

Preventing Disputes under Free Trade Agreements with Advance Ruling System

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This article aims to explore ways to prevent disputes arising from 'Origin Procedure' under FTAs through 'advance ruling system'. To achieve the aims of this article, this paper examines advance ruling systems operated by Korea and the United States to implement the Korea-US FTA, and analyzes whether the systems are realizing the original purpose of preventing disputes in terms of legal certainty and accessibility.

The results show that the advance ruling system for origin in Korea has the same high level of laws and institutions as that of the United States. However, it is necessary to further provide institutional support for staffs that operate the system, so that expertise knowledge can be consolidated and accumulated. Also the accessibility of the system requires improvements.

Key Words : advance rulings, Free Trade Agreements, FTAs, Rules of Origin, RoOs

— < Contents > —

I. Introduction	IV. Analysis Results
II. Literature Review	V. Conclusion
III. Research Methods	Reference

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I . Introduction

As interests and expectations for Free Trade Agreements (FTAs) are waning, the fewest number of FTAs since 2000 have entered into force in 2018. The situation in Korea was not so different. Except for the Korea-UK post-Brexit FTA, the progress of concluding FTAs was sluggish. There are many reasons why the proliferation of FTAs has slowed down. Of course, one reason is that, as can be seen in the case of Korea, where more than 75% of imports and exports are carried out under FTAs(Korea Customs Service, 2019), it is recognized that the existing FTAs are sufficient to cover most of its major trade partners. But the more fundamental reason is that there is skepticism about the benefits of existing FTAs, as in the cases of Brexit and of the renegotiation of NAFTA (North American Free Trade Agreement).

As has often been blamed of, the benefits of FTAs are offset by the costs caused from the complicated 'Origin Procedure' that is required for traders to utilize the FTAs. The procedure is implemented by the respective customs authorities of both parties to an FTA who have different legal and administrative systems. In the course of going through this procedure, uncertainty arises, since the exporters and importers do not have knowledge of the other country's system. Due to the complexity and uncertainty of the 'Origin Procedure,' implementing FTAs often end up with disputes with customs authorities. What worsens the situation is that dispute settlement procedure under FTAs does not play a substantial role, as it is rarely used and does not allow private sector's access (Yi, 2015, 2016).

This article aims to explore ways to prevent disputes arising from 'Origin Procedure' under FTAs through 'advance ruling system'. Advance ruling system is widely accepted in the customs administration of WTO member countries through the Revised Kyoto Convention¹⁾, and most FTAs also incorporate the system as a measure to provide companies utilizing FTAs with legal certainty. Through this system, individual companies can request customs authorities to provide legally binding determination on the origin of products under FTAs. Implementing the system is important in enhancing the transparency and credibility of freer trade under FTAs, which do not provide private sector companies with any accessible dispute settlement system. However, only

1) Standard 9.8 of the Revised Kyoto Convention

a handful of research has been conducted to verify whether this system has played its original intended role and whether there are any limitations.

This study is conducted on a preposition that in order to minimize the possibility of disputes, advance ruling system should be able to provide private companies with easily accessible venue to attain comprehensive legal stability. Therefore, this study was carried out by navigating the scope of legal certainty, and the accessibility of advance ruling system in real cases. A comparison and analysis on how Korea and the US operate this system was conducted on the basis of the case of the Korea-US FTA that has high utilization ratio in spite of controversy and concern.

The research on advance ruling system has been conducted as a part of the trade facilitation study. Thus, the study results are of academic significance in that they verify the validity of the theoretical arguments of trade facilitation studies on this system. In addition, the results are of practical importance as it seeks out institutional improvements that will lead to support and success in future FTAs by raising the certainty of the benefits of FTAs.

This article is structured as follows. The following chapter includes literature review on the background where the Korea-US FTA has concluded, the uncertainty arisen from the 'Origin Procedure', and advance ruling system under FTAs. At Chapter III, the framework of case analysis is designed based on literature review, and a research method is designed to analyze the selected case. Analysis results are described in Chapter VI, and conclusions are included in Chapter V.

