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CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

Reports of the Panel

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[1] Parties' comments to the WCO letter of 20 June 2007 were included in their respective subsequent submissions. The United States' comments to the WCO letter of 30 July 2007 were included in their comments on China's responses to written questions from the Panel after the second meeting.

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Argentina – Hides and Leather	Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather*, WT/DS155/R and Corr.1, adopted 16 February 2001, DSR 2001:V, 1779
Argentina – Textiles and Apparel	Appellate Body Report, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R and Corr.1, adopted 22 April 1998, DSR 1998:III, 1003
Belgium – Family Allowances (allocations familiales)	GATT Panel Report, *Belgian Family Allowances,* G/32, adopted 7 November 1952, BISD 1S/59
Brazil – Retreaded Tyres	Panel Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/R, adopted 17 December 2007, as modified by Appellate Body Report, WT/DS332/AB/R
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
Canada – Autos	Panel Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, as modified by Appellate Body
Canada – Dairy	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R and Corr.1, adopted 27 October 1999, DSR 1999:V, 2057
Canada – FIRA	GATT Panel Report, *Canada – Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, BISD 30S/140
Canada – Gold Coins	GATT Panel Report, *Canada – Measures Affecting the Sale of Gold Coins*, L/5863, 17 September 1985, unadopted
Canada – Periodicals	Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:I, 449
Canada – Periodicals	Panel Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/R and Corr.1, adopted 30 July 1997, as modified by Appellate Body Report, WT/DS31/AB/R, DSR 1997:I, 481
Canada – Wheat Exports and Grain Imports	Appellate Body Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/AB/R, adopted 27 September 2004, DSR 2004:VI, 2739
Canada – Wheat Exports and Grain Imports	Panel Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/R, adopted 27 September 2004, upheld by Appellate Body Report, WT/DS276/AB/R, DSR 2004:VI, 2817
Chile – Alcoholic Beverages	Panel Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by Appellate Body Report, WT/DS87/AB/R, WT/DS110/AB/R, DSR 2000:I, 303
Chile – Price Band System	Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R and Corr.1, adopted 23 October 2002, DSR 2002:VIII, 3045
Chile – Price Band System	Panel Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/R, adopted 23 October 2002, as modified by Appellate Body Report, WT/DS207AB/R, DSR 2002:VIII, 3127

Short Title	Full Case Title and Citation
Dominican Republic – Import and Sale of Cigarettes	Appellate Body Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/AB/R, adopted 19 May 2005
Dominican Republic – Import and Sale of Cigarettes	Panel Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/R, adopted 19 May 2005, as modified by Appellate Body Report, WT/DS302/AB/R, DSR 2005:XV, 7425
EEC – Animal Feed Proteins	GATT Panel Report, *EEC – Measures on Animal Feed Proteins*, L/4599, adopted 14 March 1978, BISD 25S/49
EC – Asbestos	Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
EC – Asbestos	Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/R and Add.1, adopted 5 April 2001, as modified by Appellate Body Report, WT/DS135/AB/R, DSR 2001:VIII, 3305
EEC – Bananas II	GATT Panel Report, *EEC – Import Regime for Bananas*, DS38/R, 11 February 1994, unadopted
EC – Bananas III	Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
EC – Bananas III (US)	Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas, Complaint by the United States*, WT/DS27/R/USA, adopted 25 September 1997, as modified by Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 943
EC – Bed Linen (Article 21.5 – India)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
EC – Chicken Cuts	Appellate Body Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, WT/DS286/AB/R, and Corr.1, adopted 27 September 2005
EC – Chicken Cuts (Brazil)	Panel Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts, Complaint by Brazil*, WT/DS269/R, adopted 27 September 2005, as modified by Appellate Body Report, WT/DS269/AB/R, WT/DS286/AB/R, DSR 2005:XIX, 9295
EC – Chicken Cuts (Thailand)	Panel Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts, Complaint by Thailand*, WT/DS286/R, adopted 27 September 2005, as modified by Appellate Body Report, WT/DS269/AB/R, WT/DS286/AB/R, DSR 2005:XX, 9721
EC – Computer Equipment	Appellate Body Report, *European Communities – Customs Classification of Certain Computer Equipment*, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, DSR 1998:V, 1851
EC – Export Subsidies on Sugar	Appellate Body Report, *European Communities – Export Subsidies on Sugar*, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005
EC – Export Subsidies on Sugar (Australia)	Panel Report, *European Communities – Export Subsidies on Sugar, Complaint by Australia*, WT/DS265/R, adopted 19 May 2005, as modified by Appellate Body Report, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, DSR 2005:XIII, 6499

Short Title	Full Case Title and Citation
EC – Export Subsidies on Sugar (Brazil)	Panel Report, *European Communities – Export Subsidies on Sugar, Complaint by Brazil*, WT/DS266/R, adopted 19 May 2005, as modified by Appellate Body Report, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, DSR 2005:XIV, 6793
EC – Export Subsidies on Sugar (Thailand)	Panel Report, *European Communities – Export Subsidies on Sugar, Complaint by Thailand*, WT/DS283/R, adopted 19 May 2005, as modified by Appellate Body Report, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, DSR 2005:XIV, 7071
EC – Hormones	Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135
EEC – Imports of Beef	GATT Panel Report, *European Economic Community – Imports of Beef from Canada*, L/5099, adopted 10 March 1981, BISD 28S/92
EEC – Parts and Components	GATT Panel Report, *European Economic Community – Regulation on Imports of Parts and Components*, L/6657, adopted 16 May 1990, BISD 37S/132
EC – Poultry	Appellate Body Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products*, WT/DS69/AB/R, adopted 23 July 1998, DSR 1998:V, 2031
EC – Sardines	Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002, DSR 2002:VIII, 3359
EC – Selected Customs Matters	Appellate Body Report, *European Communities – Selected Customs Matters*, WT/DS315/AB/R, adopted 11 December 2006
EC – Selected Customs Matters	Panel Report, *European Communities – Selected Customs Matters*, WT/DS315/R, adopted 11 December 2006, as modified by Appellate Body Report, WT/DS315/AB/R
EC – Tariff Preferences	Panel Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/R, adopted 20 April 2004, as modified by Appellate Body Report, WT/DS/246/AB/R, DSR 2004:III, 1009
EC – Trademarks and Geographical Indications (US)	Panel Report, *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs, Complaint by the United States*, WT/DS174/R, adopted 20 April 2005, DSR 2005:VIII-IX, 3499
Greece – Import Taxes	GATT Panel Report, *Special Import Taxes Instituted by Greece,* G/25, adopted 3 November 1952, BISD 1S/48
India – Autos	Panel Report, *India – Measures Affecting the Automotive Sector*, WT/DS146/R, WT/DS175/R and Corr.1, adopted 5 April 2002, DSR 2002:V, 1827
India – Patents (US)	Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9
Indonesia – Autos	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3 and 4, adopted 23 July 1998, DSR 1998:VI, 2201
Italy – Agricultural Machinery	GATT Panel Report, *Italian Discrimination Against Imported Agricultural Machinery*, L/833, adopted 23 October 1958, BISD 7S/60

Short Title	Full Case Title and Citation
Japan – Alcoholic Beverages I	GATT Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, L/6216, adopted 10 November 1987, BISD 34S/83
Japan – Alcoholic Beverages II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97
Japan – Film	Panel Report, *Japan – Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, adopted 22 April 1998, DSR 1998:IV, 1179
Japan – Semi-Conductors	GATT Panel Report, *Japan – Trade in Semi-Conductors*, L/6309, adopted 4 May 1988, BISD 35S/116
Korea – Alcoholic Beverages	Panel Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R, DSR 1999:I, 44
Korea – Various Measures on Beef	Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, DSR 2001:I, 5
Korea – Various Measures on Beef	Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted 10 January 2001, as modified by Appellate Body Report, WT/DS161/AB/R, WT/DS169/AB/R, DSR 2001:I, 59
Mexico – Taxes on Soft Drinks	Appellate Body Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/AB/R, adopted 24 March 2006
Mexico – Taxes on Soft Drinks	Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R, adopted 24 March 2006, as modified by Appellate Body Report, WT/DS308/AB/R
Turkey – Rice	Panel Report, *Turkey – Measures Affecting the Importation of Rice*, WT/DS334/R, adopted 22 October 2007
Turkey – Textiles	Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R, adopted 19 November 1999, as modified by Appellate Body Report, WT/DS34/AB/R, DSR 1999:VI, 2363
US – 1916 Act (EC)	Panel Report, *United States – Anti-Dumping Act of 1916, Complaint by the European Communities*, WT/DS136/R and Corr.1, adopted 26 September 2000, upheld by Appellate Body Report, WT/DS136/AB/R, WT/DS162/AB/R, DSR 2000:X, 4593
US – 1916 Act (Japan)	Panel Report, *United States – Anti-Dumping Act of 1916, Complaint by Japan*, WT/DS162/R and Add.1, adopted 26 September 2000, upheld by Appellate Body Report, WT/DS136/AB/R, WT/DS162/AB/R, DSR 2000:X, 4831
US – Carbon Steel	Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R and Corr.1, adopted 19 December 2002, DSR 2002:IX, 3779
US – Certain EC Products	Appellate Body Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, adopted 10 January 2001, DSR 2001:I, 373
US – Countervailing Measures on Certain EC Products (Article 21.5 – EC)	Panel Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS212/RW, adopted 27 September 2005, DSR 2005:XVIII, 8950

Short Title	Full Case Title and Citation
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619
US – FSC (Article 21.5 – EC)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55
US – FSC (Article 21.5 – EC II)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW2, adopted 14 March 2006, upheld by Appellate Body Report, WT/DS108/AB/RW2
US – Gambling	Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R and Corr.1, adopted 20 April 2005
US – Gasoline	Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3
US – Gasoline	Panel Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, adopted 20 May 1996, as modified by Appellate Body Report, WT/DS2/AB/R, DSR 1996:I, 29
US – Lamb	Appellate Body Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001, DSR 2001:IX, 4051
US – Malt Beverages	GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206
US – Offset Act (Byrd Amendment)	Panel Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/R, WT/DS234/R, adopted 27 January 2003, as modified by Appellate Body Report, WT/DS217/AB/R, WT/DS234/AB/R, DSR 2003:II, 489
US – Section 337 Tariff Act	GATT Panel Report, *United States Section 337 of the Tariff Act of 1930*, L/6439, adopted 7 November 1989, BISD 36S/345
US – Shrimp	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755
US – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, 571
US – Sugar	GATT Panel Report, *United States Restrictions on Imports of Sugar*, L/6514, adopted 22 June 1989, BISD 36S/331
US – Superfund	GATT Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, L/6175, adopted 17 June 1987, BISD 34S/136
US – Tobacco	GATT Panel Report, *United States Measures Affecting the Importation, Internal Sale and Use of Tobacco*, DS44/R, adopted 4 October 1994, BISD 41S/131
US – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005, DSR 2005:I, 3

