binding upon the European Community and Israel and the parties must take measures to implement the Cooperation Council's rulings.[328]

II. *COMPARISON OF THE RECENT EC-ISRAEL ASSOCIATION AGREEMENT WITH THE PRESENT CONDITIONS OF THE U.S.-ISRAEL FTA*

Israel and the European Community signed the EC-Israel Association Agreement on November 20, 1995.[329] The Association Agreement opens markets to Israeli goods and significantly changes the rules of origin that govern EC-Israel trade.[330] While the United States and Israel gained greater access to each other's agricultural markets during this past year,[331] two trade disputes recently surfaced under the U.S.-Israel FTA.[332]

A. *The EC-Israel Association Agreement: Recent Replacement of the EC-Israel FTA*

Israeli officials were disappointed with the results of the EC-Israel FTA.[333] Progress in the Middle East peace process, however, offered an opportunity to renegotiate the terms of EC-Israel trade.[334] Several rounds of trade talks produced the most comprehensive agreement to date between the European Community and Israel.[335]

1. Israel's Dissatisfaction with the EC-Israel FTA

Israel intended to utilize the EC-Israel FTA as a means to combat the political and economic isolation that had been imposed by her Arab neighbors.[336] In addition, Israel expected the EC-Israel FTA to guarantee Israel free access to a large market,

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327. Additional Protocol, *supra* note 267, art. 10, O.J. L 270/1, at 4 (1978).

328. *Id.*

329. *Cooperation Deal*, *supra* note 23.

330. *Id.*; *Economic Agenda*, *supra* note 37, at 6.

331. *Farm Products*, *supra* note 35, at 1783.

332. *Two Dozen Disputes*, *supra* note 34, at 1597; Azrieli, *supra* note 229, at 205.

333. EINHORN, *supra* note 244, at 26.

334. *Proposal for New EC-Israel Trade & Cooperation Agreement*, European Commission Press Release, Oct. 7, 1993, at 1 [hereinafter *Agreement Proposal*] (on file with the *Fordham International Law Journal*).

335. Margo L. Sugarman, *EU Treaty*, JERUSALEM REP., Dec. 14, 1995, at 12.

336. EINHORN, *supra* note 244, at 18.

producing the secure trade conditions necessary for Israeli export industries to develop.[337] Israel also intended for the EC-Israel FTA to boost foreign investment in local Israeli industries.[338] Finally, Israel hoped that the EC-Israel FTA would narrow Israel's widening trade gap with the European Community.[339]

Israeli economists were disappointed, however, with the results of the EC-Israel FTA.[340] While the European Community became Israel's largest trading partner after the creation of the industrial free trade zone,[341] Israel's trade deficit with the European Community significantly increased.[342] In addition, the EC-Israel FTA did not attract direct investment in Israel from abroad.[343] Finally, the EC-Israel FTA caused Israeli industry to become polarized between a science-based export-oriented sector and a protected import-substituting sector.[344]

Some of these disappointments may be attributable to economic factors, such as the enlargement of the European Community to include Mediterranean countries with agricultural products that are substantially the same as Israel's[345] and the fact that the European Community granted to the Maghreb[346] coun-

337. *Id.* at 19.

338. *Id.*

339. *Id.* In 1975, Israel's trade deficit with the European Community was US$784 million, not including diamonds, or US$1.015 billion, including diamonds. *Id.* A significant portion of Israel's trade deficit with the European Community can be attributed to the diamond trade, as Israel imports uncut diamonds from Europe, cuts them in situ, and re-exports them internationally. *EC/Israel Relations*, *supra* note 242, at 2.

340. EINHORN, *supra* note 244, at 26.

341. *Id.* *See supra* note 23 and accompanying text (presenting statistics that indicate that European Community is Israel's main trading partner). Israeli exports to the European Community grew from US$526 million in 1975 to US$3.626 billion in 1992, excluding diamonds, and EC exports to Israel grew from US$1.31 billion to US$7.22 billion, excluding diamonds, during the same period. EINHORN, *supra* note 244, at 27.

342. EINHORN, *supra* note 244, at 27. Israel's trade deficit with the European Community in 1992 was US$3.594 billion, excluding diamonds, or US$4.936 billion, including diamonds. *Id.* *See supra* note 339 and accompanying text (presenting smaller trade deficit that Israel had with European Community in 1975).

343. EINHORN, *supra* note 244, at 27.

344. *Id.*

345. *Id.* at 31. Due to the European Community's Common Agricultural Policy, Spain, as well as Greece and Portugal, reduced Israel's share in the market of agricultural products. *Id.* at 30-31. *See supra* note 260 and accompanying text (discussing accession of Greece, Portugal, and Spain to European Community).

346. Langer, *supra* note 241, at 77 n.66. The Maghreb countries include Algeria, Morocco, and Tunisia. *Id.* The Mashreq countries include Egypt, Jordan, Syria, and Lebanon. *Id.*

tries higher citrus-fruit tariff reductions than it had granted to Israel.[347] Political reasons also contributed to Israel's disappointment with the EC-Israel FTA.[348] EC Member States did not want their accord with Israel to jeopardize trade with the Islamic world,[349] disturb oil supplies,[350] create upheavals that could send thousands of immigrants to European shores,[351] or risk outbreaks of Arab terrorism[352] in the European Community.[353] After the 1967 Six Day War,[354] for example, France stated that it wished to have no contacts with Israel.[355] After the European Community signed its preferential agreement with Israel in 1970,[356] therefore, the European Community announced that it would look favorably upon any request for a preferential trade agreement from a Mediterranean Arab country.[357]

This European fear of an Arab reaction to favorable dealings with Israel manifested once the EC-Israel FTA was signed.[358] Necessary amendments to the EC-Israel FTA became linked to progress in the Middle East peace process.[359] The rules of origin that governed the EC-Israel FTA were originally similar to those used in European Community agreements with European Free Trade Association[360] ("EFTA") countries, yet remained in effect

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347. EINHORN, *supra* note 244, at 31. The European Community fixed Israel's citrus-fruit tariff reduction at 60% while it granted the Maghreb countries a reduction of 80%. *Id.* at 31 n.56; Langer, *supra* note 241, at 77 n.65.

348. EINHORN, *supra* note 244, at 28.

349. *Id.*

350. *Id.*

351. *Id.*

352. *Id.*

353. *Id.*

354. *See* SAFRAN, *supra* note 275, at 67, 390 (describing Six Day War as hostilities between Israel and Arab states of Egypt, Jordan, and Syria on June 5-11, 1967, in which Israel was victorious and after which Israel controlled Egyptian Sinai Peninsula and Gaza Strip, Jordanian West Bank, and Syrian Golan Heights).

355. POMFRET, *supra* note 256, at 20.

356. *See supra* note 252 and accompanying text (discussing conclusion of agreement between European Community and Israel in 1970).

357. POMFRET, *supra* note 256, at 20. Egypt, Lebanon, Jordan, and Syria responded to this offer. *Id.* The European Community reacted in a similar fashion after it signed its cooperation agreement with Israel in 1975. *See* Langer, *supra* note 241, at 84 (discussing EC proposals to negotiate new trade agreements with Egypt, Lebanon, Jordan, and Syria following conclusion of European Community's accord with Israel in 1975).

358. EINHORN, *supra* note 244, at 28-30.

359. *Id.*

360. *See supra* note 24 and accompanying text (defining EFTA and identifying EFTA Member States).

after the European Community had changed its origin rules in the EFTA agreements to reflect technological developments.[361] In addition, the European Parliament refused to approve a protocol[362] granting Israel greater access to the European Community's agricultural market following the accession of Spain and Portugal to the European Community[363] until Israel guaranteed direct export of agricultural products from the Occupied Territories to the European Community.[364] Similarly, compliance with the Arab boycott of Israel[365] prevented EC firms from investing capital in Israeli industry,[366] despite an agreement encouraging EC industry to do so.[367] Finally, despite satisfaction of scientific and technical requirements, the European Community did not allow Israel to participate in EC research and develop-

361. EINHORN, *supra* note 244, at 29. The last set of changes to the rules of origin under Protocol 3 of the EC-Israel FTA were made in 1979. *Id.* at 29 n.48. *See supra* notes 273-74 and accompanying text (discussing amendments to rules of origin in EC-Israel FTA). Rules of origin under the European Community's trade agreements with the EFTA were changed in 1984. EINHORN, *supra* note 244, at 29 n.48. *See, e.g.*, Council Regulation No. 3386/84, O.J. L 323/1 (1984) (amending rules of origin in agreement between European Community and Austria, EFTA Member State).

362. Fourth Additional Protocol, *supra* note 260, O.J. L 327/35 (1988).

363. *See supra* note 345 and accompanying text (discussing economic effect upon Israel of Spain's and Portugal's accession to European Community in 1986).

364. EINHORN, *supra* note 244, at 30. *See* Decision on the conclusion of a fourth additional protocol to the agreement between the European Economic Community and the State of Israel, O.J. C 94/55 (1988) (reporting European Parliament's rejection of protocol). Once Israel signed an agreement enabling the direct agricultural exports from the Occupied Territories, the European Parliament assented to the conclusion of the protocol. EINHORN, *supra* note 244, at 30. *See* Assent to the conclusion of a fourth additional protocol to the Agreement between the European Economic Community and the State of Israel, O.J. C 290/59 (1988) (reporting European Parliament's passage of protocol). *See also* Nikelsberg, *supra* note 27, at 373 n.13 (illustrating European Community's political concern for development of Occupied Territories and pressure that European Community placed upon Israel in 1986 and 1988 to allow direct trade between European Community and Occupied Territories). In similar fashion, the European Parliament, in January 1990, considered a freeze of its trade agreement with Israel due to the Jewish state's handling of the Palestinian uprising. *Id.* at 410 n.260.

365. L. CARL BROWN, INTERNATIONAL POLITICS AND THE MIDDLE EAST 157 (1984). The Arab League, consisting of Egypt, Iraq, Lebanon, Saudi Arabia, Syria, Transjordan, and Yemen, declared a boycott against Zionist goods in 1945. *Id.*; SAMUEL KATZ, BATTLEGROUND 79 (1985). The boycott prohibited members of Arab countries from maintaining contacts with Israel. KATZ, *supra*, at 5. Arab countries extended the initiative to include a secondary boycott of Israel that blacklisted non-Israeli companies that conducted business with Israel. *Id.* at 235.

366. EINHORN, *supra* note 244, at 29.

367. *Id.*; *See* Additional Protocol, *supra* note 267, art. 4(1), O.J. L 270/1, at 4 (1978) (containing provision encouraging European private investment in Israel).

ment programs.[368]

2. Effect of the Middle East Peace Process

These criticisms led Israel to call for EC renegotiation of the EC-Israel FTA.[369] It wasn't until the European Community was satisfied with progress in Middle East peace talks, in 1993, that it began to accelerate its exploration of a new trade agreement with Israel.[370] Formal negotiations commenced in early 1994,[371]

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368. EINHORN, *supra* note 244, at 29.

369. Dan Izenberg, *Shamir Asks EC for New Trade Pact*, JERUSALEM POST, May 10, 1991, at 2.

370. *Agreement Proposal*, *supra* note 334, at 1 (indicating that European Community sped up process of negotiating new trade accord with Israel following breakthrough in Israel-PLO talks in September 1993). Later, after the European Community reached a decision in principle to update its 1975 agreement with Israel, a European observer said, "This is the EC's reward for Israel for signing the Declaration of Principles accord (Gaza-Jericho) with the PLO." Saida Hamad & Firass al-Amine, *Europe-Middle East: Summit Settles New Deal with Israel*, INTER PRESS SERVICE, Dec. 11, 1993, *available in* LEXIS, Nexis Library, News File. EC Foreign Ministers first expressed a desire to upgrade EC-Israel relations at an informal meeting at Brocket Hall in Hartfordshire, England in September 1992. *Agreement Proposal*, *supra* note 334, at 1. Their stated purpose in doing so was to reevaluate the relationship in the wake of the development of "the Single Market, the Treaty of European Union, the creation of the EEA and the new partnership agreements proposed by the EC to the Maghreb countries." *Id.* Exploratory talks between the two parties began in December 1992 and official negotiations were scheduled to start in the second half of 1993. *Updating the 1975 Agreement*, European Report No. 1832, Feb. 3, 1993 (available from Office of Press & Public Affairs, Delegation of Commission of European Communities, Washington, DC). One of Israel's main goals in negotiating a new agreement was to restore equilibrium in its trade balance with the European Community. *Id.* *See supra* note 342 and accompanying text (discussing Israel's growing trade deficit with European Community). Israel wished to achieve this goal in part by enhancing the level of its agricultural exports to the European Community. David Makovsky, *Rabin, Peres Off to Europe to Talk Trade*, JERUSALEM POST, Nov. 23, 1993, at 2 [hereinafter *Talk Trade*]. Israeli officials also expressed a desire for any new trade deal with the European Community to contain more relaxed rules of origin, which would allow lower limits for components made in Israel. *Id.* In general, Israel wished to receive a status similar to that of EFTA nations, where there is a free exchange of goods and currency with the European Community without EC membership. *Israel, Europe Form Trade Group*, UPI, Nov. 28, 1993, *available in* LEXIS, Nexis Library, News File. It seemed unlikely that the European Community was prepared to elevate Israel to that status. Bob Mantiri, *Europe: EU Row with Tel Aviv over Product Access Rumbles On*, INTER PRESS SERVICE, Aug. 9, 1994, *available in* LEXIS, Nexis Library, News File (indicating that EC Commission official responsible for relations with Israel said that Jewish state should not expect treatment similar to that of EFTA countries because, unlike EFTA nations, Israel is not European country and is not in line for EC membership). Israeli Prime Minister Yitzhak Rabin's comments to EC officials, however, illustrated the importance of the negotiations to Israel. *Talk Trade*, *supra*, at 2 (reporting that Rabin told European ambassadors that Israel can no longer tolerate European Community's "unjustified discrimination" against Jewish state); Jeremy Gaunt, *Belgium:*

and the final draft of the EC-Israel Association Agreement[372] was

EC Foreign Mins to Discuss Israel, Russia Trade, REUTER TEXTLINE, Dec. 5, 1993, *available in* LEXIS, Nexis Library, News File (indicating that, while in Brussels, Rabin termed proposed trade deal "a justified demand" to show Israelis benefits of peace).