II. Literature Review

1. Background of the Korea-U.S. FTA

The Korean government first sought for the Korea-U.S. FTA in recognition of the political and economic importance of the U.S. market. The U.S. also had a task to lay the groundwork for expanding its exports to the Northeast Asian market by increasing

exports of agricultural products and services, expanding profits from trade investments, and expanding access to the Korean market (Ahn & Kim, 2018).

After 14 months of negotiation, the Korea-U.S. FTA was concluded on April 2, 2007. However, after a round of further negotiations, the Korea-U.S. FTA finally took effect in May 2012. The five-year gap was due to uproar over the mad cow disease, overly restrictive rules of origin for the textile sector, and other sensitive trade issues related to the U.S. Notwithstanding the worries and controversies, the Korea-U.S. FTA was generally regarded as successful. By industry, the auto part sector is regarded as the largest beneficiary, and demand for automobiles, and wireless communication devices increased rapidly after the FTA took effect (Sanghoon Lee & Chung, 2018).

With the emergence of the Trump administration in 2016, however, discussions on renegotiation of the FTA continued. After three months from the first round of negotiation that began in January 2018, it was concluded in the form of a joint declaration on March 28, 2018, and a formal signature was signed on September 25, 2018 (Ministry of Trade Industry and Energy, 2018). Major revisions have been made to mitigate the rigor of post-production verification. In addition, it agreed to pursue future revisions of imported raw materials that are not produced domestically, namely offshore raw materials, in accordance with the 'yarn-forward rule' for textiles and clothing (Kang, 2017).

2. Uncertainty of the RoOs under FTAs

Bhagwati & Panagariya (1996) provides that 'Free Trade Agreements (FTAs)' are liberalization systems that were selected as the second best option since the best option of the multilateral liberalization under the WTO system lagged. However, authors warn that the second best option may not bring about the second best consequences. Liberalization by the FTAs is limited in that the scope of liberalization covers only the members of party countries to an FTA, while the multilateral liberalization under the WTO covers all WTO member countries. This limitation demerits using FTAs, as traders cannot be benefitted without proving that the goods

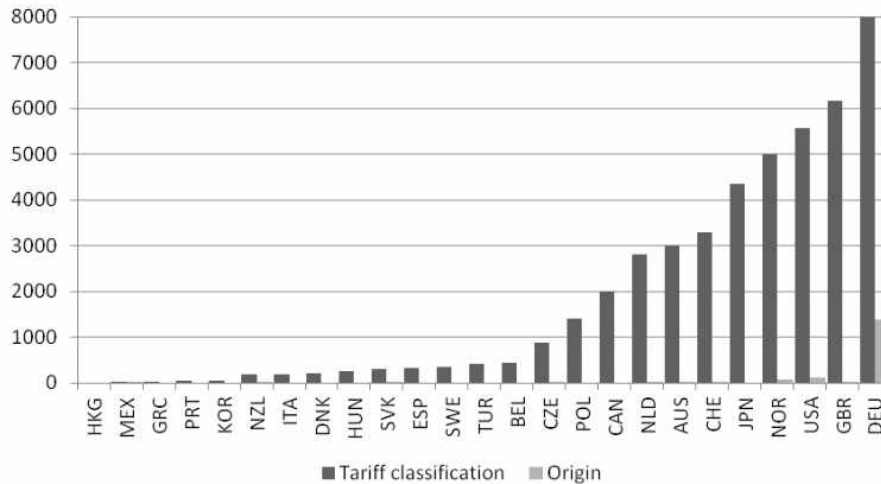
they import have been manufactured in the party country to the FTA.

Estevadeordal, Harris, & Suominen (2007) delineates that for the purpose of providing traders with the rules to determine the originating country of the good and to provide tariff elimination, FTAs include the 'Rules of Origin (RoOs)'. Authors point out that while RoOs became the core provision of FTAs, they are also characterized by restrictiveness and complexity. Therefore, as the number of FTAs increases, different RoOs for each FTA becomes even more complicated. Due to the complexity, the rules require attention to every technical details and cause uncertainty. (Bhagwati, 1995) depicts the complexity as 'Spaghetti bowl' and denounces that it causes the uncertainty to traders who use FTAs.