Short Title	Full Case Title and Citation
US – Wool Shirts and Blouses	Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323

LIST OF ABBREVIATIONS

Accession Protocol	Protocol on the Accession of China to the WTO
CGA	General Administration of Customs
CKD	Completely Knocked Down
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
GATT 1947	General Agreement on Tariffs and Trade 1947
GATT 1994	General Agreement on Tariffs and Trade 1994
GIR	General Rules for the Interpretation of the Harmonized System
HS	Harmonized System
NDRC	National Development and Reform Commission
SCM Agreement	Agreement on Subsidies and Countervailing Measures
SKD	Semi-Knocked Down
TRIMs Agreement	Agreement on Trade-Related Investment Measures
UNOG	United Nations Office at Geneva
Verification Centre	National Professional Centre for Verification of the Character of Complete Vehicles
Vienna Convention	Vienna Convention on the Law of Treaties
WCO	World Customs Organization
Working Party Report	Working Party Report on the Accession of China

I. INTRODUCTION

A. COMPLAINTS OF THE EUROPEAN COMMUNITIES, THE UNITED STATES AND CANADA

1.1 On 30 March 2006, the European Communities requested consultations with the People's Republic of China (hereinafter "China") pursuant to Article 4 of the DSU, Article XXII:1 of the GATT 1994, Article 8 of the TRIMs Agreement and Articles 4 and 30 of the SCM Agreement regarding China's imposition of measures that allegedly adversely affect exports of automobile parts from the European Communities to China.[2]

1.2 Consultations were held between the European Communities and China on 11 and 12 May 2006 in Geneva on these and other measures. They did not lead to a satisfactory resolution of the matter.

1.3 On 30 March 2006, the United States requested consultations with China pursuant to Articles 1 and 4 of the DSU, Article XXII of the GATT 1994, Article 8 of the TRIMs Agreement (to the extent that Article 8 incorporates Article XXII of the GATT 1994), and Articles 4 and 30 of the SCM Agreement (to the extent that Article 30 incorporates Article XXII of the GATT 1994) with respect to China's treatment of motor vehicle parts, components, and accessories imported from the United States.[3]

1.4 Consultations were held between the United States and China on 11 and 12 May 2006 in Geneva. However, they did not resolve the dispute.

1.5 On 13 April 2006, Canada requested consultations with China pursuant to Articles 1 and 4 of the DSU, Article XXII of the GATT 1994, Article 7 of the Agreement on Rules of Origin (ARO), Article 8 of the TRIMs Agreement, and Articles 4 and 30 of the SCM Agreement with respect to China's treatment of automobile parts from Canada.[4]

1.6 Consultations were held between Canada and China on 11 and 12 May 2006 with a view to reaching a mutually satisfactory solution. Unfortunately, the consultations failed to resolve the dispute.

1.7 On 15 September 2006, the European Communities, the United States and Canada each requested the establishment of a panel. At its meeting on 28 September 2006, the Dispute Settlement Body deferred the establishments of a panel.

B. ESTABLISHMENT AND COMPOSITION OF THE PANEL

1.8 At its meeting on 26 October 2006, the DSB established a single Panel pursuant to the requests of the European Communities in document WT/DS339/8, the United States in document WT/DS340/8 and Canada in document WT/DS342/8 in accordance with Article 9.1 of the DSU.[5]

1.9 At that meeting, the parties to the dispute agreed that the Panel should have standard terms of reference. The Panel's terms of reference are, therefore, as follows:

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[2] WT/DS339/1 of 3 April 2006.
[3] WT/DS340/1 of 3 April 2006.
[4] WT/DS342/1 of 19 April 2006.
[5] WT/DSB/M/221, para. 54.

> "To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS339/8, the United States in documents WT/DS340/8 and Canada in document WT/DS342/8, the matter referred to the DSB by the European Communities, the United States, and Canada in those documents, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.10 On 19 January 2007, the European Communities, the United States and Canada requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the DSU.

1.11 On 29 January 2007, the Director-General accordingly composed the Panel as follows:[6]

Chairman: Mr Julio Lacarte-Muró

Members: Mr Ujal Singh Bhatia
Mr Wilhelm Meier

1.12 Argentina, Australia, Brazil, Japan, Mexico, Chinese Taipei and Thailand have reserved their rights to participate in the Panel proceedings as third parties.

C. PANEL PROCEEDINGS

1.13 The Panel held the first substantive meeting with the parties on 22 and 24 May 2007. The session with the third parties took place on 23 May 2007. The Panel's second substantive meeting with the parties was held on 12 and 13 July 2007.

1.14 On 20 September 2007, the Panel issued the descriptive part of its Panel Report. The Panel submitted its Interim Reports to the parties on 13 February 2008. The Panel submitted its Final Reports to the parties on 20 March 2008.

II. FACTUAL ASPECTS

A. MEASURES AT ISSUE

2.1 This case concerns China's measures on imports of automobile parts. The European Communities, the United States and Canada have identified the following as the measures at issue in this case:[7]

(a) Policy on Development of Automotive Industry (Order of the National Development and Reform Commission (No. 8)) ("Policy Order 8"), which entered into force on 21 May 2004;

(b) Administrative Rules on Importation of Automobile Parts Characterized as Complete Vehicles (Decree of the People's Republic of China, No. 125) ("Decree 125"), which entered into force on 1 April 2005; and

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[6] WT/DS339/9, WT/DS340/9 and WT/DS342/9 of 30 January 2007.

[7] The titles and terms of China's measures used in these reports follow those provided in the texts of the common translations of the measures as agreed by the parties, attached as Annex E to these reports. See paras. 2.2-2.4 for procedural aspects of the common translations of China's measures.

(c) Rules on Verification of Imported Automobile Parts Characterized as Complete Vehicles (Public Announcement of the Customs General Administration of the People's Republic of China, No. 4 of 2005) ("Announcement 4"), which entered into force on 1 April 2005.

B. TRANSLATION OF CHINA'S MEASURES

2.2 Regarding China's measures at issue, the European Communities, the United States and Canada (also "co-complainants" hereinafter) submitted their unofficial translations of the measures into English as part of the joint exhibits attached to their first written submissions.[8] China also submitted its own unofficial translations of Chapter XI of Policy Order 8, of Decree 125 and of Announcement 4 as part of the exhibits attached to its first written submission.[9]

2.3 At the second substantive meeting with the parties, the Panel requested the parties to agree on one common translated version of China's measures. Accordingly, on 2 August 2007, the parties submitted common translations of all provisions of China's measures except for Article 28 of Decree 125.[10]

2.4 Upon the complainants' request that the Panel seek the translation of Article 28 of Decree 125 by an independent translator, the Panel sent a letter to the UNOG requesting the translation by UNOG Conference Services Section of the concerned provision.[11] On 23 August 2007, the Panel forwarded the translation by the UNOG to the parties for their comments.

C. REQUEST FOR INFORMATION FROM THE WCO

2.5 On 7 June 2007, the Panel sent a letter to the WCO requesting its assistance in issues relating to the HS.[12] The parties were invited to provide their comments on the WCO's reply at the second substantive meeting with the parties.

2.6 A second letter from the Panel was sent out to the WCO on 16 July 2007, requesting its further assistance in the same matter.[13] The parties were given the opportunity to provide their comments on the WCO's second reply.

D. UNITED STATES' REQUEST THAT THE PANEL'S FINDINGS BE PRESENTED AS SEPARATE REPORTS CONTAINED IN A SINGLE DOCUMENT WITH SEPARATE SECTIONS ON THE PANEL'S CONCLUSIONS AND RECOMMENDATIONS FOR EACH COMPLAINING PARTY

2.7 At the second substantive meeting, the United States requested pursuant to paragraph 18 of the Panel's Working Procedures that the Panel issue its findings in the form of a single document

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[8] Exhibit JE-18 (Policy Order 8); Exhibit JE-27 (Decree 125); and Exhibit JE-28 (Announcement 4).

[9] Exhibit CHI-2 (Chapter XI of Policy Order 8), Exhibit CHI-3 (Decree 125); and Exhibit CHI-4 (Announcement 4).

[10] The texts of the common translations of China's measures are attached as Annex E to these reports. In respect of Article 28 of Decree 125, the translation by the UNOG has been inserted.

[11] Both English and Chinese are official languages of the United Nations. The Panel's letter to the UNOG dated 15 August 2007 and the UNOG's reply to the Panel are reproduced in Annex D to these reports.

[12] The Panel's letter of 7 June 2007 to the WCO and the WCO's reply dated 20 June 2007 are reproduced in Annex C to these reports.

[13] The Panel's second letter to the WCO and the WCO's reply dated 30 July 2007 are reproduced in Annex C to these reports.

containing three separate reports with common sections on the Panel's conclusions and recommendations for each complaining party.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

A. EUROPEAN COMMUNITIES

3.1 The European Communities requests the Panel to find that China has acted inconsistently with:[14]

(a) Article 2.1 and Article 2.2 of the TRIMs Agreement in conjunction with paragraph 1(a) of the Illustrative List annexed to the TRIMs Agreement by applying investment measures related to trade in goods that are inconsistent with the provisions of Article III or Article XI of GATT 1994 and by applying investment measures related to trade in goods, compliance with which is necessary to obtain an advantage, and which require the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. Further, China has acted inconsistently with Article 2.1 and 2.2 of the TRIMs Agreement in conjunction with paragraph 2(a) of the Illustrative List annexed to the TRIMs Agreement, by applying investment measures related to trade in goods that are inconsistent with the provisions of Article III or Article XI of GATT 1994 and by applying investment measures related to trade in goods, compliance with which is necessary to obtain an advantage, and which restricts the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;

(b) its obligations under the Marrakesh Agreement Establishing the World Trade Organization, as set out in the Protocol on the Accession of the People's Republic of China to the WTO, in particular Part I paragraph 7.3 of the Protocol of Accession of China, and in paragraph 203 of the Working Party Report on the Accession of China in conjunction with Part I, paragraph 1.2 of the Protocol of Accession of China, and paragraph 342 of the Working Party Report on the Accession of China by failing, upon accession, to comply fully with the TRIMs Agreement, without recourse to Article 5 thereof, and to eliminate local content requirements and to not enforce the terms of contracts containing such requirements;

(c) Article III:4 of the GATT 1994 by imposing specified thresholds for imported parts in an assembled vehicle above which an additional charge applies on each imported part included in the vehicle. In addition, as part of the measures, China also imposes additional administrative requirements on importers and manufacturers that may not meet the required threshold for domestic content. Thereby, China has failed to accord, to products of the territory of the European Communities imported into the territory of China, treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use;

[14] European Communities, Request for the establishment of a panel, WT/DS339/8 and European Communities' first written submission, paras. 300-303.