371. *Council Agrees to Negotiate Agreement with Israel*, REUTERS, Dec. 7, 1993, *available in* LEXIS, Nexis Library, News File (reporting agreement in principle by European Community's General Affairs Council to negotiate accord with Israel that updates and extends 1975 EC-Israel FTA). *But see Council Postpones Decision on Revised Agreement with Israel*, REUTERS, Dec. 9, 1993, *available in* LEXIS, Nexis Library, News File (noting that EC Council postponed publication of its mandate to negotiate with Israel due to disagreement among EC Members regarding scope of agricultural concessions and proposed changes concerning rules of origin, issue complicated by Israel's FTA with United States). Actual talks between the two sides began in mid-February 1994 in Brussels. *Trade Negotiations between Israel, EU Open*, UPI, Feb. 16, 1994, *available in* LEXIS, Nexis Library, News File. Differences quickly developed over opening European markets to Israeli citrus and flower exports, Israeli competition for EC government telecommunication contracts, and Israeli participation in European research and development programs. David Makovsky, *Peres to Europe for Talks on Israeli Participation in Tenders*, JERUSALEM POST, June 13, 1994, at 3. Israel also asked for more flexible rules of origin so that the European Community would treat Israeli exports much as it treats European exports for origin purposes. *Israel Finds in EU Tough Partner*, XINHUA NEWS AGENCY, June 13, 1994, *available in* LEXIS, Nexis Library, News File. Israel had also raised the issue of outward processing traffic, referring to European manufacturers' use of Israeli textiles in production outside of the European Community, and expressed the view that such goods manufactured outside of the European Community should be able to return to the European Community under the preferential conditions of the new trade agreement. *Last Minute Delay Halts New Israel-EU Trade Pact*, 12 INT'L TRADE REP. (BNA) 1037, 1038 (June 14, 1995) [hereinafter *Israel-EU Trade Pact*]. Israel and the European Community reached an agreement in principle on a new free trade accord on December 19, 1994. *Also in the News*, 12 INT'L TRADE REP. (BNA) 34, 34-35 (Jan. 4, 1995). The European Community's Council of Ministers approved the final draft of the agreement with Israel on July 17, 1995, the same day that the European Community signed an association agreement with Tunisia. *EU Lifts Last Hurdle to Israeli Association Agreement*, AGENCE FRANCE PRESSE, July 17, 1995, *available in* LEXIS, Nexis Library, News File [hereinafter *Last Hurdle*]; Jose Rosenfeld, *Last Minute Concessions Led to Deal with EU*, JERUSALEM POST, July 19, 1995, at 1 (discussing specific compromises each side accepted in order to allow EC approval of draft agreement); *EU and Israel Strike Free Trade Agreement*, AGRA EUR., July 21, 1995, at E9 (discussing Israeli and EC products that will benefit from new agreement).

372. EC-Israel Association Agreement, *supra* note 35, SEC (95) 1719 Final. The formal name of the agreement, "Euro-Mediterranean Association Agreement," draws attention to the European Community's goal of creating a Euro-Mediterranean Economic Area that would bring free trade and prosperity to Europe's southern neighbors. *Cooperation Deal*, *supra* note 23. Earlier in 1995, the European Community reached economic and political cooperation accords with Morocco and Tunisia. *Id.*; *Last Hurdle*, *supra* note 371. The European Community's ambitious Mediterranean policy received new direction when the European Community announced its intention to establish a Mediterranean-wide free trade zone by 2010 that would improve commercial ties between the European Community and 12 Mediterranean basin countries: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Libya, Malta, Morocco, Syria, Tunisia, and Turkey. George Brock, *Struggle for Soul of the South; Euro-Med Conference 1995*, THE TIMES

initialed by both sides in Brussels on November 20, 1995.[373] This Agreement opens EC markets to Israeli agricultural exports,[374] allows Israeli competition for EC government telecommunication contracts,[375] and integrates Israeli scientists into the European Community's research and development programs.[376] The EC-Israel Association Agreement also liberalizes the rules of origin that govern EC-Israel trade[377] and specifies the amounts of third-party non-domestic materials that Israeli exports may contain and still enter the European Community duty-free.[378] While the EC-Israel Association Agreement is a significant achievement,[379] it may not have a large impact on Israel's mushrooming trade deficit with the European Community.[380] The EC-

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(London), Nov. 27, 1995, at 37. The Euro-Med Conference, at which the agreement was announced, was held in Barcelona on November 27-28, 1995, and was attended by the foreign ministers of the 15 EU Member States and 11 Mediterranean countries, as well as the Palestinian leader Yasir Arafat. *Regional Accord for Mediterranean*, N.Y. TIMES, Nov. 29, 1995, at A14.

373. *See supra* note 35 and accompanying text (discussing conclusion of EC-Israel Association Agreement).

374. *Cooperation Deal*, *supra* note 23. The agreement includes trade concessions that cover approximately 90% of Israeli agricultural imports into the European Community. *European Union Signs Pacts with Israel and Morocco*, 12 INT'L TRADE REP. (BNA) 1943, 1944 (Nov. 22, 1995) [hereinafter *European Union Signs Pacts*].

375. *Peres Signs European Union Trade Agreement*, ISR. BUS. TODAY, Nov. 30, 1995, at 1 [hereinafter *Peres Signs Agreement*].

376. *Economic Agenda*, *supra* note 37, at 6 (noting that European Community and Israel signed second accord, in conjunction with EC-Israel Association Agreement, that allowed Israel to join European Community's Fourth Framework Research and Development Program). *See EU/Israel: Member States Hope to Conclude New Accord Before the End of the Year*, European Report No. 1975, Sept. 14, 1994, at 8 (available from Office of Press & Public Affairs, Delegation of Commission of European Communities, Washington, D.C.) (discussing negotiation of EC-Israel Scientific and Technical Cooperation Agreement and conditions under which EC Research Ministers would allow Israeli participation in research program during 1994-1998 term). Israeli involvement in EC research projects is likely to boost Israeli technological development and help Israeli firms find European partners for joint ventures and markets for their products. *Peres Signs Agreement*, *supra* note 375, at 1; *Economic Agenda*, *supra* note 37, at 6. Israel and Switzerland are the only non-EC countries that can participate in EC research and development projects and tenders. *Id.*

377. *European Union Signs Pacts*, *supra* note 374, at 1944 (noting that EC-Israel Association Agreement improves rules of origin for Israeli industrial products imported into European Community).

378. *Economic Agenda*, *supra* note 37, at 6.

379. *EU Treaty*, *supra* note 335, at 12 (noting that agreement was described as Israel's most significant trade treaty ever).

380. *Economic Agenda*, *supra* note 37, at 6. *But see Peres Signs Agreement*, *supra* note 375, at 1 (reporting that Israeli officials hope EC-Israel Association Agreement will help redress trade imbalance in Israel's favor). More than 75% of Israel's overall trade defi-

Israel Association Agreement is scheduled to take effect on January 1, 1997,[381] following ratification procedures by the European Community, Israel, and EC Member States.[382]

3. Rules of Origin in the EC-Israel Association Agreement

Whether a product is eligible for preferential treatment under the EC-Israel Association Agreement is determined by the rules of origin in Protocol Four of this Agreement.[383] On their face, the rules in Protocol Four of the EC-Israel Association Agreement greatly resemble those in Protocol Three of the EC-Israel FTA.[384] The three types of goods that are considered

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cit stems from its trade with the European Community. *Economic Agenda*, *supra* note 37, at 6. The growing concern about Israel's trade deficit was highlighted in a June 7, 1995, International Monetary Fund report that warned against the negative effect of Israel's ballooning trade imbalance. *Israel-EU Trade Pact*, *supra* note 371, at 1038.

381. *Cooperation Deal*, *supra* note 23.

382. *Commission Adopts Proposal for Interim Agreement with Israel*, European Commission Press Release, Nov. 29, 1995, at 1 (on file with the *Fordham International Law Journal*). The Commission adopted a proposal asking the EC Council to allow advance implementation of certain provisions of the accord as early as January 1, 1996. *Id.* Such action would ensure that the European Community and Israel receive the benefits of the agreement's additional trade concessions at the earliest possible opportunity. *Id.* The European Parliament voted on December 15, 1995, in favor of the Commission's proposal to implement the essential points of the EC-Israel Association Agreement as of January 1, 1996. *EU Parliament Endorses Trade Measures with Israel, Tunisia, Other Countries*, 12 INT'L TRADE REP. (BNA) 2108, 2108 (Dec. 20, 1995) [hereinafter *Trade Measures*]. These main topics included changes in rules of origin, competition, state monopolies, and intellectual and industrial property rights. *Id.* *See* Council and Commission Decision No. 96/206/ECSC, EC, O.J. L 71/1 (1996) (presenting interim trade agreement between European Community and Israel). In keeping with the European Community's emphasis on a Mediterranean-wide trade policy, the Parliament's vote on the Israel accord followed its endorsement of a draft EC agreement with Tunisia on December 14, 1995. *Trade Measures*, *supra*, at 2108; *see supra* note 372 and accompanying text (discussing European Community's recent efforts to forge commercial and political ties with Mediterranean countries). The European Community stated that it was holding additional Euro-Mediterranean agreement negotiations with Egypt, Jordan, Lebanon, and Morocco. *Trade Measures*, *supra*, at 2108.

383. EC-Israel Association Agreement, *supra* note 35, art. 28, SEC (95) 1719 Final at 14; *id.* Protocol 4, arts. 1-16, at 65-73.

384. *See supra* notes 314-18 and accompanying text (specifying three basic ways in which products can be considered to originate in European Community and Israel under EC-Israel FTA). The rules for direct transport of goods in the EC-Israel Association Agreement are nearly identical to those in the EC-Israel FTA. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 14, SEC (95) 1719 Final at 71 (containing direct transport rules in EC-Israel Association Agreement) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 5, O.J. L 136/1, at 127 (1975) (containing direct transport rules in EC-Israel FTA). *See supra* note 314 and accompanying text (discussing definition of direct transport in EC-Israel FTA). The EC-Israel Association Agree-

ment incorporates the changes added to the EC-Israel FTA in 1976 relating to proof of direct transport. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 14(2), SEC (95) 1719 Final at 71 (outlining rules for proof of direct transport in EC-Israel Association Agreement) *with* 1977 Origin Amendment, *supra* note 273, O.J. L 190/1, at 4 (1977) (containing rules for proving that products satisfied direct transportation requirement of EC-Israel FTA). *See supra* note 273 and accompanying text (discussing 1977 Amendment to EC-Israel FTA concerning proof of direct transport). It also adopts basically the same approach as the 1979 Amendment to the EC-Israel FTA concerning the origin of products that are organized in sets of originating and non-originating materials. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 9, SEC (95) 1719 Final at 69 (detailing approach of EC-Israel Association Agreement to origin of sets) *with* 1979 Amendment, *supra* note 274, O.J. L 80/1, at 2 (1979) (updating EC-Israel FTA to reflect changes in definition of originating sets). *See supra* note 274 and accompanying text (discussing 1979 Amendment to EC-Israel FTA concerning definition of originating sets). The EC-Israel Association Agreement, like the EC-Israel FTA, considers accessories, spare parts, and tools that are shipped with a product to be one with the product. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 8, SEC (95) 1719 Final at 69 (stating approach to accessories, spare parts, and tools) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 6(3), O.J. L 136/1, at 128 (1975) (same). The EC-Israel Association Agreement, like the EC-Israel FTA, also states that, for the purpose of determining the origin of a product, it is not necessary to consider the origin of materials such as machines, tools, electrical energy, fuel, or plant and equipment, that were used to obtain or produce the product but that did not enter into its final composition. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 10, SEC (95) 1719 Final at 69 (stating EC-Israel Association Agreement's approach to neutral elements) *with* EC-Israel FTA, *supra* note 24, Protocol 3, Annex I, note 2, O.J. L 136/1, at 132 (1975) (stating EC-Israel FTA's approach to machines, tools, power, fuel, plant, and equipment that are used to obtain products). When packaging is included with the product for classification purposes, the packaging is included for the purposes of determining the product's origin. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 7(2), SEC (95) 1719 Final at 69 (establishing that origin of product's packaging, included for classification purposes, is considered for purposes of determining product's origin) *with* EC-Israel FTA, *supra* note 24, Protocol 3, Annex I, note 3, O.J. L 136/1, at 132 (1975) (stating that packing is not considered as forming whole with goods contained therein when packing is not normal type for article packed and packing has intrinsic value and is of durable nature, apart from its function as packing). The EC-Israel Association Agreement also specifies that the unit of qualification for the determination of origin is the basic unit used to classify the product in the Harmonized System. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 7(1), SEC (95) 1719 Final at 69. As in the EC-Israel FTA, products under the EC-Israel Association Agreement only receive preferential treatment upon submission of proof of origin, typically accomplished by producing a movement certificate. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, arts. 17-35, SEC (95) 1719 Final at 74-82 (containing sections of EC-Israel Association Agreement that address proof of origin) *with* EC-Israel FTA, *supra* note 24, Protocol 3, arts. 6-17, O.J. L 136/1, at 127-30 (1975) (discussing movement certificates under EC-Israel FTA). *See supra* note 314 and accompanying text (discussing EC-Israel FTA's movement-certificate requirement). The provision governing goods that are sent by the European Community or Israel to a third party for exhibition and subsequently imported for sale in either the European Community or Israel is nearly identical in both agreements. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 15, SEC (95) 1719 Final at 72 (discussing requirements that product exhibited in

originating products under the EC-Israel Association Agreement are goods wholly obtained in the parties to the Agreement,[385] goods produced in one party to the Agreement from materials imported from the other party to the Agreement,[386] and goods