3. Advance Ruling System under FTAs

Sangyup Lee, Kim, & Lee (2014) analyze the effects of trade facilitation measures of the seven major trading partner countries to Korea. The countries introduced advance ruling system as a part of the trade facilitation measures under the WTO regime, and have also included the system as a trade facilitation measure under individual FTAs. As applied to the FTA, however, the system has been modified, with the major scope of modification being the scope of coverage, the deadline for replying to preliminary decisions, and the validity period. In many FTAs since 2008, this system has been specified more frequently primarily in the Chapter for Customs Procedures.

Yi (2015) explains that the 'advance rulings' on the origin of goods has been introduced to FTAs as a countermeasure to remedy the legal uncertainty that stems from the RoOs. By providing opportunities to obtain an administrative decision on the origin of goods, which will be binding to entire Customs administration for a specified period of time, the advance rulings add legal certainty to the benefits under FTAs. United Nations (2012) also highlights the significance of hiring the system into FTAs in that under the Revised Kyoto Convention, binding rulings is obligatory, by which every Customs officer is bound by the advance ruling regardless of which Customs office the import or export takes place.



〈Figure II-1〉 Annual Total Number of Advance Rulings

* Source: Moïsé, E., Orliac, T., & Minor, P. (2011). Trade Facilitation Indicators: The Impact on Trade Costs (OECD Trade Policy Working Papers). P. 14.

Moïsé, Orliac, & Minor (2011) analyze the implementation of trade facilitation measures in OECD countries. The authors also highlight the importance of hiring the advance ruling system in FTAs. Among other twelve indicators of trade facilitation, they suggest that ‘advance rulings’ have the greatest impact on trade volumes and trade costs. However, while most OECD countries have introduced the advance ruling system, the use of this system by companies differed from country to country. As seen in 〈Figure II-1〉, while it was not used at all in some countries, others have used it more than 28,000 times per year. The authors point out that the validity period of advance rulings is one of the variables influencing this result. The longer the validity period is, the more the reason to not renew or re-apply for the advance rulings.

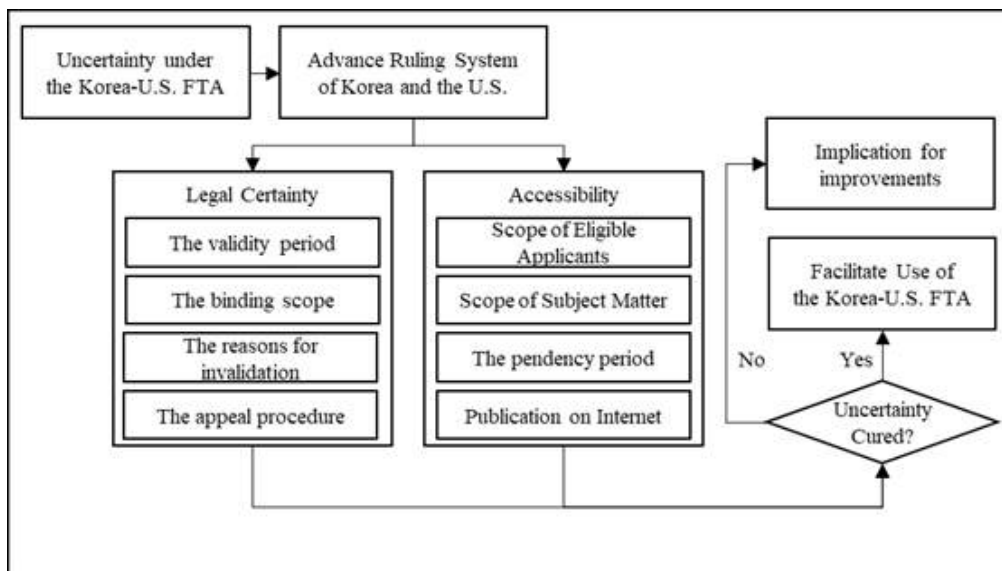
Chen (2016) compares the advance ruling systems in three different jurisdictions: the European Union (EU), China, and Taiwan. Through the analysis on five major fields of the system (including the validity period of the advance ruling, the binding scope, grounds of refusal to grant an advance ruling, reasons for invalidation, and appeal procedures), the author suggests that customs authorities are inclined to emphasize the administrative efficiency rather than legitimate expectation and procedural right of the applicant. In particular, the author observes advance ruling system for customs classification, and argues that the system has limitations in providing applicants with predictability of customs administration based on the following three factors: the binding

effect scope, the extent of legal expectation, and the protection level of the procedural rights.