(d) Article III:2 of the GATT 1994 by subjecting the products of the territory of other Members imported into the territory of China, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. China has also applied internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1 of Article III;

(e) Article III:5 of the GATT 1994 by establishing and maintaining internal quantitative regulations relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, China has applied internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1 of Article III; and

(f) its obligations under the WTO Agreement, as set out in the Accession Protocol, in particular Part I, paragraph 7.2 of the Accession Protocol, by introducing measures that are inconsistent with the provisions of the GATT 1994, in particular Article III.

3.2 In the alternative, the European Communities requests the Panel to find that China has acted inconsistently with:

(g) Article II:1(a) and (b) of the GATT 1994 by failing to accord to the commerce of another Member treatment no less favourable than that provided for in the appropriate Part of the Schedule annexed to the GATT 1994. China has failed to exempt products, which are the products of territories of another Member, on their importation into China's territory, from ordinary customs duties in excess of those set forth and provided in China's Schedule. China has failed to exempt such products from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date; and

(h) Article 3.1(b) together with Article 3.2 of the SCM Agreement by granting or maintaining subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.3 Furthermore, the European Communities requests the Panel to recommend, pursuant to Article 4.7 of the SCM Agreement, that China withdraw its prohibited subsidies within 90 days after the DSB adopts its recommendations and rulings in this dispute.[15]

B. UNITED STATES

3.4 The United States requests the Panel to find that China has acted inconsistently with:[16]

(a) Article III:2 of the GATT 1994, by imposing a charge on imported auto parts but not on domestic auto parts, and otherwise applying internal charges so as to afford protection to domestic production;

[15] European Communities' first written submission, para. 303.

[16] United States, request for the establishment of a panel, WT/DS340/8 and United States' first written submission, paras. 128-129.

(b) Article III:4 of the GATT 1994, by treating imported auto parts less favourably than like domestic auto parts by imposing additional administrative burdens and additional charges upon manufacturers that use imported parts in excess of specified thresholds, thereby affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of imported auto parts;

(c) Article 2.1 and paragraphs 1(a) and 2(a) of Annex 1 of the TRIMs Agreement, by requiring motor vehicle manufacturers in China to purchase or use domestic auto parts in order to obtain advantages such as the avoidance of administrative burdens and the payment of additional charges and by imposing restrictions which generally restrict the importation by a manufacturer of auto parts used in or related to its local production;

(d) Article III:5 of the GATT 1994, by requiring that a specified amount or proportion of the auto parts assembled into a complete motor vehicle be supplied from domestic sources, and otherwise applying internal quantitative regulations so as to afford protection to domestic production;

(e) Part I, paragraph 7.2 of the Accession Protocol, by introducing measures that cannot be justified under the provisions of the WTO Agreement, particularly with respect to Articles III and XI of the GATT 1994;

(f) Part I, paragraph 7.3 of the Accession Protocol and paragraph 203 of the Working Party Report, by failing to comply with the TRIMs Agreement and by maintaining local content requirements made effective through the measures;

(g) Articles 3.1(b) and 3.2 of the SCM Agreement, by exempting domestic auto parts from charges imposed by the measures, as well as exempting imported parts from the charges if the motor vehicle manufacturer uses domestic over imported parts in order to meet the specified thresholds; and

3.5 to the extent that the measures impose a charge on or in connection with the importation of auto parts,

(h) Article II:1(a) and (b) of the GATT 1994, by according imported auto parts less favorable treatment than that provided for in its Schedule of Concessions and Commitments annexed to the GATT 1994 and imposing charges in excess of those set forth and provided therein;

(i) paragraph 93 of the Working Party Report, by specifically identifying CKD and SKD kits for motor vehicles and assessing them the tariff for complete vehicles; and

(j) Article XI:1 of the GATT 1994, by constituting prohibitions or restrictions on the importation of auto parts other than in the form of duties, taxes or other charges.

3.6 The United States further requests that the Panel issue the recommendations set out in Article 4.7 of the SCM Agreement.[17]

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[17] United States' first written submission, para. 128.

C. CANADA

3.7 Canada requests the Panel to find that China has acted inconsistently with:[18]

(a) Article III:2 of the GATT 1994 because the measures result in charges on imported parts related to their use in manufacturing in China, while such charges are not imposed on domestically-produced parts. China also imposes internal taxes or other charges to imported products in a manner contrary to Article III:1;

(b) Article III:4 of the GATT 1994 because the measures result in less-favourable treatment for imported parts than for domestic parts. The less-favourable treatment includes the effect of additional charges on, more burdensome regulation of, and specified thresholds for the use of imported parts;

(c) Article III:5 (and also Article III:1) of the GATT 1994 because the measures constitute an internal quantitative regulation which requires specified proportions of domestic content;

(d) Article 2.1 of the TRIMs Agreement, in conjunction with paragraph 1(a) of the Agreement's Illustrative List, because the measures constitute measures requiring the purchase or use by domestic enterprises of products of domestic origin;

(e) Part I, paragraph 7.2 of the Accession Protocol, through measures inconsistent with the provisions of the GATT 1994, in particular Article III; and

(f) Part I, paragraphs 1.2 and 7.3 of the Protocol, and paragraphs 203 and 342 of the Working Party Report, through measures that establish and maintain local content requirements.

3.8 Alternatively, Canada requests the Panel to find that China has acted inconsistently with:

(g) Article II:1(a) and (b) of the GATT 1994, because the charges imposed on imported parts, if they are properly characterized as tariffs, are higher than those set out in China's Schedule of Concessions and Commitments, and therefore contrary to China's commitments on joining the WTO.

3.9 Canada also requests that the Panel find that China's measures nullify or impair benefits, as understood under GATT Article XXIII:1(b) of the GATT 1994, accruing to Canada in respect of CKD and SKD kits for motor vehicles. In particular, China has nullified or impaired benefits related to paragraphs 93 and 342 of the Working Party Report, in conjunction with Part I, paragraph 1.2 of the Accession Protocol, through applying tariffs exceeding 10 per cent on imports of CKD and SKD kits for motor vehicles.

3.10 Further, Canada requests that the Panel recommend China to bring its measures into conformity with its WTO obligations, including by removing domestic-content thresholds and

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[18] Canada, request for the establishment of a panel, WT/DS342/8 and Canada's first written submission, paras. 159-160.

eliminating the discriminatory internal charge applied in excess of the commitments set out in its Schedule.[19]

D. CHINA

3.11 China requests that:[20]

(a) the Panel reject the claims raised by the European Communities, the United States, and Canada; and

(b) in the event that the Panel finds that one or more aspects of the challenged measures is inconsistent with Article II or Article III of the GATT, China has provisionally demonstrated that any inconsistency between the challenged measures and China's GATT obligations is subject to the general exception under Article XX(d).

IV. ARGUMENTS OF THE PARTIES

4.1 The arguments presented by the parties in their written submissions and oral statements are reflected below.[21] The parties' responses to questions and comments on each other's responses are reproduced in Annex C.

A. FIRST WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

1. Introduction

4.2 China, as a WTO Member, has undertaken to comply with the obligations set out in the WTO Agreement. It has undertaken to open its markets, in part through the reduction of tariffs on auto parts and by eliminating its domestic-content requirements. Despite commitments made during WTO accession, China introduced measures imposing discriminatory internal charges on imported auto parts if vehicles manufactured in China exceed certain maximum thresholds of imported auto parts. The measures also include burdensome record-keeping, reporting and verification requirements that apply only to imported auto parts. The measures make imported auto parts more expensive and less competitive than like domestic auto parts and, thus, encourage investment in local part manufacture.

2. The measures

4.3 The measures are contained in three documents:

- Policy Order 8;
- Decree 125; and
- Announcement 4.

[19] Canada's first written submission, para. 160.
[20] China's first written submission, paras. 214-215.
[21] The summaries of the parties' arguments are based on the executive summaries submitted by the parties to the Panel. Footnotes in this section are those of the parties.

4.4 Policy Order 8 was issued on 21 May 2004 by China's National Development and Reform Commission. Decree 125 and Announcement 4, both made effective on 1 April 2005, implement and administer the Automotive Policy Order.

(a) Substantive criteria for determining the imposition of internal charges at the "Whole Vehicle" rate

4.5 If a vehicle model is manufactured using imported parts that exceed specified quantity or value thresholds, all imported parts are considered to be "automobile parts characterized as complete vehicles" and assessed a charge based on the whole vehicle rate, typically 25 per cent of the value of the imported parts. Imported parts will be automobile parts characterized as complete vehicles if any of the following three tests are met (Article 21 of Decree 125):

- As of 1 April 2005, when complete CKD or SKD kits are imported to assemble a vehicle.

- As of 1 April 2005, if a sufficient number of Deemed Imported Assemblies are used in manufacturing the vehicle. Imported parts will be characterized as complete vehicles if the following combinations of assemblies are "Deemed Imported":

  - the two main assemblies (the vehicle body and engine);

  - either of the two main assemblies as well as three or more other assemblies; or

  - five or more assemblies, other than the main assemblies.

- As of 1 July 2006, when the aggregate price of imported parts reaches 60 per cent or more of the price of all parts used in a vehicle. However, this aspect of the measures was suspended by Customs Joint Bulletin 38, dated 5 July 2006, until 1 July 2008.

4.6 An assembly will be "Deemed Imported" and thus count against the thresholds if the aggregate price of imported parts is 60 per cent or more of the total price of the assembly, or if it uses more than a specified number of "key parts", or if it is assembled from a complete set of imported parts (Article 22 of Decree 125).

4.7 If the vehicle manufacturer produces a vehicle that uses imported parts that are automobile parts characterized as complete vehicles, the manufacturer will be required to pay a charge on all imported parts incorporated into the vehicle (i.e. not just the imported parts used in the Deemed Imported Assembly). This charge generally equates to a 10 per cent tariff on the auto parts and an additional 15 per cent internal charge. Charges under the measures are levied, not at the border, but at a later date after the goods have been incorporated into manufactured vehicles, and, as described above, depending on the use to which the parts are put into China.

(b) Administrative requirements imposed on vehicle and auto parts manufacturers when any imported parts are used

4.8 Any use of imported parts in vehicle manufacturing will subject a manufacturer to the burdensome administrative regime under the measures. The administrative requirements do not apply to vehicle manufacturers that use solely domestic parts. This may result in significant delays in receiving and using imported auto parts and affects a manufacturer's ability to source imported parts not included in a registered vehicle plan.