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third country must satisfy in order to receive preferential treatment upon importation into European Community or Israel) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 15, O.J. L 136/1, at 129-30 (1975) (discussing products exhibited in third countries). In addition, both agreements contain similar statements prohibiting drawback of, or exemption from, customs duties. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 16, SEC (95) 1719 Final at 73 (prohibiting refund of customs duties when imported materials are used to manufacture exports in European Community or Israel) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 22, O.J. L 136/1, at 130 (1975) (prohibiting drawback from customs duties) *and* EC-Israel FTA, *supra* note 24, Protocol 3, Annex I, note 7, O.J. L 136/1, at 133 (1975) (defining drawback and remission of customs duties).

385. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 2(1)(a), (2)(a), SEC (95) 1719 Final at 66. The ten categories of products, listed in Protocol 3 of the EC-Israel FTA, that are considered wholly obtained in either the European Community or Israel are retained in Protocol 4 of the EC-Israel Association Agreement. *Compare id.* Protocol 4, art. 4(1), SEC (95) 1719 Final at 66-67 (listing types of products considered wholly obtained in European Community and Israel) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 2, O.J. L 136/1, at 126 (1975) (listing products that are considered wholly obtained under EC-Israel FTA). *See supra* note 316 and accompanying text (discussing types of products considered wholly obtained in European Community and Israel under EC-Israel FTA). The EC-Israel Association Agreement also adds two provisions. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 4(1)(h), (j), SEC (95) 1719 Final at 67. The first provision simply clarifies that "used articles collected [in the European Community or Israel] fit only for the recovery of raw materials" includes "used tyres [sic] fit only for retreading or use as waste." *Id.* Protocol 4, art. 4(1)(h), SEC(95) 1719 Final at 67. *Compare id.* (adding that certain used tires are included as wholly obtained products under used articles provision) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 2(h), O.J. L 136/1, at 126 (1975) (defining used articles as wholly obtained products under EC-Israel FTA but not specifying treatment of used tires). The second provision notes that when the European Community and Israel extract products "from marine soil or subsoil outside their territorial waters," such products are wholly obtained in either the European Community or Israel, "provided that [the European Community or Israel] ha[s] sole rights to work that soil or subsoil." EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 4(1)(j), SEC (95) 1719 Final at 67. *Compare id.* (addressing products obtained outside territorial waters of European Community and Israel) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 2, O.J. L 136/1, at 126 (1975) (defining types of products that are considered wholly obtained in European Community and Israel under EC-Israel FTA but not discussing products obtained outside their territorial waters).

386. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 3(1), (2), SEC (95) 1719 Final at 66. This new article, titled "bilateral cumulation," is in fact identical in meaning to the last sentences of Article 1(1)(b) and 1(2)(b) of Protocol 3 in the EC-Israel FTA. *Compare id.* (stating that materials produced in one party to agreement are considered originating in both parties to agreement) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 1(1)(b), (2)(b), O.J. L 136/1, at 126 (1975) (excluding materials from other party to agreement from sufficient working or processing requirement generally applicable to materials from foreign countries). *See supra* note 317 and

produced from materials imported from countries that are not party to the Agreement when such materials undergo sufficient working or processing in the territory of a party to the Agreement.[387] The EC-Israel Association Agreement, however, institutes three major changes in the rules of origin pertaining to the third category of goods that require working or processing in the European Community or Israel.[388] First, instead of utilizing the change-in-tariff-heading test as the general rule to determine whether non-originating materials that were incorporated into products had been sufficiently worked or processed in the European Community and Israel, the EC-Israel Association Agreement lists, in an annex to the Agreement, specific rules for each product.[389] Paralleling the rules in the EC-Israel FTA,[390] the list

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accompanying text (stating that products produced in one party to agreement from materials from other party to agreement are considered originating products under EC-Israel FTA).

387. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 2(1)(b), (2)(b), SEC (95) 1719 Final at 66. The two agreements contain nearly identical provisions specifying certain operations that do not result in sufficient working or processing of non-originating materials. *Compare id.* Protocol 4, art. 6, SEC (95) 1719 Final at 68-69 (listing operations considered to be insufficient working or processing for purpose of conferring originating status) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 3(3), O.J. L 136/1, at 127 (1975) (listing insufficient processing operations under EC-Israel FTA). *See supra* note 319 and accompanying text (discussing operations that do not confer originating status under EC-Israel FTA).

388. *See* EC-Israel Association Agreement, *supra* note 35, Protocol 4, arts. 5, 11-12, SEC (95) 1719 Final at 67-68, 70 (establishing new rules for defining when foreign materials are considered sufficiently worked or processed in European Community and Israel and when materials that are worked or processed in foreign countries are still considered originating in European Community or Israel).

389. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 5(1), SEC (95) 1719 Final at 67-68. The conditions for each good are given in the list in Annex II, which is read in conjunction with the notes in Annex I. *Id.*; *see id.* Protocol 4, Annex II, SEC (95) 1719 Final at 95-195 (containing "[l]ist of working or processing required to be carried out on non-originating materials in order that the product manufactured can obtain originating status"); *id.* Protocol 4, Annex I, SEC (95) 1719 Final at 87-94 (setting forth introductory notes that are used in conjunction with list in Annex II). *Compare id.* Protocol 4, art. 5(1), at 67-68 (establishing use of list in Annex II to determine whether non-originating materials have been sufficiently worked or processed) *with* EC-Israel FTA, *supra* note 24, Protocol 3, art. 3(1)(a), O.J. L 136/1, at 126 (1975) (stating that non-originating materials are considered sufficiently worked or processed if processing operation produces materials having classification under different tariff heading than that of original materials). *See supra* note 319 and accompanying text (discussing application of change-in-tariff-heading test in EC-Israel FTA). The tariff headings used in the EC-Israel Association Agreement are those of the Harmonized System. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 1(i), SEC (95) 1719 Final at 65. *Compare id.* (stating that tariff headings in EC-Israel Association Agreement are those of Harmonized System) *with* EC-Israel FTA, *supra* note 24, Protocol 3,

in the annex to the EC-Israel Association Agreement frequently limits the percentage of non-originating materials to between forty and fifty percent of the final product.[391] Second, where the list in the annex to the EC-Israel Association Agreement specifies that, according to the conditions established for a specific product, no non-originating materials should be used in the manufacture of that product, the EC-Israel Association Agreement nevertheless allows the use of non-originating materials as long as their total value does not exceed ten percent of the product's price.[392] Third, the EC-Israel Association Agreement establishes rules for outward processing.[393] These rules apply to materials

art. 3(1), O.J. L 136/1, at 126 (1975) (specifying that tariff headings in EC-Israel FTA refer to those in Brussels Nomenclature for Classification of Goods in Customs Tariffs). *See supra* note 319 and accompanying text (discussing use of CCT headings in EC-Israel FTA).

390. *See supra* note 323 and accompanying text (stating that, in some instances, EC-Israel FTA limits percentage of non-originating materials that products can contain to between 40% and 50% of final product).

391. *See* EC-Israel Association Agreement, *supra* note 35, Protocol 4, Annex II, SEC (95) 1719 Final at 95-195 (containing specific rules that govern determination of each product's origin and that frequently limit percentage of non-originating materials to between 40% and 50% of final product).

392. *Id.* Protocol 4, art. 5(2)(a), SEC (95) 1719 Final at 68. Even if the total value of the non-originating materials does not exceed 10% of the product's price, the percentage of non-originating materials in the final product cannot exceed the maximum value of non-originating materials allowed for that particular product in the list in Annex II. *Id.* Protocol 4, art. 5(2)(b), SEC (95) 1719 Final at 68. A product's price refers to the ex-works price of the product. *Id.* Protocol 4, art. 5(2)(a), SEC (95) 1719 Final at 68. The definition of ex-works price is similar to that in the EC-Israel FTA. *Compare id.* Protocol 4, art. 1(f), SEC (95) 1719 Final at 65 (defining ex-works price as price paid to manufacturer in whose undertaking last working or processing was carried out) *with* EC-Israel FTA, *supra* note 24, Protocol 3, Annex I, note 5, O.J. L 136/1, at 132 (1975) (defining ex-works price). *See supra* note 322 and accompanying text (discussing definition of ex-works price in EC-Israel FTA). The definition of customs value has changed in the EC-Israel Association Agreement to mean the value as determined in accordance with the 1994 WTO Agreement on Customs Valuation. *Compare* EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 1(e), SEC (95) 1719 Final at 65 (defining customs value as determined in WTO agreement) *with* EC-Israel FTA, *supra* note 24, Protocol 3, Annex I, note 5, O.J. L 136/1, at 132 (1975) (defining customs value as determined in 1950 Convention concerning Valuation of Goods for Customs Purposes). *See supra* note 322 and accompanying text (discussing definition of customs value in EC-Israel FTA).

393. EC-Israel Association Agreement, *supra* note 35, Protocol 4, arts. 11-12, SEC (95) 1719 Final at 70. *See id.* Joint Declaration on Protocol 4, SEC (95) 1719 Final at 210 (stating that European Community and Israel agree that working or processing carried on outside parties to agreement will be effected by means of outward processing or similar system). The new approach to outward processing was one of Israel's significant demands during the trade negotiations surrounding the EC-Israel Association

that are either wholly obtained in the European Community or Israel or that have undergone working or processing in the European Community or Israel.[394] The EC-Israel Association Agreement provides that these products do not lose their status as originating products if they are exported to third countries for working or processing and subsequently reimported into the European Community or Israel.[395] These products retain their originating status as long as Israeli or EC customs authorities confirm that the exported materials were subject to processing in the third country prior to being reimported into the European Community or Israel and that the total added value acquired in the third country as a result of the outward processing does not exceed ten percent of the price of the final product for which originating status is claimed.[396]

B. *Present State of the U.S.-Israel FTA*

Following passage of the U.S.-Israel FTA,[397] U.S. exports to

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Agreement and was reportedly unresolved up until one month before the European Community approved the final draft of the accord. *See Israel-EU Trade Pact*, *supra* note 371, at 1038 (discussing Israel's desire for Israeli textiles that are used by European manufacturers in production outside of European Community to be given preferential treatment upon their return to European Community).

394. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 12(1)(a), SEC (95) 1719 Final at 70. Simple operations performed in the European Community or Israel do not confer originating status on foreign materials. *See supra* note 387 and accompanying text (specifying certain simple operations that do not qualify as sufficient working or processing under EC-Israel Association Agreement).

395. EC-Israel Association Agreement, *supra* note 35, Protocol 4, art. 12(1)(a), SEC (95) 1719 Final at 70. The general rule states that the acquisition of originating status in either the European Community or Israel is interrupted whenever the products that are undergoing working or processing in either the European Community or Israel leave the territory of that party. *Id.* Protocol 4, art. 11, SEC (95) 1719 Final at 70. If a product is exported from the European Community or Israel to a third country and subsequently returned, the product is treated as if it never left the concerned party as long as the returned product is identical to the product that was exported and the product did not undergo any operations in the third country or during export beyond operations required to preserve the product in good condition. *Id.* Protocol 4, art. 13, SEC (95) 1719 Final at 71.

