

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
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RULES OF ORIGIN AND THE U.S.-KOREA TRADE AGREEMENT
FREQUENTLY ASKED QUESTIONS

Q: What are rules of origin?

A: Rules of origin are a set of detailed rules used to ensure that the tariff benefits from the U.S.-Korea trade agreement (KORUS) go to the United States and Korea, not third countries. American and Korean goods that meet the rules of origin qualify for KORUS benefits and are considered “originating” goods. By contrast “non-originating” goods do not receive the benefit of lower duties under the KORUS.

Rules of origin are central to all of our trade policy initiatives that provide preferential tariff treatment to goods from some countries over others, including trade agreements. Strong rules of origin – like those in KORUS – are an effective means of guaranteeing trade agreement benefits go to the United States and our partner countries, not third countries.

Q: What determines if a good is eligible for tariff benefits from the trade agreement?

A: Under the KORUS and most U.S. trade agreements, a good is considered “originating,” and therefore eligible for tariff benefits from the agreement, if it meets one of the three following rules of origin:

- The good is wholly obtained or produced entirely in the United States or Korea. For example, most plants, livestock, and minerals meet this condition.
- The good is produced entirely from materials originating in the United States or Korea. This would include, for example, welded tubes made entirely out of steel from the United States.
- The good is produced entirely in the United States or Korea, and any materials that originated in another country used in the production of the good underwent a “substantial transformation” in the United States or Korea.

Q: What is substantial transformation and how do we tell whether a good has been substantially transformed?

A: “Substantial transformation” under the KORUS is generally premised on the idea that a good is turned into a new or different article of commerce in some way, such as by acquiring a new character or use. The factors determining whether a good has been substantially transformed vary product by product. There are two types of tests under KORUS governing whether a product has been substantially transformed.

Change in tariff classification test. This type of test applies when a good is so transformed that it is reclassified in a new tariff category: for example, when a company that imports grapes from France (i.e., non-originating grapes) and makes wine from them in the United States. Under KORUS rules of origin, the grapes, which are classified in one tariff category, are substantially transformed when processed into wine, which is classified in another tariff category. The resulting wine would be eligible for KORUS tariff benefits – assuming it otherwise met the rules of origin, taking into account any other materials in the bottle of wine.

Regional value content test. This type of test sets a minimum amount of a product that must come from the United States or South Korea – usually a percentage of the value of the finished good – for a good to be considered “originating.” This test can be met using either the minimum percentage of U.S. or Korean content (called the “build-up” method) or, alternatively, the maximum percentage of material from another country (called the “build-down” method). Under both methods, there is a defined set of input costs the exporter can use in its calculation, such as the cost of parts and materials, labor, shipping, marketing and packing.

Q: Using the regional value content test, what percentage of the value of the good must be from the United States or South Korea to be eligible for tariff benefits?

A: In the KORUS, the minimum percentage of U.S. or South Korean content a product must have in order to be eligible for tariff benefits is tailored to the production processes for each product and varies product by product. For many products under the KORUS, 55 percent of the product by value must be made up of South Korean or U.S. content to qualify for KORUS tariff benefits. The United States has similar rules in all of our trade agreements.

Q: What are the rules of origin for autos?

A: Automakers in the United States and Korea exporting under KORUS may qualify for tariff benefits if they meet one of three methods for determining regional value content.

Build-down method. The first method is the “build-down” method described above, which requires that 55 percent of the value of the car be made of South Korean or U.S. content. This rule corresponds with the rule used by European and Korean automakers in the Korea-EU FTA, which requires that “non-originating” content not exceed 45 percent.

Net cost method. The second method for automakers is the “net cost” method, which was a major negotiating priority for U.S. automakers and better reflects their production, accounting, and record-keeping methods than the rule used in Korea-EU Trade Agreement. This method achieves the same amount of domestic content as the “build-down” method described above, but bases the calculation on a smaller set of inputs, principally materials, labor and overhead. The “net cost” method does not include other inputs used in the “build-down” method such as domestic selling, administrative, promotion and marketing costs.

This calculation is advantageous for U.S. automakers and autoworkers because it is based on fewer, less variable input costs, and helps ensure that the maximum amount of U.S. parts and labor are used in U.S. automobiles produced for export to Korea under the KORUS.

Build-up method. There is a third method for autos called the “build-up” method which is similar to the other methods but is not likely to be used by automakers because it would require them to change their current inventory management methods. The “build-up” method remains in the KORUS industrial goods chapter principally to benefit good exports other than autos.

Q: Why does the agreement provide for three Regional Value Content formulas for the auto industry?

A: There are three formulas because not all auto producers calculate costs in the same way. For example, auto producers often prefer the net cost formula because it focuses on a smaller set of input costs that are less variable, such as labor and materials, and is therefore easier to calculate. But auto producers will retain the option to use the build-down formula, which is based on the entire final value of the car. KORUS allows these rules of origin options to maximize U.S. automakers’ opportunities to export autos to Korea.

Q: Who makes the rules of origin in KORUS?

A: The United States negotiated the KORUS rules of origin with Korea as it did the other provisions in the agreement. The United States’ negotiating position was developed in close consultation with U.S. exporters, manufacturers and producers, Congress and other stakeholders. The rules the United States negotiates in trade agreements are carefully considered and reflect the unique production and sourcing needs of American companies. These rules also balance the cost of compliance for U.S. companies with the economic benefits of exporting under the KORUS. If the rules are too restrictive or the costs of compliance with the rules are higher than the duty benefits, producers may not be able to take advantage of the jobs-supporting export opportunities under the KORUS.

Q: These rules sound complicated. Are they enforced?

A: Yes. Every exporter needs to be able to provide documentation to allow Customs and Border Protection (CBP) officials to verify that the good the exporter wants to export meets KORUS rules of origin. Exporters must keep these documents for five years after they export the good. The KORUS also requires that the United States and Korea maintain detailed certification and verification procedures, which CBP uses to deny preferential treatment when unsubstantiated claims of origin are made and may impose penalties in cases of fraud.

Q: I heard the KORUS has loose rules of origin that encourage South Korean companies to use inputs from China. Is that true?

A: No. KORUS rules of origin are specifically designed to make sure that only goods produced in the United States or Korea benefit from lower tariffs under the agreement. By granting tariff benefits only to goods with sufficient “originating content” produced in the United States or Korea, KORUS encourages manufacturers to use American parts, labor and other inputs, rather than inputs from China or other third countries.