4.9 The administrative burden requires vehicle manufacturers using imported parts, among other things, to:

(a) perform a self-evaluation on proposed vehicle models to determine if the quantity or value of imported parts to be used in manufacturing the vehicle renders those parts characterized as complete vehicles;

(b) file documents with Customs showing the quantity and value of imported parts actually used in manufacturing a vehicle model;

(c) apply for and undergo verification by Customs of self-evaluation (if imported parts are not characterized as complete vehicles) or of the first batch of vehicles produced (if imported parts are characterized as complete vehicles);

(d) prior to import provide the district customs office in charge of the area where the manufacturer is located with a general duty guarantee where a vehicle model uses parts that are characterized as complete vehicles;

4.10 Another administrative burden on the face of the measures comes from deeming imported parts to be "in bond". To date, that deeming is a fiction. Imported auto parts have not been subject so far to Chinese bonding requirements and are used freely at the manufacturing sites of vehicle and auto parts manufacturers. But, if and when applied, this would add substantial complication (such as special record-keeping, restrictions on entry and exit including special passes for personnel, Customs approval for moving parts out of the bonded areas ...).

4.11 The measures also impose specific administrative requirements when modifications are made to the vehicle model using imported parts rather than domestic parts. This goes from the obligation to report to Customs when imported optional parts are fitted on the vehicle model to repeating all the administrative hurdles to register and import parts. The effect is to limit the ability of vehicle manufacturers to freely source imported auto parts.

4.12 The measures also require manufacturers to track down the chain of supply to determine whether individual assemblies and key parts are to be treated as imported for purposes of the measures. As a result, parts manufacturers and suppliers that use imported parts have to maintain records of the quantity, type and cost of imported parts used in any parts incorporated into a manufactured vehicle. The parts manufacturers and suppliers do this in order to meet their contractual obligations to vehicle manufacturers and guarantee to them that they meet the domestic content requirements of the measures.

(c) Impact of the measures

4.13 The overall impact of the measures is to discriminate against imported auto parts by encouraging the use of domestic parts in auto parts and vehicle manufacturing in China. Due to the price-sensitivity of the Chinese market, vehicle and auto part manufacturers would be "priced out" of the Chinese marketplace if they passed on the additional 15 per cent internal charge to their customers, and they would suffer a loss if they absorbed the cost themselves. The result is that manufacturers are forced to meet the domestic content thresholds under the measures. This also serves to devalue the investment of foreign vehicle and auto parts manufacturers that had invested in China on the premise they would be able to import auto parts at the 10 per cent rate to which China bound itself in its Schedule of Concessions.

3. Legal argument

(a) The violation of the TRIMs Agreement and the Accession Protocol relating to the TRIMs Agreement

4.14 The European Communities considers that the measures are inconsistent with Article 2 of the *TRIMs Agreement* in conjunction with paragraphs 1(a) and 2(a) of the Illustrative List.

4.15 The measures are "investment measures" because they are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts for motor vehicles in China. Inherent to this objective is that these measures necessarily have a significant impact on investment in these sectors. The whole investment strategy of both local and foreign vehicle and part manufacturers is governed by the constraints laid down by these measures.

4.16 The measures are "trade-related" because they apply and relate only to imported parts. Furthermore, local content requirements are necessarily "trade-related" because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade.

4.17 The measures fall squarely within the scope of paragraphs 1(a) and 2(a) of the Illustrative List to the TRIMs Agreement as (i) they require compliance with local content thresholds to obtain a number of advantages (lower charges and procedural advantages) and (ii) since such local content requirements have, by definition, considerable effects on the importation of products used or related to local production.

4.18 As China has specifically undertaken to comply with the TRIMs Agreement in its Accession Protocol, the measures are consequently also inconsistent with its obligations under the *WTO Agreement*, as set out in the Accession Protocol (Part I, Article 7.3 and paragraph 203 of the Working Party Report in conjunction with Part I, Article 1.2 and paragraph 342 of the Working Party Report).

(b) The violation of Article III of the GATT 1994 and China's Accession Protocol relating to Article III of the GATT 1994

4.19 The application of the measures is triggered by the actual manufacturing process taking place in China. Therefore, the measures are "internal" measures. Indeed, it is only once the imported parts have been assembled and processed into a complete vehicle that the internal charge is imposed if the domestic content is insufficient.

(i) Article III:4 of the GATT 1994

4.20 The measures are inconsistent with Article III:4 of the GATT 1994 because all the three elements for a finding of inconsistency there under are fulfilled.

4.21 The imported and domestic automobile parts are "like products" because the measures themselves treat domestic and imported parts as "like". The only distinction is made on the basis of the origin of the products.

4.22 The measures constitute "laws, regulations or requirements affecting the internal sale, offering for sale, purchase, transportation, distribution, or use" of the imported like products since they impose very strict procedural and administrative rules and a possibly 15 per cent internal charge

and thus adversely modify the conditions of competition between the domestic and imported products on the internal market.

4.23 Finally, the imported automobile parts and components are accorded "less favourable" treatment than that accorded to like domestic products since car manufacturers are not free to purchase imported parts in excess of a certain proportion without heavy consequences. These consequences consist of an additional charge and the obligation to comply with additional procedural requirements.

(ii) Article III:2 of the GATT 1994

4.24 The measures also violate Article III:2, first sentence. Imported and domestic auto parts are "like products" because the measures only apply to imported, and not to domestic auto parts. Imported auto parts identical in all respects to domestic auto parts, except for their origin, will – depending on the amount of local content in the assembled vehicle – be subject to internal charges. As these internal charges do not apply to domestic auto parts, the charges applied to imported auto parts are necessarily "in excess of" the charges applied to like domestic products.

4.25 In the alternative, the measures are inconsistent with Article III:2, second sentence in conjunction with the relevant Ad Article. As the measures discriminate between auto parts on the basis of their origin, imported and domestic auto parts are necessarily "directly competitive or substitutable". They are "not similarly taxed" since the internal charges are only imposed on imported auto parts. The protective application within the meaning of Article III:1 follows from the fact that the differential in charges is significantly above the de minimis level, from the discriminative structure of the measures and the stated goal of the measures to protect domestic production.

(iii) Article III:5 of the GATT 1994

4.26 Furthermore, the measures violate Article III:5, first sentence. First, they constitute an "internal regulation" since they are authoritative rules from Chinese authorities on the administrative and fiscal treatment of imported auto parts. Secondly, they are "quantitative … relating to the mixture, processing or use of products in specified amounts or proportions" because they are concerned with the amounts and proportions of domestic or imported auto parts in assembled vehicles and their assemblies. The measures set out maximum amounts and proportions of imported auto parts which must not be surpassed when using them in the assembly of vehicles. Thirdly, the measures "requir[e], directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources". If vehicle manufacturers do not use sufficient domestic parts to remain within the maximum thresholds of imported parts set out in the measures, all imported parts assembled in that vehicle are categorized "automobile parts characterized as complete vehicles" and charged according to the duty rate for complete vehicles.

4.27 In the alternative, the European Communities demonstrates that the measures are inconsistent with Article III:5, second sentence because they are applied "so as to afford protection to domestic production". The factors indicating protective application under Article III:2, second sentence above also lead to the conclusion of inconsistency with Article III:5, second sentence.

(iv) Accession Protocol

4.28 As demonstrated above, the measures are inconsistent with Article III, paragraphs 2, 4 and 5 of the GATT 1994 and China in its Accession Protocol has undertaken to implement *inter alia* Article III without introducing, re-introducing or applying non-tariff measures that cannot be justified

under the WTO Agreement. By adopting the measures China has introduced non-tariff measures that cannot be justified under the provisions of the WTO Agreement. Clearly, China cannot implement Article III of the GATT 1994 by introducing measures that are inconsistent with that provision without violating the commitments it has taken under the terms of its accession to the WTO. Consequently, China has acted inconsistently with its obligations under the WTO Agreement, as set out in the Accession Protocol, (Part I, paragraph 7.2).

(c) Article II:1 (a) and (b) of the GATT 1994

4.29 Alternatively the European Communities considers that the measures are inconsistent with Article II:1 (a) and (b) of the GATT 1994. Under Article II China has committed to treat imports no less favourably than provided for in its Schedule. In particular, ordinary customs duties must not be applied in excess of the bound rates provided for in China's Schedule.

4.30 There are four different general categories of automotive products relevant for this case under the nomenclature of the Chinese tariff schedule, namely

1. complete vehicles (headings 87.01 to 87.05 of which headings 87.02 to 87.04 are most relevant in view of the scope of the measures – bound rate of duty of typically 25 per cent;

2. intermediate products such as the body and the chassis with engine (a combination of vehicle elements and/or parts fitted and/or equipped together without being complete vehicles (headings 87.06, 87.07) – bound rate of duty of typically 10 per cent;

3. parts and accessories of Chapter 87 (heading 87.08) – bound rate of duty of typically 10 per cent or less;

4. parts and accessories of motor vehicles classified elsewhere than Chapter 87 (tyres, engines, accumulators) – bound rate of duty of typically 10 per cent or less.

4.31 The Chinese tariff schedule provides for separate tariff lines for complete motor vehicles on the one hand, and parts and accessories of such motor vehicles on the other hand. However, the measures are not consistent with these tariff lines and the bound rates of duty provided for in China's Schedule.

4.32 Under the measures, automotive parts are classified (or "deemed") as complete or whole vehicles and are imposed duties accordingly. Already on the basis of the ordinary meaning of the terms "whole" or "complete" motor vehicle as compared with "part" of motor vehicles this is not only a manifest error but a contradiction in terms.

4.33 Even when the ordinary meanings of "whole or complete motor vehicles" as compared with "part(s)" of such vehicles are examined in their context, there is nothing that supports the view that parts or some parts for motor vehicles could be classifiable under the relevant headings covering complete motor vehicles. In particular, the measures classify parts of products as complete products in a context where China's tariff schedules provide for a clear separation between the products and parts thereof:

- "a chassis fitted with engines" are deemed a "whole vehicle" and subject to the generally 25 per cent duty for complete vehicles despite the specific heading (87.06) and the final bound duty rate of typically 10 per cent;

- the imported vehicle body and the engine are deemed a "whole vehicle" and subject to the generally 25 per cent duty for complete vehicles despite the specific headings (87.07, 84.07 and 84.08) and the final bound rate of duty of typically 10 per cent or less;

- the tariff of complete vehicles is imposed on SKD and CKD kits instead of the lower tariff for the relevant automotive parts and components;

- Imported parts in any random configuration are classified as complete or whole vehicles as long as their aggregate price attains 60 per cent or more of the complete vehicle price.

4.34 The measures also provide for considerable unpredictability in terms of when a part of a product is "deemed" to be the complete product and subject to a much higher tariff. Therefore the measures fundamentally undermine the object and purpose of the WTO Agreement and the GATT namely "the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade".

(d) Article 3 of the SCM Agreement

4.35 Should the Panel find that the Chinese measures are border charges and, secondly, that China is entitled to accord to the imports of auto parts the treatment it provides for vehicles in its Schedule, *quod non*, then the measures would in any case be a prohibited subsidy pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement.