396. *Id.* Protocol 4, art. 12(1)(b)(i)-(ii), SEC (95) 1719 Final at 70. In addition, the total value of the non-originating materials used to manufacture the product in either the European Community or Israel and the total value added in the third country as a result of outward processing cannot exceed the maximum values for non-originating materials that are applicable to the given product according to the list in Annex II. *Id.* Protocol 4, art. 12(2), SEC (95) 1719 Final at 70.

397. *See supra* note 21 and accompanying text (stating that United States and Israel signed U.S.-Israel FTA on April 22, 1985).

Israel nearly tripled and Israel's exports to the United States more than doubled during the ten-year period from 1985 to 1994.[398] January 1, 1995, marked the full implementation of the U.S.-Israel FTA[399] when, on that date, Israel eliminated all remaining customs duties on imports from the United States.[400] The year 1995 also witnessed a series of trade talks that led to greater inclusion of agricultural products in the U.S.-Israel FTA[401] and an extension of the U.S.-Israel FTA that allowed

398. *See supra* notes 31-32 and accompanying text (discussing increase in U.S.-Israel trade from 1985 through 1994).

399. *See supra* note 30 and accompanying text (noting that United States and Israel celebrated full implementation of U.S.-Israel FTA in 1995).

400. *Israel to Lift All Customs Duties on U.S. Imports*, REUTER EUR. BUS. REP., Dec. 27, 1994, *available in* LEXIS, Nexis Library, News File (reporting that final list of goods whose tariffs were to be removed on January 1, 1995, included: refrigerators (customs tax of 14%), air conditioning units (10.5%), footware (16-22%), telephones (18%), cellular and cordless phones (12.7%), textiles (up to 3%) and fresh fruits and vegetables (14%)). *See supra* note 28 and accompanying text (stating that United States and Israel implemented remaining tariff reductions in U.S.-Israel FTA on January 1, 1995). Under the U.S.-Israel FTA, goods fall into four categories, and duties were eliminated in each category at different stages along the ten-year phase-in period of 1985-95. Nikelsberg, *supra* note 27, at 377; *see* Ward, *supra* note 19, at 218-19 (discussing different classes of products that gradually receive duty-free status over ten-year period). Unlike the EC-Israel FTA, in which the elimination of all customs duties applied only to industrial products while some tariffs on Israeli agricultural goods were permitted, the U.S.-Israel FTA elimination of all customs duties applies to both the industrial and agricultural sectors. Gil J. Bonwitt, *Is There Milk and Honey in the Promised Land?: A Profile of Investing in Israel*, 25 LAW & POL'Y INT'L BUS. 491, 497-98, 500 (1994).

401. Tova Cohen, *U.S., Israel Reach Accord on Agriculture Trade*, REUTERS, Oct. 18, 1995, *available in* LEXIS, Nexis Library, News File [hereinafter *Agriculture Trade*]. Israel and the United States reached an understanding on October 18, 1995, to provide preferential access to each other's agricultural markets and to negotiate an extension of the U.S.-Israel FTA to cover all agricultural products for five years. *Id.*; *Farm Products*, *supra* note 35, at 1783. The agreement divides agricultural products into three groups. *Agriculture Trade*, *supra*. Goods in the first group will be free of all trade restrictions. *Id.* They include products that already enjoy duty-free status and that are not produced in Israel. *Farm Products*, *supra* note 35, at 1783. These products include grains, nuts, sugar, and coffee. *Id.* Goods in the second group will be imported duty-free within a certain quota. *Agriculture Trade*, *supra*. These include beef and some cheeses that are currently imported under a quota system. *Farm Products*, *supra* note 35, at 1783. The quotas for goods in this second category will increase and tariffs will apply to all goods exceeding the new quotas. *Id.* The levels of the quotas will increase gradually and the tariffs will reportedly be lower than those being negotiated in the WTO for third-country trade. *Id.* Goods in the third group will receive preferential tariff treatment at rates below those which Israel applies to its MFN trading partners. *Agriculture Trade*, *supra*. Goods in this category, including milk products, fruits, vegetables, and honey, are the most sensitive agricultural products and were not eligible for Israeli import permits prior to the October 1995 agreement. *Farm Products*, *supra* note 35, at 1783. Further negotiations will decide the size of the quotas, the degree of preference, and the rate of

goods produced in Palestinian-controlled territory to enter the United States duty-free.[402] The United States and Israel agreed

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improvement. *Agriculture Trade, supra.* Israel planned to have the new agricultural arrangement in operation by December 1995. *Farm Products, supra* note 35, at 1783. Much of the U.S. pressure to complete the deal began when members of the House Committee on International Relations met with Israeli Finance Minister Avraham Shochat on April 28, 1995, in Tel Aviv and stated that Israel's non-tariff barriers to the importation of U.S. agricultural products violated the spirit of the U.S.-Israel FTA. *Also in the News*, 12 INT'L TRADE REP. (BNA) 875, 875 (May 17, 1995). Minister Shochat contended that the U.S.-Israel FTA only covers industrial goods. *Id.* U.S. Ambassador to Israel Martin Indyk followed suit by requesting Israel to open up its market to agricultural imports. *U.S. Asks Israel to Open Up Agriculture Market*, REUTER BUS. REP., May 21, 1995, *available in* LEXIS, Nexis Library, News File. Indyk specifically asked whether Israel would allow imports of apples, a fruit that Israel produces in abundance. *Id.* Israeli Agriculture Minister Yaacov Tsur responded by saying that Israel feared it could not withstand the competition from subsidized imported produce from a large market such as the United States. *Id.* Israel's Agriculture Ministry, however, stated that Israel might be willing to commit to making all of its wheat purchases from the United States, a policy that would mark a shift from Israel's past practices of importing wheat from both the United States and Europe. *Id.* The United States and Israel reported progress on a new U.S.-Israel free trade deal once Israel agreed to reduce restrictions on agricultural trade. *United States, Israel Seek Trade Accord*, UPI, July 11, 1995, *available in* LEXIS, Nexis Library, News File. Criticism of Israel's agricultural trade position continued unabated in the United States until the parties reached the new agreement. *See, e.g.*, Colin MacKinnon, *U.S. Presses Israel on Trade Barriers*, MIDDLE E. EXEC. REP., Aug. 1995, at 4 (reporting U.S. officials' complaints that Israel favors purchasing goods from Europe over United States despite extensive U.S. financial assistance to Israel); *U.S.-Israel Agreement's Flaws Must Be Fixed*, DALLAS MORNING NEWS, Oct. 6, 1995, at 26A (arguing that United States should seek ruling against Israel under U.S.-Israel FTA's dispute-resolution mechanism or sue Israel in newly-formed WTO because Israel did not fulfill its pledge under world trade agreement to convert its non-tariff barriers to U.S. farm products into tariffs by September 1, 1995). Prior to the October 1995 Agreement, Israel imported very few agricultural products from the United States: wheat, soybeans, and corn pellets, goods that are not domestically produced in Israel. *Kantor Sees U.S.-Israel Agriculture Accord Soon*, REUTER EUR. BUS. REP., Oct. 17, 1995, *available in* LEXIS, Nexis Library, News File. While Israel traditionally prohibits imports of most fruits and vegetables, it recently has allowed agricultural imports from Jordan and the Palestinian-controlled Gaza Strip. *Id.* Israel's agricultural exports to the United States were even less significant than Israel's agricultural imports from the United States. Hanan Sher & Margo Sugarman, *High-Level Deal*, JERUSALEM REP., Nov. 16, 1995, at 34 [hereinafter *High-Level Deal*] (indicating that, in 1994, United States exported US$415 million in farm products to Israel, while Israel exported only US$80 million of agricultural goods to United States, less than 10% of annual Israeli agricultural exports).

402. *See supra* note 41 and accompanying text (reporting that United States extended U.S.-Israel FTA to include goods produced in Palestinian-controlled territory). Because the Palestinians are stateless, they were not party to any bilateral trade agreements with the United States. Judith Kipper & David Karol, *Uncle Sam Plays the Matchmaker; Confers Peace Rewards*, WORLDPAPER, Sept. 1995, at 6 [hereinafter *Uncle Sam Plays Matchmaker*]. Israel and the Palestinians, however, signed an agreement in April 1995 granting the Palestinian economy free trade with the Jewish state, thus creating an indirect route, through Israel, for U.S. goods to reach the West Bank and Gaza duty-free.

Ohio's Mideast Trade Office Gives State's Businesses Access to Vast Market, COLUMBUS DISPATCH, Oct. 5, 1995, at 13A. But the U.S. Customs Service's determination that goods manufactured in the West Bank and Gaza Strip could no longer be marked "Made in Israel" underscored the need for the United States to develop a new plan for Palestinian access to U.S. markets. *Made in Israel*, *supra* note 41, at 13; *See Country of Origin Marking of Products from the West Bank and Gaza*, 60 Fed. Reg. 17,607 (1995) (establishing that goods produced in West Bank and Gaza Strip must be marked "West Bank," "Gaza," or "Gaza Strip" and cannot contain word "Israel"). Although goods from Palestinian-controlled territories were never eligible for preferential treatment under the U.S.-Israel FTA, the fact that Palestinian manufacturers could label them "Made in Israel" frequently allowed such products to enter the United States duty-free. *Made in Israel*, *supra* note 41, at 13. The marking change would most likely prevent such goods from continuing to benefit from the U.S.-Israel FTA. *Id.* The United States first addressed this problem in April 1995, when it extended GSP status to all Palestinian-made goods entering the United States. *Uncle Sam Plays Matchmaker*, *supra*, at 6. *See supra* note 76 and accompanying text (defining U.S. GSP program). The introduction of the U.S.-Palestinian GSP program was insufficient, however, due to many restrictions that the program contains, such as limitations in the areas of textiles, shoes, petroleum, and other products. *Remarks by U.S. Trade Representative Mickey Kantor Before the Association of North America-Israel Chamber of Commerce*, FED. NEWS SERVICE, Apr. 3, 1995, *available in* LEXIS, Nexis Library, News File; *Made in Israel*, *supra* note 41, at 13 (noting that GSP benefits require level of industrial development that does not yet exist in Palestinian territories). The United States therefore proposed to extend the U.S.-Israel FTA itself to goods produced in several planned industrial parks along Israel's borders with the West Bank and Gaza. *The Dealing's Not Over Yet*, 27 NAT'L J. 2397, 2397 (1995). This development resembled an earlier U.S. statement expressing the possibility of free-trade status for any goods produced in a potential Egypt-Israel-Jordan free trade zone in the tri-border area of Taba, Eilat, and Aqaba. *See Transcript of Feb. 12 Background Briefing on Mideast Peace Process Foreign Ministers Meeting by Senior Administration Official*, U.S. NEWSWIRE, Feb. 13, 1995, *available in* LEXIS, Nexis Library, News File (providing transcript of background briefing by senior administration official regarding Mideast peace process). The United States greatly expanded its position by offering to extend the U.S.-Israel FTA to the entire West Bank and Gaza, a move that would allow goods produced in the West Bank and Gaza to have unrestricted access to U.S. markets and to be exported into the United States duty-free. *Concessions to Palestinians*, *supra* note 41. The United States was careful to note that the extension of the U.S.-Israel FTA only applied to the agreement's tariff provisions and not to other sections of the accord. *Id.* Israel stated that it would not prevent U.S. goods from enjoying duty-free status when they arrived for importation into Palestinian areas. Gary G. Yerkey, *U.S., Palestinians Agree to Work Toward Free Trade, Official Says*, 12 INT'L TRADE REP. (BNA) 1739, 1739 (Oct. 18, 1995). The Palestinian authorities agreed to assist the United States in verifying compliance with U.S. trade laws and also pledged to prevent the unlawful transshipment to the United States of products not qualifying for duty-free access, a potentially significant problem as non-Palestinian producers could attempt to circumvent the restrictions of the agreement's rules of origin. *Id.* The House Ways and Means Committee agreed on September 21, 1995, to an amendment to the U.S.-Israel FTA that provides for the elimination or modification of duties for goods manufactured in the West Bank or Gaza Strip or in a qualifying industrial zone. Rossella Brevetti & Gary Yerkey, *Kantor Says Talks Will Continue on Ways and Means' Fast-track Bill*, 12 INT'L TRADE REP. (BNA) 1593, 1594 (Sept. 27, 1995). The Senate introduced a bill to extend the U.S.-Israel FTA to Palestinian-controlled areas. *See Senate: Bills and Resolutions Introduced*, 12 INT'L TRADE

to disagree, however, concerning the Uruguay Round's effect upon the U.S.-Israel FTA.[403] The United States cited the Uruguay Round trade accord as the basis for eliminating all of Israel's barriers to U.S. farm products, while Israel claimed that the U.S.-Israel FTA and WTO rules allow it to maintain non-tariff protections from agricultural imports.[404]

Finally, the United States prepared to make unilateral changes in the U.S.-Israel FTA's rules of origin that would have prevented some Israeli exports from receiving duty-free status upon their importation into the United States.[405] U.S. officials informed the Israelis that the changes were administrative in nature and that they would only be instituted if Israel approved them.[406] After Israel expressed its opposition to the U.S. plan, the Clinton Administration decided to delay making any changes to the U.S.-Israel FTA's rules of origin.[407]

1. Specific Disputes

In 1990, Israel initiated the first dispute to be brought under the auspices of the U.S.-Israel FTA.[408] The main issue of contention between the United States and Israel was interpretation of rules of origin.[409] In 1995, a second dispute developed between the United States and Israel that also focused on a disagreement over the application of the U.S.-Israel FTA's rules of

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REP. (BNA) 2114, 2114 (Dec. 20, 1995) (noting introduction of Senate bill to extend U.S.-Israel FTA to West Bank and Gaza Strip).