Prior studies on the advance ruling system have mainly focused on customs classification. Accordingly, only a few previous studies have been conducted on advance ruling system for the rules of origin under the FTA. Yi (2016) covers some administrative issues of implementing FTAs, and mentions the system. She suggests that advance rulings on customs classification and origin may also add some certainty on the appropriate interpretations on classification and origin. However, she points out that due to the long pendency period of advance ruling, firms are reluctant to use the measure for products with a short life cycle.

III. Research Method

In this paper, we applied a case study method based on a qualitative approach to comparing the advance ruling systems under the Korea-U.S. FTA. According to a previous study, advance ruling system was introduced as a way to secure traders' legal certainty on the originating country of goods. Accordingly, the legal certainty and the accessibility are two important aspects in evaluating whether the system plays its intended role (Chen, 2016; Kim, Kim, & Park, 2015; Sangyup Lee et al., 2014; United Nations, 2012; Yi, 2016).



<Figure III-1> Analysis Framework

Previous studies identify sub-factors that comprise legal certainty of the system including the geographical and periodical scope of the binding rulings, the grounds of refusal to grant advance rulings, the reasons for invalidation, and the appeal procedure. Preceding studies also suggest that the accessibility to the system can be embodied by factors like the scope of eligible applicants and subject matters, the pendency period, and the publication of rulings on internet. To summarize, the analysis of this study was carried out based on the analysis framework illustrated in <Figure III-1>.

The data required for the analysis was collected from the text of Korea-U.S. FTAs and of related legislation. The reports from governments and international organizations were also used to verify its application in practice. Telephone and face-to-face interviews with staffs at the Korea Customs Service and its affiliates were added to increase the reliability of the analysis.

IV. Analysis Results

1. Advance Rulings under the Korea-U.S. FTA

For the implementation of FTAs in Korea, 'Customs Act'(Ministry of Economy and Finance, 2019) and the 'Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements' (Ministry of Economy and Finance, 2016) are applied. Customs Act allows importers, exporters and manufacturers the right to request for advance rulings from Korea Customs Service (KCS) for customs valuation²⁾ and classification³⁾, 'Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements (FTA Act)' was enacted to implement the FTA. Advance ruling system for determining the origin of the goods⁴⁾ was included in the Act (Kim et al., 2015).

Advance rulings under the Korea-U.S. FTA are applied in accordance with Articles 31 and 32 of the FTA Act subject to a proviso that the system is not applicable if the individual FTA does not specify a provision for advance ruling system. The system is

2) Article 37 (Prior Examination of Methods for Determining Dutiable Value) of Customs Act

3) Article 86 (Prior Examination of Tariff Classification Applied to Specific Goods) of Customs Act

4) Article 31 (Advance Rulings on Origins, etc.) of Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements

allowed for a comprehensive range of subjects. Applicants can request the rulings, not only on the origin of the goods but also of the materials, regarding the country of origin, customs classification, valuation, and cost, value added, duty drawback, reduction of tariff rates, and labeling of the country of origin (Presidential Decree, 2018). In addition to importers based in Korea, exporters, producers and agents of the party to the FTA can apply for the rulings as well.

Ministry of Trade, Industry (2014), UNECE (2012) describe the case of the U.S. advance ruling system. The U.S. Customs Service has introduced the advance ruling system in the late 1960s.⁵⁾ Over the next 50 years, the U.S. advance ruling system evolved, and in 2002, it evolved into an online system called the Customs Rulings On-line Search System (“CROSS”).⁶⁾ Currently the U.S. Customs and Border Protection (“CBP”) provides rulings for a variety of customs-related issues based on Part 177(administrative Rulings) of Title 19(Customs Duties) of the U.S. Code of Federal Regulations. National Commodity Specialist Division (NCSO) processes the applications filed with customs throughout the country to ensure rulings are consistent.