4.36 First, the measures constitute a financial contribution since "government revenue that is otherwise due is foregone or not collected" (Article 1.1(a)(1)(ii) of the SCM Agreement). The appropriate benchmark for comparison is the revenue that China raises through duties on imports of auto parts that are automobile parts characterized as complete vehicles. China has established a duty rate which typically amounts to 25 per cent of the value of the parts. If the local content requirements of the measures are not satisfied, this duty would be paid on imports of auto parts. If the imports, on the other hand, satisfy the local content requirements, China has given up an entitlement to raise revenue that it could "otherwise" have raised. By charging this second category of parts imports with duties of typically only 10 per cent, China has ignored the normative benchmark that it established for the first category of parts imports and, thus, has forgone "government revenue that is otherwise due".

4.37 Secondly, the measures confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement. Vehicle manufacturers which satisfy the local content requirements of the measures are financially "better off" than those which do not. They do not have to pay the higher import duties for parts of typically 25 per cent and are instead only charged at 10 per cent.

4.38 Thirdly, the measures are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement. The benefit of the lower duty rate of typically 10 per cent is only conferred if vehicle manufacturers satisfy the local content requirements of the measures. Consequently, they are deemed to be specific pursuant to Article 2.3 of the SCM Agreement.

B. FIRST WRITTEN SUBMISSION OF THE UNITED STATES

1. Introduction

4.39 China has adopted measures that favor domestic auto parts over imported parts, so as to afford protection to the domestic production of auto parts. These measures include an internal charge of 25 per cent that China imposes on imported auto parts, with no comparable charge on domestic auto parts. The measures provide that the charge only applies if domestically-produced autos include an amount (in volume or value) of imported auto parts that exceeds specified thresholds. And the measures include extensive record-keeping, reporting, and verification requirements that apply if and only if domestic automobile manufacturers make use of imported auto parts.

4.40 These measures amount to clear and straightforward inconsistencies with China's national treatment obligations under Article III of the GATT 1994". In particular, these measures impermissibly result in internal charges on imported parts in excess of those applied on domestic parts (Article III:2); the measures accord treatment less favorable to imported parts with respect to requirements affecting internal sale, purchase, distribution, and use (Article III:4); and the measures directly or indirectly require that specified amounts or proportions of auto parts used in vehicle manufacturing must be supplied from domestic sources (Article III:5).

4.41 Before proceeding with a detailed factual and legal analysis, the United States would emphasize the following two points. First, the measures are subject to Article III even though China has labelled them as "customs duties". China's measures are not applied at the border; rather, they are internal measures that apply charges and procedural requirements based on the specific details of the auto manufacturing processes that occur within China. It is not the label that a Member applies to its measure that determines whether an obligation under a covered agreement applies; rather it is the substance of the measure that matters. Otherwise the GATT 1994's core national treatment obligations under Article III would be eviscerated. Second, although the detailed operation of China's measures on auto parts contain considerable complexity, the analysis of those measures under Article III is neither ambiguous nor complex. Rather, despite the complexity of China's auto parts scheme, the results of an analysis under the text of Article III, as clarified by prior GATT panel and WTO panel and Appellate Body reports, is clear – namely, China's measures are inconsistent with China's obligations under Article III.

2. Argument

(a) The disciplines of Article III of the GATT 1994 apply to the measures

4.42 Article III of the GATT 1994 ensures that "internal taxes and other internal charges ... affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products" are not applied in a manner so as to afford protection to domestic production. China's Policy Order 8, Decree 125, and Announcement 4 together establish internal charges and burdensome procedures that apply only to foreign goods and that indeed afford protection to domestic production.

4.43 Although China's measures label the 25 per cent charge as an "import duty," the name assigned to the charge is not determinative in deciding whether the charge is an internal one – thus subject to the disciplines of Article III – or an import duty subject to tariff bindings under Article II of the GATT 1994. Rather, it is necessary to examine whether the charge is based on the internal use and/or sale of the product, or if the charge is instead a border measure. In this dispute, China's measures apply after importation of the product, and cannot be considered border measures.

4.44 The distinction between internal charges and customs duties had been addressed in prior panels under the GATT 1947. In one of the first GATT 1947 reports, *Belgian Family Allowances*, the panel examined whether a particular charge should be treated as an "internal charge" within the scope of Article III:2 of the GATT 1994 or an "import charge" within the scope of Article II. Belgium imposed the charge at issue on imported goods purchased by public bodies when the goods originated in a country whose system of family allowances failed to meet specific requirements. The panel concluded that because the charge (a) "was collected only on products purchased by public bodies for their own use and not on imports as such" and (b) "was charged, not at the time of importation, but when the purchase price was paid by the public body," the charge constituted an internal charge. In other words, because the charge depended on the internal use of the product, it could not be considered a border charge.

4.45 The issue was again addressed in *EEC – Parts and Components*. In that dispute, the GATT 1947 Panel examined whether charges imposed to allegedly prevent the circumvention of anti-dumping duties should be analysed as customs duties or internal charges. In making its determination, the Panel focused on "whether the charge is due on importation or at the time or point of importation or whether it is collected internally." The Panel noted that the duties were levied on finished products assembled or produced in the EEC and were not imposed "conditional upon the importation of a product or at the time or point of importation." Accordingly, the Panel concluded that the EEC charges qualified as "internal charges" under Article III.

4.46 As in *Belgian Family Allowances* and *EEC – Parts and Components*, China's measures at issue in this dispute are internal ones, not border measures. China's charges are not imposed at the time of, or as a condition to, the entry of the parts into China. Indeed, the measures at issue do not impose charges on all imported parts, but only on parts used by manufacturers in the assembly of new vehicles that exceed the thresholds established by Decree 125.

4.47 Instead of being border measures, China's measures at issue in this dispute are internal measures, the application of which turns on the details of the manufacturing operations conducted within China. All of the following factors lead to this conclusion:

- The determination of whether imported parts constitute "features of a complete automobile" is made at the time the parts are used in the assembly process rather than at the time the parts enter the territory to which China's Schedule relates.

- Under the measures, all of the parts of a completed vehicle are combined for the determination of whether the 25 per cent charge applies, regardless of where those parts originate, when or where they entered the territory of China, or who imported them. Even if a part has been imported by a supplier, and even if the supplier has already paid customs fees and duties, the part is nonetheless grouped together with parts imported by the manufacturer itself when making the determination.

- The 25 per cent charge is imposed not on the importer, but on the manufacturer – whether or not the manufacturer is actually the importer of the part in question.

- Official verification is performed by the Chinese authorities at the manufacturer's site, not at the border. And, this determination is not made by China Customs through normal customs procedures, but by a special administrative body pursuant to measures developed by agencies with industrial policy functions.

4.48 In short, the measures are not focused on importation, but rather on the internal use of imported parts in the manufacture of new automobiles. China's measures are thus internal ones, and are subject to the disciplines of Article III of the GATT 1994.

(b) The charges are inconsistent with Article III:2, first sentence

4.49 The charges imposed under China's measures are inconsistent with the first sentence of Article III:2 of the GATT 1994. As confirmed by the Appellate Body in *Japan – Alcoholic Beverages*, a determination of an internal charge's inconsistency with Article III:2, first sentence is a two step process: First, the imported and domestic products at issue must be "like." Second, the internal charge must be applied to imported products "in excess of" those applied to the like domestic products. "If the imported and domestic products are 'like products', and if the charges applied to the imported products are 'in excess of' those applied to the like domestic products, the measure is inconsistent with Article III:2, first sentence."

(i) Imported auto parts and domestic auto parts are like products

4.50 Where the number or value of the imported parts used in the assembly of a vehicle in China exceeds the specified thresholds, the measures impose an internal charge of 25 per cent on all imported parts in the vehicle. This internal charge applies only to parts of foreign origin – domestic parts are exempt.

4.51 Where a WTO Member draws an origin-based distinction in respect of internal charges, a case-by-case determination of "likeness" between the foreign and domestic product is unnecessary. As such, in this dispute, the requirement that the "like products" be established is readily satisfied.

(ii) Imported auto parts are taxed in excess of domestic auto parts

4.52 When the number or value of the imported parts used in the assembly of a vehicle in China exceed the thresholds established in the measures, the measures impose an internal charge on all imported parts in the vehicle. Domestic parts are exempt. This differential taxation of imported and domestic auto parts breaches Article III:2. Indeed, any taxation of imported products in excess of like domestic products, regardless of amount, is sufficient to render a charge inconsistent with Article III:2, first sentence.

(c) The charges and reporting requirements applied to the use of imported auto parts are inconsistent with Article III:4 of the GATT 1994

4.53 In examining a claim under Article III:4, the Appellate Body has identified three distinct elements required to establish a breach: (1) the imported and domestic products are "like products;" (2) the measure is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product.

(i) Imported auto parts and domestic auto parts are like products

4.54 As with the Article III:2 analysis above, the determination of "like products" for purposes of Article III:4 is established where the measures at issue make distinctions between products based solely on origin. As noted above, China's measures at issue apply the internal charge, and the burdensome administrative requirements on car manufacturers, solely on an origin-based distinction. As such, foreign and domestic auto parts satisfy the "like products" requirement of Article III:4.

(ii) The charges and reporting requirements are laws or regulations affecting the internal sale, offering for sale, purchase, distribution and use of imported auto parts

4.55 The second element of an Article III:4 analysis is that the measures "affect[] [the] internal sale, offering for sale, purchase, distribution ... or use" of the like products. The Appellate Body has noted that the term "affecting" in Article III:4 should be interpreted as having a "broad scope of application." In addition, the panels in *EC – Bananas III* and *India – Autos* both concluded that the word "affecting" covered more than measures which directly regulate or govern the sale of domestic and imported like products. In fact, the term "affecting" was broad enough to cover measures that might "adversely modify the conditions of competition between domestic and imported products." Thus, in *India – Autos*, the Panel found that a measure "affects" the internal sale, offering for sale, purchase and use of an imported product, because it provided an incentive to purchase local products. In *Canada – Wheat Exports*, the Panel found that a Canadian measure "affects" internal distribution of like products, because it created a disincentive to accept and distribute imported grain.

4.56 In this instance, China's Policy Order 8, Decree 125 and Announcement 4 work together to create an incentive to purchase domestic auto parts. By establishing a system that (1) levies an internal charge equal to 25 per cent of the total value of imported parts used in the automobile, and (2) imposes burdensome administrative recording requirements when a certain threshold of imported parts are used in the manufacturing of vehicles, China has established a disincentive to purchase, use and distribute imported auto parts. Thus the measures at issue "affect" the international sale, offering for sale, purchase, distribution, and use of imported auto parts.