403. *High-Level Deal*, *supra* note 401, at 34. *See supra* note 33 and accompanying text (stating that, in 1995, United States and Israel would address conflict between Uruguay Round and U.S.-Israel FTA).

404. *Israel to Lift Curbs on Some Farm Imports*, 12 INT'L TRADE REP. (BNA) 1238, 1238 (July 19, 1995). While the U.S.-Israel FTA requires the United States and Israel to eliminate all tariffs between them but allows both countries to impose quotas and fees on some goods, such as agricultural products, the Uruguay Round requires that all fees and quotas be changed to tariffs, which are not allowed under the U.S.-Israel FTA. *High-Level Deal*, *supra* note 401, at 34. *See supra* note 8 and accompanying text (discussing Uruguay Round multilateral trade negotiations).

405. Jose Rosenfeld, *Three Projects Win First Awards from U.S.-Israel Commission*, JERUSALEM POST, Feb. 7, 1995, at 8 [hereinafter *U.S.-Israel Commission*]; *Farm Products*, *supra* note 35, at 1783.

406. *U.S.-Israel Commission*, *supra* note 405, at 8.

407. *Id.*; *Farm Products*, *supra* note 35, at 1783. *See supra* note 35 and accompanying text (noting that United States refrained from making changes in U.S.-Israel FTA's rules of origin that Israel had opposed).

408. Azrieli, *supra* note 229, at 205.

409. *Id.*

origin.[410]

a. The Machine Tools Dispute

The first dispute under the U.S.-Israel FTA that led to the formation of a conciliation panel involved the origin of Israeli-made machine tools and industrial robots that were imported into the United States.[411] Sharnoa Electronics, a Michigan-based company owned by a U.S. and European holding group, manufactured the heavy equipment in Israel and incorporated Taiwanese components into the final product.[412] The U.S. Customs Service[413] first ruled that because the machine tools were substantially transformed in Israel and over thirty-five percent of the product's value was added there the tools originated in Israel according to the U.S.-Israel FTA's rules of origin[414] and were eligible for duty-free treatment upon importation into the United States.[415] Subsequently, the U.S. Commerce Department[416]

410. *Two Dozen Disputes*, *supra* note 34, at 1597.

411. Ziv Hellman, *Israeli Firm Wins FTA Victory*, JERUSALEM POST, June 19, 1991, at 6 [hereinafter *FTA Victory*]. *See* U.S. INT'L TRADE COMM'N, PUB. NO. 2403, OPERATION OF TRADE AGREEMENTS PROGRAM, 42ND REPORT, 1990, at 362-65 (1991) [hereinafter ITC Report] (discussing facts and legal arguments pertaining to U.S.-Israel machine tools dispute).

412. ITC Report, *supra* note 411, at 363; *Israel Invokes FTA Arbitration Provisions to Resolve Bilateral Machine Tools Dispute*, 7 INT'L TRADE REP. (BNA) 1433, 1433 (Sept. 19, 1990) [hereinafter *FTA Arbitration*] (noting that equipment was composed of U.S. motor, Israeli computer, and Taiwanese mechanical base); Alisa Odenheimer, *U.S. Accused of Violating Trade Pact*, JERUSALEM POST, May 8, 1990, at 8 [hereinafter *U.S. Violation*]; *Honda of America Will Begin Auto Exports to Israel Despite Japan's Boycott Stance*, 7 INT'L TRADE REP. (BNA) 9, 9 (Jan. 3, 1990) [hereinafter *Honda of America*] (noting that Taiwanese component was motor in equipment). Information regarding the machine tools dispute was collected from secondary sources such as trade reports and periodical accounts because the rulings of the U.S. Customs Service, the U.S. Commerce Department, and the U.S.-Israel FTA conciliation panel have not been made public. Azrieli, *supra* note 229, at 206 n.105. The facts contained in these secondary sources occasionally conflict. *Compare, e.g.*, *FTA Arbitration*, *supra*, at 1433 (stating that mechanical base was Taiwanese component in machine tools) *with Honda of America*, *supra*, at 9 (noting that motor was Taiwanese component in machine tools).

413. BLACK'S LAW DICTIONARY, *supra* note 1, at 386. One of the responsibilities of the U.S. Customs Service is to assess and collect customs duties on imported merchandise. *Id.*

414. ITC Report, *supra* note 411, at 363. One source reports that the Customs ruling was issued in July 1988. *FTA Arbitration*, *supra* note 412, at 1433. Another source states that it was issued in late 1989. ITC Report, *supra* note 411, at 363.

415. *FTA Arbitration*, *supra* note 412, at 1433.

416. BLACK'S LAW DICTIONARY, *supra* note 1, at 269. The U.S. Commerce Department is defined as "[p]art of executive branch of federal government headed by cabinet member (Secretary of Commerce) which is concerned with promoting domestic

ruled that the machine tools could also be classified as Taiwanese in origin.[417] Pursuant to the Commerce Department's decision, the United States counted imports of Sharnoa's machine tools against an existing U.S. quota on machine tools from Taiwan.[418] Under that determination, Sharnoa was in violation of the quota stipulated by Taiwan's VRA[419] with the United States.[420] Sharnoa, therefore, was forced to cease its exports to the United States, which at that time accounted for 100% of its annual sales.[421] Additionally, Sharnoa paid US$62,500 in fines levied against the Taiwanese companies that exported the components to Israel.[422] Israel protested the United States' country-of-origin determination[423] and, in May 1990, initiated the U.S.-Israel FTA's dispute settlement mechanism.[424]

Israel submitted a two-pronged argument to the U.S.-Israel FTA's Joint Committee[425] in opposition to the United States' position.[426] First, Israel claimed that the Commerce Department's decision violated the U.S.-Israel FTA's rules of origin because Sharnoa substantially transformed the Taiwanese materials in Israel through the addition of high-tech Israeli or U.S. compo-

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and international business and commerce." *Id.* The International Trade Administration, an agency within the U.S. Commerce Department, is charged with "defend[ing U.S.] industry against injurious and unfair trade practices by administering . . . the machine tool arrangements with Japan and Taiwan under the President's Machine Tool Program." OFFICE OF THE FEDERAL REGISTER, THE UNITED STATES GOVERNMENT MANUAL, 1995/1996, at 160-61 (1995).

417. *FTA Victory*, *supra* note 411, at 6. One source reports that the Department of Commerce ruling was issued in mid-1989. *FTA Arbitration*, *supra* note 412, at 1433. Another source states that it was issued in January 1990. ITC Report, *supra* note 411, at 363.

418. ITC Report, *supra* note 411, at 363.

419. *See supra* note 78 and accompanying text (defining VRA).

420. *FTA Arbitration*, *supra* note 412, at 1433. Because Taiwan did not wish an Israeli company to use up its quotas on imports to the United States, the Taiwanese manufacturer stopped selling components to Sharnoa. *FTA Victory*, *supra* note 411, at 6; *U.S. Violation*, *supra* note 412, at 8.

421. *FTA Arbitration*, *supra* note 412, at 1433. Sharnoa eventually solved the problem by importing the table of its computerized numerical-centered machining tool from Hungary and expanding its exports to other countries. *Id.*

422. *Id.*

423. *Honda of America*, *supra* note 412, at 9.

424. ITC Report, *supra* note 411, at 364.

425. *See supra* note 233 and accompanying text (discussing functions of U.S.-Israel FTA's Joint Committee).

426. ITC Report, *supra* note 411, at 364.

nents that produced the final product for export to the United States.[427] Second, Israel argued that, by counting Israeli exports against Taiwan's VRA quota, the United States was quantitatively limiting Israel's exports to the United States, an action that the U.S.-Israel FTA prohibits.[428] The U.S.-Israel FTA Joint Committee was unable to resolve the dispute and the parties began forming a conciliation panel[429] in July 1990.[430] The panel unanimously ruled in favor of Israel's position and issued its report in June 1991.[431] Israel heralded the decision as setting an important precedent for future application of rules of origin, as the panel rejected the U.S. position that a non-domestic product can have more than one country of origin.[432] Although the panel found that the machine tools were of Israeli origin, the United States refused to accept the panel's non-binding decision.[433]

b. The Ethanol Case

In February 1994, Frost Fuels Corporation ("Frost"), Dor Chemicals, Ltd. ("Dor"), and MMM Alcohols ("MMM"), a joint venture of U.S., Israeli, and Belgian companies, submitted to the U.S. Customs Service a request for a ruling on the eligibility of Israeli-produced anhydrous ethyl alcohol[434] for preferential

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427. *Id.* at 364-65.

428. *Id.* at 365.

429. *See supra* note 235 and accompanying text (discussing role of U.S.-Israel FTA's conciliation panel).

430. ITC Report, *supra* note 411, at 365. *See Also in the News*, 8 INT'L TRADE REP. (BNA) 55, 55 (Jan. 9, 1991) (announcing three members of conciliation panel); *FTA Arbitration*, *supra* note 412, at 1433 (noting that Israel had invoked arbitration clause for first time since U.S.-Israel FTA was created).

431. *Arbitration Panel Says U.S. Violated Israel FTA in Attempt to Block Taiwan Machine Tools*, 8 INT'L TRADE REP. (BNA) 1069, 1069 (July 17, 1991) [hereinafter *Arbitration Panel*]; *FTA Victory*, *supra* note 411, at 6 (noting decision's precedential value by establishing that U.S.-Israel FTA takes precedence over U.S. trade agreements with other nations that were concluded after U.S.-Israel FTA took effect).

432. *Arbitration Panel*, *supra* note 431, at 1069 (quoting Yoram Turbowicz, legal advisor to Israeli Ministry of Industry and Trade). *See* Evelyn Gordon, *Talks Set to Iron Out Bilateral Trade Issues*, JERUSALEM POST, July 24, 1991, at 8 (discussing problematic nature of classifying Sharnoa's products as both Israeli and Taiwanese).

433. Evelyn Gordon, *FTA Talks 'Cordial' But Unhelpful*, JERUSALEM POST, July 26, 1991, at 17. The United States declared that it would not accept the panel's ruling and instead would set up an interdepartmental committee to investigate ways of alleviating the harm to Sharnoa. *Id.*

434. Headquarters Ruling Letter 558852, Dec. 21, 1994, at 2, *available in* LEXIS, Itrade Library, Csomni File [hereinafter Ethanol II]. The distillation of raw ethyl alcohols in aqueous solution produces hydrous ethyl alcohol that can be converted into

treatment under the U.S.-Israel FTA.[435] Frost, Dor, and MMM stated that they wished to import feedstocks consisting of highly acidic raw ethyl alcohols in aqueous solution into Israel from European and other non-domestic sources.[436] Frost, Dor, and MMM then planned to produce three separate chemical products, fusel oils,[437] methanol,[438] and hydrous ethyl alcohol,[439] from the distillation of the raw ethyl alcohols feedstocks.[440] Frost, Dor, and MMM further intended to transform the hydrous ethyl alcohol into anhydrous ethyl alcohol.[441] Frost, Dor, and MMM claimed that both transformations would require the alcohols to undergo significant and complex manufacturing processes.[442] Frost, Dor, and MMM submitted, therefore, that the production of hydrous ethyl alcohol from the imported raw ethyl alcohols feedstocks resulted in a substantial transformation of the imported product and that the processing of the hydrous ethyl alcohol into anhydrous ethyl alcohol represented the second substantial transformation.[443] Frost, Dor, and MMM claimed that there was a double substantial transformation of the imported product, raw ethyl alcohols feedstocks, and that the value of the imported product should have counted toward the thirty-five percent Israeli content requirement under the U.S.-Israel FTA.[444]

U.S. Customs responded by comparing the facts presented

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anhydrous ethyl alcohol. *Id.* Frost, Dor, and MMM planned to create anhydrous fuel ethanol, consisting of 95% anhydrous ethyl alcohol and 5% petroleum distillates, by adding gasoline to the anhydrous ethyl alcohol. *Id.* Frost, Dor, and MMM would then ship the anhydrous fuel ethanol to the United States for use as "an octane enhancer and oxygenate blending component in gasoline-based motor fuels." *Id.* at 3.

435. Headquarters Ruling Letter 557830, Aug. 19, 1994, at 1, *available in* LEXIS, Itrade Library, Csomni File [hereinafter Ethanol I].

436. *Id.* at 2. According to the USTR, the company built its plant in Israel in order to "de-water EU-origin ethanol made from surplus EU wine." INTERGOVERNMENTAL POLICY ADVISORY COMM., OFFICE OF THE U.S. TRADE REPRESENTATIVE, BRIEFING PAPER: U.S. INTERNATIONAL TRADE DISPUTE SETTLEMENT 7 (Aug. 31, 1995) [hereinafter BRIEFING PAPER].