2. Legal Certainty

(1) The Validity Period

The results of advance rulings on customs classification under Korean Customs Act are valid for three years, and in the case of any change, they are valid for three years from the date of notification of the results. However, except for the rulings on customs classification, no expiration date is provided for rulings on customs valuation or origin determination. Accordingly, rulings on the country of origin of the goods is effective until any exceptional change is induced as for the facts and circumstances affecting the originating status of the goods after receiving the rulings.

Revision or modification to the rulings may be made when the facts or circumstances underlying the results are changed. If they are changed, the customs office notifies the applicant. Changes are applied to the goods declared for import after the date of

5) The Advance Ruling System has first been introduced as Treasury Decisions and Customs Service Decisions.

6) <https://rulings.cbp.gov/home>

change, subject to a 90-day⁷⁾ or 60-day⁸⁾ grace period, depending on the FTA.

Under the U.S. system, advance rulings are also valid until they are revised or revoked by the CBP. The revision or the revocation should be notified through Customs Bulletin and 30 days of hearing opinion period is provided to the public⁹⁾. The rulings so revised or revoked take into effect in 60 days after the notification.

(2) The Binding Scope

Advance rulings of KCS are recognized by all customs officers in Korea, and in accordance with the rulings, preferential tariffs under an FTA are applied at the time of import declaration. However, if the basic facts or circumstances of the rulings are changed, or if there is a serious error due to the submission of false data, or the final decision or judgment through the appeal procedure or through the filing of a lawsuit on the same matter is different from the contents of the preliminary examination, the customs office has the right to refuse application of the preferential tariffs.

The same is true for advance rulings offered by the U.S. CBP. Traders can find comfort in that he or she will be given the treatment set forth in advance rulings at every U.S. port of entry.

(3) The Ground of Refusal

Customs officers in Korea can refuse to provide the treatment according to the ruling in the cases of changes due to the amendment of the relevant Agreement or statutes; of a serious mistakes caused by the applicant's false materials; or of an objection, a petition for examination or adjudication, or a lawsuit filed with respect to a case involving the same subject matter that is different from the details of the advance ruling.¹⁰⁾

Customs authorities at U.S. ports of entry may also refuse to apply advance rulings on the actual imported goods if the application information is inaccurate or if the imported goods are different from those listed on the application. Accordingly, the CBP may examine the actual transaction as to determine whether the goods are the

7) Korea-Chile FTA, Korea-Canada FTA

8) Korea-Singapore FTA

9) 19 USC 1625

10) Article 37 (6). Enforcement Decree of the Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements

same as those listed in advance rulings.

(4) The Appeal Procedure

Advance ruling system under Korean Customs Act offers an appeal procedure for any person who has objection against the rulings. The complaint must be filed with the Commissioner of the KCS and must be completed within thirty (30) days of the notification of the result¹¹⁾.

The U.S. advance ruling system also offers an opportunity to appeal, and the objection should be filed within 30 days from the date of issue of the advance rulings. Including any previous rulings, it should be indicated the basis for alleged misappropriation of applicable law.

2. Accessibility

(1) Eligible Applicants

In both Korea and the United States, there is an opportunity to not only importers, but also to exporters or manufacturers of Contracting Parties, or their agents, to request preliminary examination of origin.

(2) Subject Matter of the Advance Rulings

Advance rulings in both Korea and the U.S. are offered for all matters related with the application of preferential tariffs under FTAs. Those topics include: tariff classification, valuation, country of origin, duty drawback, duty deferral, applicability of any quota or tariff quota, eligibility under preference programs, and treatment of goods in transit.

(3) Pendency Period

The period granted for the examination under the advance ruling system of Korea is 90 days from the date of receipt of the application, which does not include a

11) Article 31(5). Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements

maximum of 20 days for the supplementation of documents.