(iii) By establishing thresholds on the use of imported auto parts that trigger additional internal charges and burdensome procedural requirements, the measures accord less favorable treatment to imported auto parts than to domestic auto parts

4.57 The last element for determining a breach of Article III:4 is to assess whether the measures accord less favorable treatment to imported products relative to the domestic product. Previous panels have found that measures meet this element of the analysis if they impose requirements on foreign products that are not imposed on domestic products; create an incentive to purchase and use domestic products or a disincentive to utilize imported products; or "adversely affect . . . the equality of competitive opportunities of imported products in relation to like domestic products." Significantly, the Appellate Body in *US – FSC (Article 21.5)* noted that a measure could still be inconsistent with Article III:4 even if unfavorable treatment did not arise in every instance.

4.58 Here, the measures treat foreign parts less favourably than domestic parts by creating different competitive conditions for the parts so that protection is afforded to the domestic products. This is done in two ways.

4.59 With respect to the first, i.e., through the application of the additional charge, consider the following: When a manufacturer assembles a vehicle, the manufacturer can choose to include either an imported part or, if one is available, a domestic part. As explained above, the measures establish thresholds (i.e., what constitutes "features of a complete automobile") for the number of imported parts that can be included in a finished vehicle; if the threshold is exceeded, then a charge equal to 25 per cent of the value of each imported part (instead of the import duty on the imported part) is imposed on each and every imported part included in the vehicle. The measures accordingly alter the conditions of competition by creating a significant incentive to include domestic parts over imported parts.

4.60 The second method by which the measures treat foreign parts less favourably than domestic parts is through the imposition of burdensome administrative reporting requirements on any manufacturer who chooses to use imported auto parts in building an automobile in China. These requirements also create different competitive conditions for the imported parts so that protection is afforded to the domestic products.

4.61 Decree 125 requires manufacturers to perform a "self-evaluation" to determine the number of imported parts used in the assembly of a particular vehicle model. To perform this self-evaluation, a manufacturer must catalogue all the parts of each model it manufactures, determine whether, under the measures, the parts are foreign or domestic, and calculate the thresholds for each assembly system and the overall price percentage of imported parts in the model. Should this self-evaluation result in a determination that the imported parts used constitute "features of a complete automobile," as defined in the Decree, the manufacturer must register the vehicle model with CGA. None of this is required if the manufacturer uses only domestic auto parts.

4.62 To register the vehicle model with CGA, the manufacturer must include the following information:

- a description of the manufacturer;
- the annual production plan for the vehicle model;
- a list of all domestic and foreign suppliers; and
- a detailed list of all imported and domestic parts used in the model being filed.

4.63 This information must then be constantly updated to take into account changes in the source and relative price of various parts of every automobile model, as well as changes to individual automobiles (e.g., if optional imported parts are fitted on an individual vehicle).

4.64 Further, if imported parts are used, China's special payment system for the internal charges requires that the imported parts – if entering China through a port not administered by the district customs office where the manufacturer is located – be "transferred" to the district customs office, where the manufacturer is required to maintain a general financial guarantee in an amount no lower than the average total amount of total duties payable by the enterprise for its average monthly imports of parts and components. The manufacturer is required to make payments on a monthly basis, at which time the following information is required: verification report, the previous month's total production figures, and a list of parts and components used by the manufacturer in the prior month to assemble completed vehicles.

4.65 Should the manufacturer use imported parts that he himself did not import, the manufacturer is required to maintain records regarding the actual importer of record, and any evidence of duties and value-added taxes paid.

4.66 None of these burdensome reporting requirements are necessary for manufacturers who choose to use only domestic auto parts to manufacture automobiles in China. Such administrative requirements thus create different competitive conditions for the imported parts so that protection is afforded to the domestic products. In sum, the imposition of internal charges and burdensome procedural requirements on manufacturers who use imported rather than domestic parts results in a breach of Article III:4 of the GATT 1994.

(d) China's measures are inconsistent with Article 2.1 and Paragraph 1(a) of Annex 1 of the TRIMs Agreement.

4.67 China's measures are inconsistent with Article 2 of the TRIMs Agreement. First, these measures fall within the types of measures covered in the Illustrative List in the Annex to the TRIMs Agreement. The Chinese measures at issue provide an advantage, i.e., an exemption from paying the internal charge and related burdensome administrative requirements, for auto manufacturers that decide to purchase or use domestic auto parts. Thus, the measures require "the purchase or use by an enterprise of products of domestic origin or from any domestic source" so as "to obtain an advantage"; they fall squarely within the Illustrative List of measures covered by the TRIMs Agreement.

4.68 Further, under Article 2 of the TRIMs Agreement, a TRIM that is inconsistent with Article III of the GATT 1994 is also inconsistent with the TRIMs Agreement. As the measures at issue are already determined to be "trade-related investment measures" in that they fall squarely within Illustrative List 1(a) of the TRIMs Agreement, and they are also inconsistent with China's obligations under Article III:4 (as discussed above), these measures are thus inconsistent with Article 2 of the TRIMs Agreement as well.

(e) China's measures are inconsistent with Article III:5 of the GATT 1994

4.69 China's measures are also inconsistent with Article III:5 of the GATT 1994. China's measures at issue impose additional internal charges and burdensome administrative requirements if, among other things, the quantity of the imported parts and components used by a car manufacturer (1) exceed specified limits on the number of imported assembly systems, or (2) results in the total price of the imported parts and components being 60 per cent or more of the total price of all parts and components in the finished vehicle. Given that these provisions are expressed in quantitative terms, they are by their nature "quantitative regulations." Moreover, given that their terms specify the quantitative amounts of imported parts that would result in the internal charges and reporting requirements being applicable, the measures are also quantitative regulations that relate "to the mixture, processing or use of products in specified amounts or proportions," and require that a specified amount or proportion of an automobile be supplied from domestic sources or else a penalty in the form of an additional charge is assessed. As such, the Chinese measures are inconsistent with Article III:5 of the GATT 1994.

(f) China's measures are inconsistent with Part I, Article 7.2 of the Accession Protocol

4.70 Part I, Article 7.2 of China's Accession Protocol states in relevant part: "In implementing the provisions of Articles III and XI of the GATT 1994 and the Agreement on Agriculture, China shall eliminate and shall not introduce, re-introduce or apply non-tariff measures that cannot be justified under the provisions of the WTO Agreement." Therefore, by introducing measures that are inconsistent with Article III:2, Article III:4, and Article III:5 of the GATT 1994 and that thus cannot be justified under the provisions of the WTO Agreement, China's measures at issue consequentially are in breach of Part I, Article 7.2 of China's Accession Protocol.

(g) China's measures are inconsistent with Part I, Article 7.3 of the Accession Protocol and paragraph 203 of the Working Party Report

4.71 Part I, Article 7.3 of China's Accession Protocol states in relevant part: "China shall, upon accession, comply with the TRIMs Agreement, without recourse to the provisions of Article 5 of the TRIMs Agreement. China shall eliminate and cease to enforce ... local content ... requirements made

effective through laws, regulations or other measures." Paragraph 203 of the Working Party Report reiterates this obligation.

4.72 In light of the earlier discussion that China's measures are inconsistent with obligations under Article 2 of the TRIMs Agreement, and in light of the fact that the measures effectively maintain the local content requirement initially set forth in China's *Automotive Industry Industrial Policy* of 3 July 1994, China's measures at issue consequentially are inconsistent with China's obligations under Part I, Article 7.3 of China's Accession Protocol and paragraph 203 of the Working Party Report.

(h) In the alternative, China's measures are inconsistent with Article II of the GATT 1994 and paragraph 93 of the Working Party Report

4.73 As the United States has explained above, China's measures at issue are internal charges and other internal requirements, not border measures. Accordingly, the United States submits that these measures are to be analysed under (and are inconsistent with) the obligations set out in Article III of the GATT 1994.

4.74 Nonetheless, even if the measures were considered border measures, China's measures would be inconsistent with Article II of the GATT 1994 and paragraph 93 of the Working Party Report.

4.75 First, if China's measures are considered to result in the imposition of customs duties subject to Article II obligations, the measures would result in the imposition of customs duties in an amount greater than allowed under Article II. Under China's Schedule of Concessions and Commitments, most motor vehicles are classified under items 87.02 through 87.04, while auto parts and components are classified under several different items including 84.07-84.09 (engines and engine parts), 87.07 (bodies for motor vehicles), and 87.08 (parts and accessories of motor vehicles). China's final bound tariff rate for complete vehicles is 25 per cent, while its bound rate for auto parts and components is 10 per cent (and in some cases, even lower). Accordingly, should the 25 per cent charges under the measures be considered customs duties on auto parts, those charges would violate China's tariff binding (of 10 per cent or lower) on such parts.

4.76 Second, should China's measures be considered border measures rather than internal measures subject to Article III, the 25 per cent charge on imported CKD and SKD kits would be inconsistent with China's commitments in paragraph 93 of the Working Party Report. Part I, Article 1.2 of the Accession Protocol provides that the Protocol, which includes the commitments referred to in paragraph 342 of the Working Party Report, shall be an integral part of the WTO Agreement. Paragraph 342 of the Working Party Report includes China's commitment reproduced in paragraph 93 of the Working Party Report. As a result, China's commitment in paragraph 93 of the Working Party Report is an integral part of the WTO Agreement.

4.77 Paragraph 93 of the Working Party Report provides:

> Certain members of the Working Party expressed particular concerns about tariff treatment in the auto sector. In response to questions about the tariff treatment for kits for motor vehicles, the representative of China confirmed that China had no tariff lines for completely knocked-down kits for motor vehicles or semi-knocked down kits for motor vehicles. If China created such tariff lines, the tariff rates would be no more than 10 per cent. The Working Party took note of this commitment.

4.78 To the extent that the charges imposed by the measures are considered to be tariffs, the measures would in effect specify a tariff line for CKD and SKD kits that imposes a 25 per cent tariff, rather than a 10 per cent tariff as required under the Working Party Report.

(i) China's measures constitute an import substitution subsidy in breach of Articles 3.1(b) and 3.2 of the SCM Agreement

4.79 China's measures impose additional duties and other requirements on imported auto parts, thereby resulting in a breach of China's obligations under Article III of the GATT 1994. Another way to view these charges is that they exempt manufacturers from the charges otherwise due if they use domestic auto parts rather than imported auto parts. From this perspective, the measures constitute an import substitution subsidy in breach of Articles 3.1(b) and 3.2 of the SCM Agreement.

4.80 The reduction available for using domestic parts is a subsidy pursuant to Article 1.1 of the SCM Agreement. First, pursuant to the chapeau of Article 1.1(a)(1), the reduction is a "financial contribution" by the Chinese Government, where "government revenue that is otherwise due is foregone or not collected." Under China's measures, on domestic parts the government foregoes the difference between the across-the-board 25 per cent charge on auto parts and the customs duty (10 per cent or less) applied to imported parts. Likewise, on certain imported parts, the government foregoes the difference between the across-the-board 25 per cent charge and the customs duty (10 per cent or less) when the thresholds for using domestic parts in a finished vehicle are satisfied. Second, this financial contribution results in a "benefit ... conferred," pursuant to Article 1.1(b) of the SCM Agreement, because the auto manufacturer is able to retain the amount of money equivalent to the amount of revenue foregone by the government.