437. Ethanol I, *supra* note 435, at 3.

438. *Id.*

439. *Id.* at 3-4.

440. *Id.*

441. *Id.* at 4.

442. *Id.*

443. *Id.* at 7.

444. *Id.* at 12. *See supra* notes 226-28 and accompanying text (discussing U.S.-Israel FTA's rule that foreign materials be subject to two substantial transformations in United States or Israel before they may be included in 35% value-added requirement).

by Frost, Dor, and MMM to court cases and U.S. customs rulings dealing with substantial transformation of imported material.[445] First, U.S. Customs established that there was no substantial transformation when an imported product was essentially the same as the finished product and when any changes that occurred after importation did not affect the name, character, and use of the imported material.[446] Second, U.S. Customs presented several rulings[447] to illustrate the well-settled principle of U.S. customs law[448] that simple refining or purification of a crude substance does not result in its substantial transformation.[449] U.S. Customs acknowledged, however, that in certain circumstances processing can substantially transform crude substances.[450] After examining laboratory tests to determine the

445. Ethanol I, *supra* note 435, at 13-21, 31-42.

446. *Id.* at 13-16. Customs specifically relied on two cases: *Uniroyal, Inc. v. United States*, 542 F. Supp. 1026 (Ct. Int'l Trade 1982), *aff'd per curiam*, 702 F.2d 1022 (Fed. Cir. 1983) and *National Juice Prods. Ass'n v. United States*, 628 F. Supp. 978 (Ct. Int'l Trade 1986). *Id.* In *Uniroyal*, the court held that the addition of an outsole to an imported shoe upper did not result in substantial transformation. *Uniroyal*, 542 F. Supp. at 1029. Substantial transformation did not occur because the attachment of the outsole to the upper was a minor manufacturing process, the process left the identity of the upper intact, and the upper was the very essence of the completed shoe. *Id.* at 1029-30. In *National Juice*, the court found that imported frozen concentrated orange juice was not substantially transformed when it was processed into retail orange juice products. *National Juice*, 628 F. Supp. at 991. Substantial transformation did not occur because the imported juice is the main ingredient in the final product and the character, name, and use of the imported juice was not changed as a result of the post-importation processing. *Id.*

447. Ethanol I, *supra* note 435, at 17-19.

448. *Id.* at 16.

449. *Id.* at 16-17. Customs discusses two Headquarters Ruling Letters ("HRLs") that support this principle: Headquarters Ruling Letter 556143, Mar. 2, 1992, *available in* LEXIS, Itrade Library, Csomni File [hereinafter HRL 556143] and Headquarters Ruling Letter 554644, Oct. 29, 1987, *available in* LEXIS, Itrade Library, Csomni File [hereinafter HRL 554644]. *Id.* at 17-18. In HRL 556143, Customs held that purification of crude octamine that is 85 to 87% pure into octamine R that is 97% pure did not result in a substantial transformation. HRL 556143, *supra*, at 11. A substantial transformation did not occur because, although the original product had been refined, its essential character had not been altered and the resulting product was not a new and different article of commerce. *Id.* at 10. In HRL 554644, Customs held that the processing of crude linseed oil into a fully refined oil did not result in a substantial transformation. Ethanol I, *supra* note 435, at 17. A substantial transformation did not occur because the refinement of the original product and the removal of its impurities did not alter the essential character of the original product and the crude linseed oil did not become a new and different article of commerce. *Id.* at 18.

450. Ethanol I, *supra* note 435, at 19-21. Customs cites Headquarters Ruling Letter 555032, Sept. 23, 1988, *available in* LEXIS, Itrade Library, Csomni File [hereinafter HRL 555032]. *Id.* at 19-20. In HRL 555032, Customs held that distillation of crude

chemical composition of the company's alcohols at various stages of production, U.S. Customs ruled that the process was similar to those in the simple purification rulings, where refining operations did not produce a substantial transformation.[451] Instead, the essential character of the imported product, raw ethyl alcohol, was retained and the various transformations that occurred during the distillation process, producing hydrous and anhydrous ethyl alcohol, were part of the manufacturing process and were not different stages in the production of anhydrous ethyl alcohol.[452] U.S. Customs held, therefore, that not a single

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petroleum into fractions of kerosene, gas oils, and naphtas resulted in a substantial transformation of the imported crude petroleum. HRL 555032, *supra*, at 12. A substantial transformation occurred because the distillation produced new and different articles of commerce having different uses and different chemical and physical characteristics than the original product. *Id.* at 12-13. In addition, a second substantial transformation occurred when the kerosene, gas oils, and naphtas were converted into the final products of motor fuel, jet fuel, and heating oil. *Id.* at 13. Customs also cites Headquarters Ruling Letter 557180, Dec. 23, 1993, *available in* LEXIS, Itrade Library, Csomni File [hereinafter HRL 557180]. Ethanol I, *supra* note 435, at 20-21. In HRL 557180, Customs held that distillation of imported crude petroleum that produced light straight run naphta ("LSR") was a substantial transformation and subsequent distillation of the LSR into two new articles of commerce produced a second substantial transformation. *Id.*

451. Ethanol I, *supra* note 435, at 21-42. Customs found that the process that Frost, Dor, and MMM claimed was the first substantial transformation did not substantially transform the raw ethyl alcohol. *Id.* at 26-27. Customs described this process as the simple upgrading of a cruder form of ethyl alcohol, the raw ethyl alcohol that is 156 to 182 proof, to a purer form of ethyl alcohol, hydrous ethyl alcohol that is 190 proof. *Id.* at 25-26. Customs also found that the process that Frost, Dor, and MMM described as the second substantial transformation, the transformation of hydrous ethyl alcohol into anhydrous ethyl alcohol, was not a substantial transformation either. *Id.* at 31. Customs held that the creation of anhydrous ethyl alcohol from hydrous ethyl alcohol did not involve a chemical reaction but a physical separation, that the two alcohols were used in the same way, for either alcoholic beverages or industrial solvents, and that the two alcohols were both referred to as ethanol. *Id.* at 28-30.

452. *Id.* at 31. Customs cites two cases to support this claim: *Azteca Milling Co. v. United States*, 703 F. Supp. 949 (Ct. Int'l Trade 1988), *aff'd*, 890 F.2d 1150 (Fed. Cir. 1989) and *F.F. Zuniga v. United States*, 16 Ct. Int'l Trade 459 (1992), *aff'd*, 996 F.2d 1203 (Fed. Cir. 1993). *Id.* In *Azteca*, the court found that a double substantial transformation did not occur during the production of prepared corn flour products in Mexico from corn grown in the United States. *Azteca*, 703 F. Supp. at 954. The court held that the operations in Mexico were an essentially continuous process. *Id.* As a result, the goods resulting at certain steps were materials in process advancing toward the finished product, not new products that had substantially transformed the corn. *Id.* In *Zuniga*, the court held that using a multiple step processing operation to produce kiln furniture in Mexico from dry ingredients of U.S. origin did not result in a double substantial transformation. *Zuniga*, 996 F.2d at 1208. The court found that the products resulting from the steps in the operation represented transitional stages of materials in process,

substantial transformation had occurred in the production of Frost, Dor, and MMM's anhydrous ethyl alcohol in Israel, thus, the double substantial transformation requirement in the U.S.-Israel FTA was not satisfied.[453]

Two months after U.S. Customs rejected preferential status for anhydrous ethyl alcohol, Frost, Dor, and MMM requested that U.S. Customs reconsider its position.[454] In response, U.S. Customs applied, in detail, the name, character, and use test to the two transformations in question, from raw ethyl alcohols feedstocks to hydrous ethyl alcohol and from raw ethyl alcohols feedstocks to anhydrous ethyl alcohol, and illustrated that the original product did not become a new and different article of commerce.[455] U.S. Customs, therefore, based its determination upon the traditional elements of the substantial transformation test and compared the processing in question to the purification rulings where distillation created a more refined version of the original product, not an entirely new product.[456] U.S. Customs also explained its decision not to rely on precedential rulings[457] that had found distillations of ethyl alcohol to constitute substantial transformations.[458] In addressing its rejection of rulings that would have been favorable to Frost, Dor, and MMM, U.S. Customs first stated that it was not bound by its prior decisions because ruling letters only apply to the specific transactions that they address.[459] U.S. Customs also argued that, in conforming with congressional action[460] and judicial interpretation,[461] it had

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advancing toward the finished product, not new products that resulted from substantial transformations. *Id.* at 1207.

453. Ethanol I, *supra* note 435, at 41-42.

454. Ethanol II, *supra* note 434, at 1.

455. *Id.* at 11-18.

456. *Id.* at 25-26.

457. *Id.* at 27.

458. *Id.* at 26-30. In one such ruling, Customs had held that 190-proof ethanol was substantially transformed into ethanol of greater than 199 proof after undergoing azeotropic distillation, the same process used by Frost, Dor, and MMM to produce anhydrous ethyl alcohol. Reclassification of Certain Fuel Grade Ethanol, 51 Fed. Reg. 2,990 (1986).

459. Ethanol II, *supra* note 434, at 27 (citing 19 C.F.R. § 177.9(c) (1995)).

460. *Id.* at 27-28. Congress passed legislation in 1986 that made it more difficult for non-beverage grade ethyl alcohol to receive duty-free treatment as an import from a U.S. insular possession or a CBI beneficiary country. *Id.* *See* Tax Reform Act of 1986 § 423(a)-(c), *as amended by* Steel Trade Liberalization Program Implementation Act of 1989 § 7(a), 19 U.S.C. § 2703(a) (1994) (setting forth more stringent criteria for determining when ethyl alcohol from U.S. insular possessions and CBI beneficiary countries

overruled its prior rulings that had held that distillations of ethyl alcohol could result in substantial transformations.[462] While U.S. Customs acknowledged that it had not published its 1989 ruling[463] that signified a change in the law, it deemed this fact irrelevant, as customs rulings do not need to be published in order to be relied upon as precedent.[464] U.S. Customs dismissed Frost, Dor, and MMM's claim that rules of origin under the U.S.-Israel FTA should be determined using the administrative and judicial opinions that existed at the time that the U.S.-Israel FTA was implemented in 1985.[465] U.S. Customs affirmed its original ruling that the U.S.-Israel FTA would not grant preferential treatment to Frost, Dor, and MMM's Israeli-produced anhydrous ethyl alcohol.[466]

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is entitled to duty-free entry into United States). *See supra* notes 174-88 and accompanying text (discussing rules of origin for products from CBI beneficiary countries and U.S. insular possessions).

461. Ethanol II, *supra* note 434, at 28-29. Following the congressional change in criteria for allowing ethyl alcohol to enjoy duty-free entry into the United States, the Court of International Trade acknowledged that Congress, in its implementation of the Tax Reform Act of 1986, intended to implement legislation overruling U.S. Customs' decisions that had held that azeotropic distillation of hydrous ethyl alcohol affects a substantial transformation when carried out in a CBI beneficiary country. National Corn Growers Ass'n v. Von Raab, 650 F. Supp. 1007, 1008-09 (Ct. Int'l Trade 1986), *aff'd*, 814 F.2d 651 (Fed. Cir. 1987).

462. Ethanol II, *supra* note 434, at 27-30.

463. Headquarters Ruling Letter 084850, Sept. 15, 1989, *available in* LEXIS, Itrade Library, Csomni File [hereinafter HRL 084850]. In HRL 084850, Customs found that Russian hydrous ethanol of approximately 184 proof that was processed in the United Kingdom using solvent azeotropic extraction to produce 200 proof anhydrous ethanol was not substantially transformed and did not become a product of the United Kingdom. Ethanol II, *supra* note 434, at 29-30. In this ruling, Customs stated that it not only embraced § 423 of the Tax Reform Act of 1986, that established more stringent criteria for allowing ethyl alcohol to enter the United States duty-free from U.S. insular possessions and CBI beneficiary countries, but had decided to apply the new approach to ethyl alcohol from all countries involved in trade with the United States, not just to ethyl alcohol from U.S. insular possessions and the CBI beneficiary countries. *Id.*; Ethanol I, *supra* note 435, at 34.

464. Ethanol II, *supra* note 434, at 30 (citing 19 C.F.R. § 177.10(a) (1995)). The regulation states that "[w]ithin 120 days after issuing any precedential decision under the Tariff Act of 1930, as amended, relating to any Customs transaction (prospective, current, or completed), the Customs service shall publish the decision in the Customs Bulletin or otherwise make it available for public inspection." 19 C.F.R. § 177.10(a) (1995). The ruling, HRL 084850, was made available for public inspection on microfiche and thus conformed to the above Customs regulation. Ethanol II, *supra* note 434, at 30.

465. Ethanol II, *supra* note 434, at 31-37.

466. *Id.* at 37.