The review period of origin under the CBP NCSD is 30 days, but this review period does not include a supplemental period of up to 30 days.

(4) Publication of Advance Rulings on Internet

U.S. CBP's advance rulings are published through CROSS, within 90 days of the decision, and searchable at the site. The entire decision can be viewed including: 'facts' based on the information submitted by the applicant for the item to be reviewed, 'issues' as to whether they are applicable depending on the type of application for examination, 'law and analysis' that describes the analysis and 'holding' of the final conclusion.

Although the FTA Act does not include any provision for publishing KCS' advance rulings, KCS is publishing the rulings through the website of Customs Valuation and Classification Institute when the individual FTA has a disclosure rule for the rulings. The publication is held once a year and not all details are disclosed.

4. Summary and Discussions

(1) Legal Certainty and Advance Rulings

The results of this study verify that both Korea and the United States are implementing advance ruling system appropriately in their legal system reflecting the intent of the system. The rulings are effective across national customs until they are revised. While customs have discretion against false advance rulings, the applicant has the right to appeal, thereby resolving the issue of reliability of the rulings.

Decisions for the rulings are made at one consolidated organization, such as NCSD in case of CBP, or Korea Customs Valuation and Classification Institute in case of KCS. By doing so, the consistency of the rulings is secured, and the expertise of the staff officers can be developed and accumulated.

As such, advance ruling systems in Korea and the United States under the Korea-US FTA have an effective legal system and administrative organization as a means of maintaining legal certainty. Thus, the performance of this system depends on the capability of their officers to apply these laws and systems to practical cases in line

with its intent. Customs authorities should establish a training system, and career path management to enhance and build the expertise of the officers.

(2) Accessibility and Advance Rulings

The system provides opportunities for application to various stakeholder related to the importation of goods under FTA, and the subjects to be examined are extensive. The application process is simplified and the application can be submitted through the online Uni-Pass System in Korea, and through e-ruling system in the U.S. However, in all FTAs, only a smaller number of applications for origin rulings are being submitted, in comparison to the application for the other themes. In particular, there has been no advance ruling request for origin since 2017 in Korea.

While technological progress and new product development of import and export goods are accelerating, the pendency period granted for the rulings is too long, explaining some of the reasons for the low utilization of this system. In particular, it may take as long as 90 days to receive results in the case of Korea.

Another reason for the small number of application is that it is not well known because the ruling system of origin was introduced late compared to that of customs classification or customs valuation. The advance rulings for the classification was introduced in 1981, while the rulings on the country of origin was introduced in 2006. Recognition of the system is decreasing due to the difficulty of searching the rulings results on the internet. Though CROSS, rulings on all subjects can be retrieved, but KCS is operating different websites to search by subject. The application for advance rulings on the country of origin cannot be distinguished from that of classification or valuation. For this reason, managing the results separately by subject may cause confusion for the users of the system and adversely affect the recognition of the system.

In summary, Korea's advance ruling system is a system that can be used by a wide range of stakeholders on a variety of topics. The purpose of the system, however, is not fully achieved due to the long review period, low awareness of the system, and the inefficient management of the search system by subject. In order to improve these issues, efforts should be made to increase the number of specialist officers, to legislate the process of publishing the audit results, and to further organize the results on search site.

V. Conclusion

This paper examines advance ruling systems operated by Korea and the United States to implement the Korea-US FTA, and analyzes whether the systems are realizing the original purpose of preventing disputes in terms of legal certainty and accessibility. The results show that the advance ruling system for origin in Korea has the same high level of laws and institutions as that of the United States. However, it is necessary to further provide institutional support for staffs that operate the system, so that expertise knowledge can be consolidated and accumulated. Also the accessibility of the system requires improvements.

This paper studies advance ruling systems of Korea and U.S. under the Korea-U.S. FTA. As an exploratory study, the results are meaningful in that the arguments in the study of trade facilitation, which are the basis of advance ruling system, are verified through practical cases and the implications for customs administration are found. However, in order to improve the accessibility of this system, it is necessary to verify the cause of the small number of applications through empirical methods, which remains a topic for future research.

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