4.81 Article 2.3 of the SCM Agreement further specifies that a subsidy shall be deemed "specific" if it falls within the provisions of Article 3 of the SCM Agreement relating to "prohibited" subsidies. As shown below, China's measures are "prohibited" and therefore are deemed "specific" within the meaning of Article 2.3 of the SCM Agreement.

4.82 China's measures are "prohibited" within the meaning of Article 3.1(b) because they are "contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." China's measures are contingent upon the use of domestic over imported goods, in that the subsidy provided by these measures is only available to an auto manufacturer when (1) the quantity of the domestic parts and components used by the auto manufacturer exceeds specified thresholds on the number of domestic assembly systems or (2) the quantity of the domestic parts and components used by the auto manufacturer results in the total price of the domestic parts and components being more than 40 per cent of the total price of all parts and components in a finished vehicle. As such, the measures violate Articles 3.1(b) and 3.2 of the SCM Agreement, which provide that a Member shall neither grant nor maintain subsidies contingent upon the use of domestic over imported goods.

4.83 Since China's measures amount to a prohibited subsidy, the provisions of Article 4.7 of the SCM Agreement apply. Those provisions provide that the Panel shall recommend that the subsidizing Member withdraw the subsidy without delay, and that the Panel shall specify in its recommendation the time-period within which the measure must be withdrawn.

C. FIRST WRITTEN SUBMISSION OF CANADA

1. Introduction and background

4.84 In 2005 China introduced measures inconsistent with its WTO obligations and its Accession Protocol by imposing discriminatory internal charges and administrative burdens on imported auto parts. The internal charges under the measures apply when imported auto parts are used in manufacturing a vehicle and the quantities or values of imported parts exceed specified thresholds. The administrative burdens apply when any imported auto parts are used in vehicle manufacturing. Neither the internal charges nor the administrative burdens apply to domestic parts.

4.85 Before its accession, China imposed differential charges on imported auto parts based on the domestic content of the vehicles in which they were incorporated. As it committed to do in its Accession Protocol, China removed those differential charges and reduced its bound tariff rate on most auto parts to 10 per cent, and on most vehicles to 25 per cent, by 1 July 2006. China also specifically agreed that the tariff imposed on kits imported to form vehicles (described as either CKD or SKD kits) would be no more than 10 per cent.

2. The measures

4.86 The measures are contained in three documents:

- Policy Order 8;
- Decree 125; and
- Announcement 4.

4.87 Decree 125 and Announcement 4, both made effective on 1 April 2005, are legally binding instruments designed to implement and administer Policy Order 8.

(a) Substantive criteria for determining the imposition of internal charges at the "whole vehicle" rate

4.88 If a vehicle model is manufactured using imported parts that exceed specified quantity or value thresholds, all imported parts are considered to be "automobile parts characterized as complete vehicles" and assessed a charge of 25 per cent of the value of the imported parts. This 25 per cent charge equates to a 10 per cent tariff on the auto parts and an additional 15 per cent internal charge. Charges under the measures are levied, not at the border, but *after* the goods have entered into free circulation in the Chinese market and have been incorporated into manufactured vehicles. Imported parts will be automobile parts characterized as complete vehicles if any of the following three tests are met:

- As of 1 April 2005, when complete CKD or SKD kits are imported to assemble a vehicle.
- As of 1 April, 2005, if a sufficient number of assemblies characterized as imported assemblies are used in manufacturing the vehicle. Imported parts will be automobile parts characterized as complete vehicles if the following combinations of assemblies are characterized as imported:

– the two main assemblies (the vehicle body and engine);

– either of the two main assemblies as well as three or more other assemblies; or

– five or more assemblies, other than the main assemblies.

- As of 1 July 2006, when the aggregate price of imported parts reaches 60 per cent or more of the price of all parts used in a vehicle. However, this aspect of the measures was suspended by Customs Joint Bulletin 38, dated 5 July 2006, until 1 July 2008.

4.89 An assembly will be characterized as imported assembly and thus count against the thresholds if the value of imported parts comprises 60 per cent or more of the price of all parts used in the assembly, or if it uses more than a specified number of "key parts".

4.90 If the vehicle manufacturer produces a vehicle that uses imported parts that are automobile parts characterized as complete vehicles, the manufacturer will be required to pay a charge on *all* imported parts incorporated into the vehicle (i.e., not just the imported parts used in the automobile parts characterized as imported assembly).

(b) Administrative requirements imposed on vehicle and auto parts manufacturers when *any* imported parts are used

4.91 *Any* use of imported parts in vehicle manufacturing will subject a manufacturer to the burdensome administrative regime under the measures. The administrative requirements do not apply to vehicle manufacturers that use solely domestic parts. This may result in significant delays in receiving and using imported auto parts and affects a manufacturer's ability to source imported parts not included in a registered vehicle plan.

4.92 The administrative burden requires every vehicle manufacturer using imported parts, among other things, to:

(a) perform a self-evaluation on proposed vehicle models to determine if the quantity or value of imported parts to be used in manufacturing the vehicle renders those parts characterized as complete vehicles;

(b) provide the district customs office with a general duty guarantee where a vehicle model uses parts that are characterized as complete vehicles;

(c) file documents with the customs office showing the quantity and value of imported parts actually used in manufacturing a vehicle model. That filing must then be re-evaluated by the Chinese government's Verification Centre, and a verification report prepared; and

(d) pay internal charges based on the verification report.

4.93 Another administrative burden on the face of the measures is the deeming of imported parts to be "in bond". However, that deeming is a fiction. Imported auto parts are not subject to Chinese bonding requirements and are used freely at the manufacturing sites of vehicle and auto parts manufacturers.

4.94 The administrative requirements make it difficult to source imported parts not included in a vehicle model registered with CGA. Such changes may require repeating all the administrative hurdles to register and import parts. The effect is to limit the ability of vehicle manufacturers to freely source imported auto parts.

4.95 The measures also require manufacturers to track down the chain of supply to determine whether individual assemblies and key parts are to be treated as imported for purposes of the measures. As a result, parts manufacturers and suppliers that use imported parts have to maintain records of the quantity, type and cost of imported parts used in any parts incorporated into a manufactured vehicle. The parts manufacturers and suppliers do this in order to meet their contractual obligations to vehicle manufacturers and guarantee to them that they meet the domestic content requirements of the measures.

(c) Impact of the measures

4.96 The overall impact of the measures is to discriminate against imported auto parts by encouraging the use of domestic parts in auto parts and vehicle manufacturing in China. Due to the price-sensitivity of the Chinese market, vehicle and auto part manufacturers would be "priced out" of the Chinese marketplace if they passed on the additional 15 per cent internal charge to their customers, and they would suffer a loss if they absorbed the cost themselves. The result is that manufacturers are forced to meet the domestic content thresholds under the measures. This also serves to devalue the investment of foreign vehicle and auto parts manufacturers that had invested in China on the premise they would be able to import auto parts at the 10 per cent rate to which China bound itself in its Schedule of Concessions.

3. Legal argument

4.97 The measures are inconsistent with China's WTO obligations, including the terms of its Accession Protocol. Specifically, the measures result in the following violations:

- Articles III:2, III:4 and III:5 of the GATT 1994, and Articles 1.2 and 7.2 of the Accession Protocol;

- Article 2 of the TRIMs Agreement and Articles 1.2 and 7.3 of the Accession Protocol;

- Article II of the GATT 1994, and thereby Article 1.2 of the Accession Protocol; and

- Article XXIII:1(b) of the GATT 1994, in respect of, but not limited to, China's commitments under Article 1.2 of the Accession Protocol and paragraphs 93 and 342 of the Working Party Report.

(a) China is bound by the WTO Agreement and China's Accession Protocol

4.98 China agreed on its accession to be bound by all the obligations contained in the WTO Agreement and covered agreements, and all of the terms set out in its Accession Protocol. These terms include the specific commitments contained in its Working Party Report and its tariff commitments in its Schedule.

(b) The measures impose internal charges on internal trade in China

4.99 The measures regulate internal trade, not the process of importation. They are, therefore, subject to obligations relating to internal measures imposed by Article III of the GATT 1994, not obligations relating to border measures under Article II of the GATT 1994.

4.100 Internal charges and border charges can readily be distinguished. First, Members have a greater degree of flexibility in varying internal charges and duties than with tariffs. Internal charges need not be specified by a WTO Member and, subject to the restrictions in Article III of the GATT 1994 and elsewhere, they can be increased at will. In contrast, all border charges, both "ordinary customs duties" and "other duties and charges", must be limited to those recorded in a Member's Schedule against the tariff item to which they apply. Second, internal charges are imposed on activities occurring within the territory of a Member in relation to normal internal trade of a product, while border charges are imposed "at the time or point of importation". A Member may not, at its discretion, "deem" imported products not to have entered their internal commerce. To permit otherwise would allow Members subjectively to determine *after the fact* whether Articles II or III would apply to their charges.

4.101 China attempts to move the border inwards by deeming imported parts to be "bonded" while they are being used in manufacturing. However, this deeming is irrelevant: the measures apply charges and administrative requirements after imported parts have entered into commerce in China. As such, the measures are properly characterized as internal measures subject to the disciplines of Article III.

(c) The measures violate national treatment obligations in Articles III:2, III:4 and III:5 of the GATT 1994 and Articles 1.2 and 7.2 of *the Accession Protocol*

4.102 Under Articles 1.2 and 7.2 of China's Accession Protocol, China commits itself to remove and not to introduce measures contrary to Article III of the GATT 1994. Consequently, China's violations of Article III of the GATT 1994 set out below also constitute violations of the Accession Protocol.

(i) The measures violate Article III:2 first sentence of the GATT 1994

4.103 The measures violate Article III:2, first sentence of the GATT 1994, because they impose an internal charge on imported auto parts in excess of that imposed on like domestic parts. A measure is inconsistent with the first sentence where: (1) the imported and domestic products at issue are "like products"; and (2) the imported products are subject to internal charges "in excess of" those applied to the like domestic products.

4.104 WTO jurisprudence has established that origin alone cannot distinguish an imported product from an otherwise like domestic product. The measures' only distinction between imported and domestic auto parts is on the basis of origin, and therefore the parts are like for purposes of Article III:2.

4.105 Further, *any* taxation above that "in excess of" that applied to the like domestic product is inconsistent with Article III:2, first sentence. China has imposed a 15 per cent internal charge on imported auto parts, thereby taxing imported auto parts "in excess of" like domestic parts.