After the USTR consulted with Israeli officials in mid-May 1995,[467] the ethanol dispute was referred to the U.S.-Israel FTA's Joint Committee in July 1995.[468] Israel continued to contend that U.S. Customs' ruling is inconsistent with the U.S.-Israel FTA and the United States and Israel agreed at the July 1995 meeting that Israel could request formation of a dispute-resolution panel by October 7, 1995, if the ethanol dispute had not been resolved by that time.[469] No further information has been made public concerning the U.S.-Israel ethanol dispute.[470]

2. Calls for Reform of the Substantial Transformation Test and the U.S.-Israel FTA's Rules of Origin by Commentators and Government Officials

Commentators and government officials have widely criticized the continued use of the traditional substantial transformation test as the basis for U.S. rules of origin.[471] They have characterized the substantial transformation test as unpredictable,[472]

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467. BRIEFING PAPER, *supra* note 436, at 7. The mid-May consultations were initiated pursuant to Article 19 of the U.S.-Israel FTA. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(b), 24 I.L.M. at 665.

468. BRIEFING PAPER, *supra* note 436, at 7. The convening of the U.S.-Israel Joint Committee in July 1995 was authorized by Article 19 of the U.S.-Israel FTA. U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(c), 24 I.L.M. at 665.

469. BRIEFING PAPER, *supra* note 436, at 7. The panel, pursuant to Article 19 of the U.S.-Israel FTA, could be formed 90 days after the dispute was referred to the U.S.-Israel Joint Committee in July 1995. *Id.*; U.S.-Israel FTA, *supra* note 20, art. 19, ¶ 1(d), 24 I.L.M. at 665.

470. Search of LEXIS, News library, Curnws file (Apr. 21, 1996).

471. Palmeter, *supra* note 67, at 4; Galfand, *supra* note 67, at 470-71; Bello & Holmer, *supra* note 17, at 214; Cooper, *supra* note 45, at 454; Asker, *supra* note 204, at 1549; Turbowicz, *supra* note 6, at 192; Michael P. Maxwell, *Formulating Rules of Origin for Imported Merchandise: Transforming the Substantial Transformation Test*, 23 GEO. WASH. J. INT'L L. & ECON. 669, 673 (1990); John P. Simpson, *Reforming the Rule of Origin*, J. COM., Oct. 4, 1988, at 12A; *GATT Signatories Seen Using Universal Rule of Origin Within the Next Decade*, 7 INT'L TRADE REP. (BNA) 1776, 1776 (Nov. 21, 1990) [hereinafter *Universal Rule of Origin*]; *Caribbean Basin: New 50 Percent Value Rule of Origin Urged to Clarify, Stabilize CBI Program Benefits*, 8 INT'L TRADE REP. (BNA) 109, 109 (Jan. 23, 1991) [hereinafter *New 50 Percent Value Rule of Origin*]. *But see* Palmeter, *supra* note 101, at 27-28, 33 (noting that substantial transformation test may be no worse than other proposed rule-of-origin standards).

472. Asker, *supra* note 204, at 1549 (describing substantial transformation test as "[an] ambiguously worded formulation [that] yielded poor predictability from case to case"); Galfand, *supra* note 67, at 470; Cooper, *supra* note 45, at 454; Turbowicz, *supra* note 6, at 192.

unclear,[473] subjective,[474] and difficult to apply consistently.[475] The Canadian Government refused to allow use of the U.S. substantial transformation test in the U.S.-Canada FTA[476] and recent calls for a uniform international rule of origin have abandoned the traditional U.S. substantial transformation test for a more objective change-in-tariff-heading standard.[477]

Additionally, many cases and administrative rulings apply the substantial transformation test in inconsistent manners.[478] The cases of *Ferrostaal Metals Corp. v. United States*[479] and *Superior Wire v. United States*[480] illustrate the inconsistent application of this test.[481] Both cases addressed the application of steel restraints to imported merchandise.[482] In *Ferrostaal Metals*, the court held that sheet steel from Japan that was annealed and galvanized in New Zealand underwent substantial transformation in New Zealand and, thus, was not subject to the Japanese steel quota.[483] In *Superior Wire*, the court held that steel-rod from Spain that was drawn into wire in Canada did not undergo substantial transformation in Canada and, thus, was subject to the

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473. Simpson, *supra* note 471, at 12A; Maxwell, *supra* note 471, at 671; Turbowicz, *supra* note 6, at 192.

474. Bello & Holmer, *supra* note 17, at 214.

475. Maxwell, *supra* note 471, at 673; Palmeter, *supra* note 67, at 4 (stating that "[t]he only consistency is a policy that results either in higher duties or in fewer imports"); Galfand, *supra* note 67, at 470.

476. Asker, *supra* note 204, at 1552.

477. *Universal Rule of Origin*, *supra* note 471, at 1776 (citing John P. Simpson, U.S. Treasury Department Deputy Assistant Secretary, who noted that determination of origin on case-by-case basis is unacceptable in today's trading environment); *New 50 Percent Value Rule of Origin*, *supra* note 471, at 109 (presenting testimony before ITC that called for more predictable bright-line test to replace substantial transformation standard).

478. *See* Palmeter, *supra* note 67, at 5-7, 7 n.15 (bringing cases and administrative rulings that arrived at contradictory interpretations of substantial transformation for purposes of applying U.S. country-of-origin marking requirement). In *United States v. Murray*, 621 F.2d 1163, 1169 (1st Cir.), *cert. denied*, 449 U.S. 837 (1980), the court dismissed some of the U.S. Customs Service rulings that the defendant had cited because, the court noted, the rulings "may not be consistent with our interpretation of the subterm 'substantial transformation.' " United States v. Murray, 621 F.2d 1163, 1169 (1st Cir.), *cert. denied*, 449 U.S. 837 (1980). The court continued by stating that "[w]e feel no obligation to defer or give much weight to those administrative rulings which are not supported by reasoning, which are 'unprincipled,' and which Judge Learned Hand would have analogized to decisions by a Kadi at the gate." *Murray*, 621 F.2d at 1169.

479. 664 F. Supp. 535 (Ct. Int'l Trade 1987).

480. 669 F. Supp. 472 (Ct. Int'l Trade 1987), *aff'd*, 867 F.2d 1409 (Fed. Cir. 1989).

481. Palmeter, *supra* note 67, at 34-37.

482. *Ferrostaal*, 664 F. Supp. at 536; *Superior*, 669 F. Supp. at 473.

483. *Ferrostaal*, 664 F. Supp. at 536.

Spanish steel quota.[484] The court's application of the substantial transformation test in *Ferrostaal Metals* focused on the change in character that the manufacturing process in New Zealand produced, while the court in *Superior Wire* examined the relative cost of the processing operations in Canada.[485] Even though most of the factors that supported the finding of substantial transformation in *Ferrostaal Metals* were present in *Superior Wire*, the same court found two different results in cases that it decided less than two months apart.[486]

The traditional U.S. substantial transformation test is a main feature of the U.S.-Israel FTA's rules of origin.[487] As a result, commentators have characterized the rules of origin in the U.S.-Israel FTA as confusing and inconsistent.[488] At least two U.S.-Israel disputes, the machine tools dispute and the ethanol case, have stemmed from the ambiguous nature of the U.S.-Israel FTA's rules of origin.[489]

III. *THE U.S.-ISRAEL FTA'S RULES OF ORIGIN SHOULD BE RESTRUCTURED TO FACILITATE GREATER ECONOMIC COOPERATION IN THE MIDDLE EAST*

The ten-year-old U.S.-Israel FTA has much to learn about the rules of origin from its twenty-year-old brother, the EC-Israel FTA, and from the newborn EC-Israel Association Agreement, to which the EC-Israel FTA gave birth. It is only natural that the rules of origin in the U.S.-Israel FTA are problematic. After all, when the parties met to discuss the formation of the agreement, the United States presented Israel with a non-negotiable set of origin rules.[490] Congress provided the USTR with a specific set

484. *Superior*, 669 F. Supp. at 480.

485. *Ferrostaal*, 664 F. Supp. at 539-40; *Superior*, 669 F. Supp. at 478-80.

486. *See Superior*, 669 F. Supp. at 480 (arguing that *Ferrostaal* can be distinguished from *Superior* even though "the changes in use and character [in *Ferrostaal*] were not greatly different from those involved [in *Superior*]").

487. *See supra* note 227 and accompanying text (discussing use of substantial transformation test for non-domestic materials under U.S.-Israel FTA).

488. Maxwell, *supra* note 471, at 692.

489. *See supra* notes 411-70 and accompanying text (discussing machine tools dispute and ethanol case).

490. Turbowicz, *supra* note 6, at 148. *See supra* note 219 and accompanying text (stating that legislation that authorized negotiation of U.S.-Israel FTA mandated use of CBI's rules of origin). In contrast, the United States and Canada treated rules of origin as a significant subject of negotiations in the talks that led to the U.S.-Canada FTA. Turbowicz, *supra* note 6, at 165.

of rules in the Trade and Tariff Act of 1984 to which any trade agreement negotiated by the Executive Branch had to comply.[491] This shortsighted provision meant that an FTA with Israel or with any other country which the United States could have concluded a trade accord under the 1984 legislation would be subject to origin rules conceived for the CBI, regardless of the specific needs and character of U.S. trade with Israel or any other FTA-party.[492] While it took twenty years for the European Community to alter its rules of origin with Israel to reflect the realities of trade between the parties, the United States should act now and not wait another ten years before fixing this problem.

A. *Replacing the Substantial Transformation Test with Specific Origin Rules for Each Product*

The U.S.-Israel FTA rules of origin must provide a greater degree of certainty and predictability to those involved with U.S.-Israel trade. To do so, the parties should amend the rules of origin by replacing the U.S.-Israel FTA's substantial transformation test with specific rules for each product, much like those in the recently-concluded EC-Israel Association Agreement.[493] The specific rules should be based upon changes in the Harmonized System's tariff headings. Determining whether non-originating materials have become new and different articles of commerce in either the United States or Israel so that they may be included in the U.S.-Israel FTA's thirty-five percent domestic content requirement would, as a result, become a much easier task.[494] A product's ability to receive preferential treatment under the U.S.-Israel FTA would be known in advance and the origin standard would be consistent and objective, not subject to the arbitrary conclusions and balancing tests of U.S. judges.[495] While

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491. *See supra* note 111 and accompanying text (stating requirements that had to be fulfilled before U.S. President could enter FTA negotiations with another country).

492. Turbowicz, *supra* note 6, at 110.

493. *See supra* note 389 and accompanying text (noting that EC-Israel Association Agreement lists specific rules for each product to determine whether non-domestic materials were sufficiently worked or processed in European Community or Israel).

494. *See supra* note 226 and accompanying text (discussing when imported material can be included in 35% domestic content requirement under U.S.-Israel FTA).

495. Simpson, *supra* note 471, at 12A (stating that "[a]lthough tariff classification is not a wholly objective science, it is vastly less subjective than the rule of origin scheme currently in use"). *See supra* notes 471-75 and accompanying text (discussing criticism of substantial transformation test).

the Harmonized System was not created for rules of origin purposes, it is an attractive option because of its international use and broad scope.[496]

Both the machine tools dispute and the ethanol case, discussed above, are examples of the consequences that flow from the United States' unpredictable application of the substantial transformation test.[497] The rules that determine a product's duty-free potential should be clear and understandable to exporters abroad, not buried in government regulations.[498] Not only does the substantial transformation test negatively affect commerce between the United States and Israel, but it also leads to trade disputes that waste the time and resources of both countries' trade negotiators and may needlessly harm the political relations between the parties to the agreement.[499]

In addition, replacing the substantial transformation test with specific rules for each product, based on changes in the product's Harmonized System tariff classification, would bring the U.S.-Israel FTA up-to-date with the rules of origin in the U.S.-Canada FTA and the NAFTA.[500] A review of the United States' rules of origin schemes for different programs reveals the evolution of the substantial transformation test from a flexible standard to one that has fallen out of favor as goods regularly contain components from around the globe.[501] Use of a standard that determines origin based upon changes in tariff classification would also prepare the U.S.-Israel FTA to conform with a soon-to-be-concluded international rule of origin that will reportedly involve a change-in-tariff heading component.[502] The United States did not use the traditional substantial transformation test

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496. *See supra* note 95 and accompanying text (discussing Harmonized System and its classification of nearly 10,000 products).

497. *See supra* notes 411-70 and accompanying text (discussing machine tools dispute and ethanol case).

498. *See supra* notes 463-64 and accompanying text (noting that, in ethanol case, U.S. Customs did not publish ruling that overturned prior law).

499. *See supra* notes 229-40 and accompanying text (outlining dispute settlement process under U.S.-Israel FTA).

500. *See supra* notes 203-18 and accompanying text (presenting rules of origin in U.S.-Canada FTA and NAFTA that are based upon change in products' tariff heading).

501. *See supra* notes 134-218 and accompanying text (outlining rules of origin for several U.S. trade programs).

502. *See supra* notes 101-02 and accompanying text (discussing U.S. proposal of uniform rule of origin standard that is based upon changes in Harmonized System tariff headings).

in the U.S.-Canada FTA and the NAFTA and did not recommend its adoption as the international standard at the Uruguay Round trade talks. The United States should similarly avoid using the substantial transformation test in the context of the U.S.-Israel FTA.

B. *Exclusivity of U.S.-Israel FTA's Rules of Origin*

The machine tools dispute illustrates that products cannot be dual citizens for origin purposes under the U.S.-Israel FTA.[503] The United States and Israel must draft a provision that states that the rules of origin in the U.S.-Israel FTA have exclusive authority over the determination of origin of all products traded between the United States and Israel.[504] Otherwise, Israeli exporters such as Sharnoa will be left holding two U.S. administrative rulings, one based upon the U.S.-Israel FTA rules of origin that confers preferential treatment on an Israeli product and one based upon another U.S. agreement with a third party that strips away the U.S.-Israel FTA's favorable terms of importation.[505] Without a U.S.-Israel declaration that the U.S.-Israel FTA's rules of origin are controlling in the context of U.S.-Israel trade, Israeli exporters who research the applicable U.S. court decisions and administrative rulings cannot be positive that another provision, whether published or unpublished, will deprive their products of duty-free status in the United States.[506] The current system does not grant sufficient authority to the U.S.-Israel FTA and does not promote certainty in business planning.[507]

C. *Tolerance of De Minimis Non-Originating Materials and Outward Processing*

Like the EC-Israel Association Agreement,[508] the U.S.-Israel

503. *See supra* note 432 and accompanying text (stating that decision in Israel's favor in machine tools dispute indicated that product cannot have more than one country of origin).

504. Turbowicz, *supra* note 6, at 428.

505. *Id.* at 246. *See supra* notes 415-20 and accompanying text (illustrating problematic situation where one ruling indicated that machine tools could enter United States duty-free and one ruling stated that they could not enter in violation of Taiwanese quota).

506. Turbowicz, *supra* note 6, at 405-06.

507. *Id.* at 404.

508. *See supra* note 392 and accompanying text (allowing use of non-originating

FTA must allow for small percentages of foreign material in Israeli and U.S. products that do not deprive such products of preferential treatment upon importation into the United States and Israel, respectively. The U.S.-Israel FTA should also contain an outward processing provision to allow Israeli and U.S. products to undergo minor processing in third countries before being returned to the United States and Israel for export to the other party to the U.S.-Israel FTA.[509] The recently concluded Canada-Israel FTA[510] contains a novel provision that recognizes the parties' extensive ties to the United States by allowing goods that undergo minor processing in the United States to qualify for preferential treatment under the Canada-Israel FTA.[511] Unlike the United States, Canada allowed Israel to negotiate rules of origin that addressed the unique nature of trade between the two countries, particularly in response to the trade disadvantages Israel experiences as a result of the NAFTA.[512] While the European Community, like the United States, presented Israel with a standard set of origin rules when it first negotiated an FTA with the Jewish State,[513] the European Community allowed these rules to be significantly altered in the EC-Israel Association Agreement to reflect the distinct character of EC-Israel trade.[514] The outward processing provision and the tolerance of non-originating materials which comprise up to ten percent of a domestic good's value are reflections of the reality that the European Community and Israel frequently ship goods to third parties for minor production purposes and then re-import them for

materials under EC-Israel Association Agreement as long as they do not exceed 10% of product's price).

509. *See supra* notes 393-96 and accompanying text (discussing outward processing provision in EC-Israel Association Agreement).

510. *Also in the News*, 13 INT'L TRADE REP. (BNA) 82, 82 (Jan. 17, 1996). The Canada-Israel FTA, in its present form, would eliminate all tariffs on manufactured goods and abolish selected tariffs on agricultural products and fisheries. *Id.* If approved by both countries' parliaments, the FTA would take effect on July 1, 1996. *Id.* Canada and Israel first outlined their plans for the FTA on November 24, 1994. *Id.*

511. *Canadian, Israeli Aides Work Out Terms of Free-Trade Pact*, WALL ST. J., Jan. 16, 1996, at C17.

512. *Canada, Israel on Course to Sign Free-Trade Deal*, OTTAWA CITIZEN, Jan. 3, 1996, at B7.

513. Turbowicz, *supra* note 6, at 294. *See supra* note 360 and accompanying text (stating that rules of origin in EC-Israel FTA were similar to those used in EC agreements with EFTA countries).

514. *See supra* notes 392-96 and accompanying text (discussing de minimis and outward processing provisions in EC-Israel Association Agreement).

export to Israel and the European Community, respectively.[515] Instituting such improvements in the U.S.-Israel FTA would address the particular nature of trade between the United States and Israel that frequently involves third countries, particularly in regard to Israel's small economy and dearth of natural resources.[516]

D. *Bilateral Cumulation*

The United States should liberalize the bilateral cumulation provisions in the U.S.-Israel FTA.[517] The current allowance of fifteen percent U.S. content in Israeli products, and vice versa, that does not need to be manufactured into a new and different article of commerce in the exporting country, must be expanded. Both the EC-Israel FTA[518] and the EC-Israel Association Agreement[519] allow for 100% EC content in Israeli goods, and vice versa, without conferring upon those goods the status of non-originating products. Greater tolerance for U.S. content in Israeli goods would only lead to an increase in Israeli purchases of U.S. components and raw materials.[520]

E. *Multilateral Cumulation*

Another area of reform that must be addressed is that of multilateral cumulation. While the U.S.-Israel FTA,[521] the EC-Israel FTA,[522] the EC-Israel Association Agreement,[523] and the

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515. *See supra* note 393 and accompanying text (discussing Israel's demand during negotiation of Association Agreement that outward processing provision be included in Agreement).

516. *See supra* note 225 and accompanying text (discussing need for Israel to purchase raw materials from United States because Israel does not possess significant natural resources).

517. Turbowicz, *supra* note 6, at 317. *See supra* note 225 and accompanying text (providing that 15% of 35% domestic content requirement under U.S.-Israel FTA can originate in country of import).

518. *See supra* note 317 and accompanying text (conferring originating status upon products manufactured from materials of other party to EC-Israel FTA).

519. *See supra* note 386 and accompanying text (providing for bilateral cumulation under EC-Israel Association Agreement).

520. *See supra* note 225 and accompanying text (discussing likelihood that Israel will purchase raw materials from United States because Israel does not possess significant natural resources).

521. *See supra* note 225 and accompanying text (providing that 15% of 35% domestic content requirement under U.S.-Israel FTA can originate in country of import).

522. *See supra* note 317 and accompanying text (conferring originating status upon products manufactured from materials of other party to EC-Israel FTA).

European Community's trade agreement with the Occupied Territories[524] contain bilateral cumulation provisions, none of these accords allow multilateral cumulation that would consider goods from Palestinian-controlled areas to be Israeli goods for the purposes of the EC-Israel or U.S.-Israel trade agreements and thus offer Palestinian-produced goods preferential access to the European Community or United States.[525] Were such treatment to be included in the U.S.-Israel FTA's amended rules of origin, the United States would further its foreign policy objectives of strengthening the Palestinian economy and, thus, Yasir Arafat's authority in the Palestinian-controlled areas, furthering economic cooperation between Israel and the Palestinian entity. The draft free trade agreement between Canada and Israel does, in fact, include the areas under Palestinian rule and therefore furthers the above political and economic goals.[526]

Multilateral cumulation would not only benefit Israeli goods with Palestinian content, but could also apply to Israeli products containing material from Jordan, Egypt, or other Arab countries. This approach would address the reality of growing economic cooperation among the parties in the region and further the prospects for peace and economic development in the Middle East. Indeed, Israel already has a customs union with the Palestinian National Authority,[527] has been negotiating a free trade agreement with Jordan,[528] and will soon establish a free trade area with Jordan and Egypt around the tri-border area of Taba, Eilat, and Aqaba.[529] Although criticized by some as fanciful,[530] there has even been talk of a future Middle East Free Trade Area

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523. *See supra* note 386 and accompanying text (providing for bilateral cumulation under EC-Israel Association Agreement).

524. *See supra* note 277 and accompanying text (providing for bilateral cumulation between European Community and Occupied Territories).

525. *See supra* notes 170 and 181 and accompanying text (discussing multilateral cumulation provisions in U.S. GSP and CBI programs).

526. *Also in the News*, *supra* note 510, at 82.

527. *See supra* note 39 and accompanying text (stating that Israel and Palestinians signed Economic Protocol that creates economic relationship between them resembling both FTA and customs union).

528. Suleiman al-Khalidi, *Israel Drops Demand Jordan Commit to Free Trade*, REUTERS, June 26, 1995, *available in* LEXIS, Nexis Library, News File.

529. Gary G. Yerkey, *U.S. Will Urge EU to Join in Setting up Free Trade Zones in Mideast, Kantor Says*, 12 INT'L TRADE REP. (BNA) 637, 637 (Apr. 5, 1995).

530. Charles W. Holmes, *Commerce in Middle East Is Changing, But Slowly*, AUSTIN AM. STATESMAN, Oct. 22, 1995, at D4; David Rosenberg, *In Israel, Peace Won't Mean Prosperity*, N.Y. TIMES, Mar. 5, 1995, at 9.

that would remove barriers to trade between Israel and her Arab neighbors.[531] The United States should acknowledge the reality created by progress in the Middle East peace process and include a provision in the U.S.-Israel FTA's rules of origin that allows cumulation of Israeli and third-party material such that a limited percentage of an Israeli product can be derived from a country that is party to an FTA with Israel, without the product losing its wholly-obtained-in-Israel status. While it is true that many of Israel's neighbors have yet to conclude trade agreements with the Jewish State, a multilateral cumulation provision in the U.S.-Israel FTA could serve as an incentive for Israel and other countries to reach trade accords, as both Israel and the other parties will know that the goods that they produce from each other's raw materials will be eligible for preferential access to the United States under the U.S.-Israel FTA's multilateral cumulation provision. In addition, the U.S.-Israel FTA, with amended rules of origin that allow for such cumulation, will be a forward-looking document and will not have to be altered once there is greater integration of economies in the Middle East.

However the United States and Israel restructure the rules of origin in the U.S.-Israel FTA, care should be taken to adopt rules that have as much in common as possible with the rules contained in other agreements that Israel has concluded. It is difficult for Israeli firms to keep two stocks of inventories, one to satisfy the origin rules of the U.S.-Israel FTA and one to satisfy the origin rules of the EC-Israel FTA.[532] As the world business community realizes the potential for trade with Israel, due to the spread of peace and stability in the region, Israel's high-tech capabilities, and the highly educated labor pool of immigrants from the former Soviet Union who have been arriving in Israel,[533] the number of bilateral FTAs between Israel and other

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531. INSTITUTE FOR SOCIAL AND ECONOMIC POLICY IN THE MIDDLE EAST, JOHN F. KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY, SECURING PEACE IN THE MIDDLE EAST: PROJECT ON ECONOMIC TRANSITION 24-26 (1993); Matthew A. Goldstein & Leonard J. Hausman, Remarks at the Association of the Bar of the City of New York, *Prospects for an Israeli-Palestinian Free Trade Area and Its Ramifications for the U.S.-Israel FTA* (Jan. 13, 1994); Paul C. Homsy, Remarks at Columbia Business School, *The Economic Consequences of the Peace Process in the Middle East* (Nov. 16, 1994).

532. Turbowicz, *supra* note 6, at 112.

533. ALLAN S. GALPER, FROM BOLSHOI TO BE'ER SHEVA, SCIENTISTS TO STREETSWEEPERS: CULTURAL DISLOCATION AMONG SOVIET IMMIGRANTS IN ISRAEL 6 (1995). *See* Pinchas Landau, *How to Reach the World*, JERUSALEM POST, Jan. 10, 1996, at 2 (discussing

countries will greatly increase.[534] Accordingly, if each agreement contains a different rules of origin regime, the potential for confusion and damage to trade with Israel will rise. While, as mentioned above, the United States and other nations must consider the distinct aspects of their trade with Israel when negotiating rules of origin with the Jewish State, these parties should attempt to establish rules with some degree of uniformity in order to better facilitate commerce between Israel and her trade partners.

CONCLUSION

Both the United States and Israel hailed the U.S.-Israel FTA when it was first enacted in 1985. More than a decade later, it is clear that the Agreement's rules of origin lend a degree of unpredictability to commerce between the two trade partners. The United States should look at the European Community's trade accords with Israel, particularly the recently-concluded EC-Israel Association Agreement, to find a more predictable and consistent rules of origin regime. The United States should also go further than the European Community has been willing and adopt a multilateral cumulation provision with Israel. Amending the U.S.-Israel FTA's rules of origin now is crucial in order to take advantage of the fact that Israel has not yet negotiated many FTAs with other countries. The new U.S.-Israel FTA rules would serve as a model for future rules of origin in other agreements and could contribute to a convenient degree of uniformity among the rules in Israel's agreements with other countries. Restructuring the U.S.-Israel FTA's rules of origin would take account of the changing political climate in the Middle East and further economic cooperation between Israel, her Arab neighbors, and her world trade partners.

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combination of foreign capital, direct investment, local Israeli talent, and influx of highly qualified Russian immigrants that gives Israel unique advantages that are recognized by international business community).

534. *See supra* note 41 and accompanying text (listing number of countries with which Israel is currently negotiationg FTAs).