4.106 The measures therefore meet the two conditions required to show a violation of Article III:2, first sentence.

(ii) The measures violate Article III:4 of the GATT 1994

4.107 The measures violate Article III:4 of the GATT 1994 by providing less favourable treatment for imported auto parts than domestic auto parts. Three elements must be satisfied for a measure to violate Article III:4: (1) there are imported products that are like domestic products; (2) the measure constitutes a law, regulation or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution or use; and (3) that measure accords less favourable treatment to the imported products by modifying the conditions of competition in the relevant market to the detriment of imported products.

4.108 In the present circumstances, the only distinction between imported and domestic auto parts is their origin, which alone cannot distinguish an imported product from an otherwise like domestic product. Imported and domestic auto parts are, therefore, like for purposes of Article III:4.

4.109 The measures constitute "laws, regulations and requirements" affecting the sale, offering for sale, purchase, transportation, distribution or use of imported auto parts. This condition has broad application, and includes both obligations that an enterprise is "legally bound to carry out" and those that an enterprise voluntarily accepts in order to obtain an advantage from the government. The measures meet this second element as they are legally binding and affect the conditions of competition for imported auto parts.

4.110 The measures modify the conditions of competition, as required by the third element, in two ways.

(a) They create an economic incentive for manufacturers to use domestic parts. If a manufacturer exceeds the level of imported parts specified in the measures, even by a nominal quantity or value, that manufacturer is subject to additional charges equal to 15 per cent of the value of all imported parts that it uses.

(b) A vehicle manufacturer using *any* imported auto parts is subjected to burdensome administrative requirements. The only way to avoid these administrative requirements under the measures is for a vehicle manufacturer to use *solely* domestic auto parts.

4.111 China's measures violate Article III:4, as all three elements are satisfied.

(iii) The measures violate Article III:5, first sentence of the GATT 1994

4.112 The measures are inconsistent with Article III:5 of the GATT 1994, first sentence, by requiring the use of domestic auto parts in specified quantities or values. In order to find a violation of the first sentence of Article III:5, the measure must be: (1) an internal regulation; (2) that is quantitative, relating to the mixture, processing or use of products in specified amounts; and (3) requiring, directly or indirectly, the use of those products from domestic sources.

4.113 The measures constitute "internal regulations" as they are legally binding and regulate conduct with respect to the purchase, sale or use of imported auto parts in China.

4.114 The measures are quantitative and relate to the use of auto parts in specified amounts. The measures "relate" to the use of domestic parts and are "quantitative" as they specify quantity and value thresholds for the use of domestic parts. The measures therefore "relate" to the use of auto parts in specified amounts.

4.115 The measures "require" the use of domestic auto parts. If measures provide advantages conditioned on the purchase of a specified quantity of goods from domestic sources, then those measures "require" such a purchase. The measures "require" that vehicle manufacturers satisfy these domestic content thresholds because failure to meet such thresholds results in the imposition of the additional charges on all imported auto parts.

4.116 In summary, the measures violate Article III:5, first sentence, because they are internal quantitative regulations relating to the use of domestic auto parts in specified quantities and values that impose financial penalties if those specified quantities and values of domestic parts are not met.

(d) The measures violate the TRIMs Agreement and Articles 1.2 and 7.3 of the Accession Protocol

(i) The measures violate Article 2 of the TRIMs Agreement

4.117 The measures are inconsistent with Article 2 of the TRIMs Agreement because they are trade-related investment measures ("TRIM") that establish domestic-content thresholds that adversely affect imports of auto parts. In addition, the measures also violate Articles 1.2 and 7.3 of the Accession Protocol, which bind China to all obligations contained in the TRIMs Agreement.

4.118 The TRIMs Agreement applies where: (1) a challenged measure is a TRIM, i.e., an "investment measure" that is "trade-related"; and (2) the measure is inconsistent with Articles III or XI of the GATT 1994. The inconsistency required for the second element is apparent if the measure is included in the Illustrative List.

4.119 The measures constitute a TRIM. An "investment measure" includes receiving an advantage by meeting domestic content requirements, such as choosing to use domestic over imported goods. It also includes a measure designed to develop domestic manufacturing capability. The measures constitute an "investment measure" because they impose domestic content requirements that are designed to improve domestic auto parts manufacturing capability. "Trade-related" investment measures are those that adversely affect the conditions of competition between WTO Members respecting trade in goods, and necessarily include those that prescribe domestic-content requirements. As the measures specify domestic-content thresholds and apply to trade in auto parts, they are "trade-related".

4.120 The measures violate Article III of the GATT 1994, both for the reasons set out above regarding Article III generally and because they fall within paragraph 1(a) of the Illustrative List referenced in Article 2.2 of the TRIMs Agreement, and therefore necessarily violate Article III of the GATT 1994. A measure must satisfy two elements to fall within paragraph 1(a) of the Illustrative List: (1) it must be mandatory or enforceable, or there must be compliance with it in order to obtain an advantage; and (2) it must require the purchase of domestic product.

4.121 A simple advantage conditional on the use of domestic goods meets the requirement for the first element. The measures provide two distinct advantages conditional on the use of domestic auto parts: avoiding additional internal charges and avoiding additional administrative requirements.

4.122 The second element is met because the measures "require" vehicle manufacturers to meet specified quantities or values of domestic auto parts. If vehicle manufacturers do not comply, all imported parts used will be subject to an internal charge of 15 per cent. Accordingly, the measures "require" a specified quantity or value of domestic content in order to avoid those internal charges.

4.123 In sum, the measures are a TRIM that is inconsistent with Article 2 of the TRIMs Agreement and China's Accession Protocol.

(e) Even if the measures are characterized as tariffs, they violate Article II:1 of the GATT 1994 and China's Accession Protocol

4.124 Canada has submitted that the measures impose an internal charge. However, if the Panel determines, contrary to Canada's position, that the additional charge under the measures constitutes a tariff on the importation of auto parts, then the charge violates Article II:1(a) and (b) of the GATT 1994, Article 1.2 of the Accession Protocol and China's Schedule, by imposing a tariff rate on auto parts greater than 10 per cent.

(i) China's tariff commitments in its Schedule with respect to auto parts and whole vehicles

4.125 The relevant bound tariff rates in China's Schedule fall into three categories:

- **whole vehicles,** whose bound tariff rate is generally 25 per cent;
- **vehicle chassis fitted with engines and bodies**, whose bound tariff rate is generally 10 per cent; and
- **auto parts**, whose bound tariff rate is generally 10 per cent.

4.126 There is presently no explicit tariff line in China's Schedule for CKD and SKD kits, but China specifically committed in the Working Party Report to charge them a tariff no greater than 10 per cent, a commitment incorporated into the Accession Protocol in Article 1.2.

4.127 The only relevant factor in levying a customs tariff is the classification of the product based on its condition at the time of importation at the border. Contrary to this well-established principle, the measures impose a 25 per cent charge on imported auto parts characterized as complete vehicles *after* importation based upon their use in manufacturing. China has therefore violated its GATT and Accession Protocol obligations to apply a tariff rate of 10 per cent on imported auto parts.

(ii) The measures provide "less favourable treatment" than is set out in China's Schedule and are thereby inconsistent with Article II:1(a) and (b) of the GATT 1994

4.128 Article II:1(b) of the GATT 1994 contains two distinct commitments. A Member may not, except as set out in its Schedule, impose in connection with the importation of products from other Members: (1) any ordinary customs duty; or (2) any other duty or charge.

4.129 Canada has submitted that, should the Panel determine, contrary to Canada's position that the measures impose internal charges, that the entire 25 per cent charge under the measures constitutes a tariff on importation of auto parts, then that charge is an ordinary customs duty "in excess of" that set forth in China's Schedule. Imported parts are not whole vehicles. China, through its arbitrary deeming of imported parts as whole vehicles and thus charging a 25 per cent tariff rate, provides less favourable treatment to imported auto parts than that provided for in its Schedule, contrary to Article II:1(b), first sentence.

4.130 If the charge under the measures is not an "ordinary customs duty", it must be an "other duty or charge". China has not recorded the measures as an "other duty or charge" in its Schedule. Therefore, the additional 15 per cent charge on auto parts, even if it is an "other duty or charge",

violates Article II:1(b), second sentence, by imposing charges not set out in China's Schedule, and Article II:1(a), by providing less favourable treatment to auto parts from Canada than China's Schedule permits.

4.131 Further, in the Working Party Report China committed to charging no more than 10 per cent for parts imported as CKD and SKD kits. China's imposition of a 25 per cent charge on CKD and SKD kits therefore violates its obligations under the WTO Agreements.

(f) China's measures nullify or impair benefits accruing to Canada under Article XXIII:1(b) of the GATT

4.132 Even if the Panel finds, contrary to Canada's position, that China is entitled to charge a tariff rate in excess of 10 per cent on CKD and SKD kits, China has nevertheless nullified or impaired benefits owing to Canada in the sense of Article XXIII:1(b) of the GATT 1994. A complaining party must establish three elements for a claim under Article XXIII:1(b): (1) application of a measure by a WTO Member; (2) a benefit accruing under the relevant agreement, including legitimate expectations of improved market access opportunities arising out of relevant tariff concessions; and (3) the nullification or impairment of the benefit as the result of the application of the measure.

4.133 The measures are legally enforceable measures applied to imported auto parts from other Members. As such they are "measures" within the meaning of Article XXIII:1(b).

4.134 Canada had a benefit accruing: a legitimate expectation of improved market access opportunities for auto parts imported, notably that CKD and SKD kits would be charged tariffs no greater than 10 per cent. That expectation derives from China's Schedule, where tariff lines for auto parts are bound at 10 per cent. It also derives from China's commitment in paragraph 93 of the Working Party Report, incorporated as an obligation in Article 1.2 of the Accession Protocol, to charge no more than 10 per cent on CKD and SKD kits.

4.135 China has nullified or impaired that benefit by upsetting the competitive relationship between imported and domestic auto parts by imposing on imported auto parts an additional 15 per cent internal charge that is not imposed on domestic auto parts.

4.136 Thus, the three elements are met for establishing that China has nullified or impaired a concession to Canada within the meaning of Article XXIII:1(b) of the GATT 1994.

D. FIRST WRITTEN SUBMISSION OF CHINA

1. Introduction

4.137 This case concerns the relationship between substance and form in the administration of national customs laws. The European Communities, the United States, and Canada submit that the GATT 1994 does not permit China to look beyond the *form* of how an auto manufacturer imports and assemble auto parts into complete motor vehicles. China considers that, on the contrary, its authority to give effect to the *substance* of how an auto manufacturer imports and assembles auto parts is entirely supported by Article II of the GATT 1994.

4.138 Under GIR 2(a), customs authorities should classify as a complete article any group of parts and components that has the essential character of that article, regardless of the state of assembly or disassembly of the parts and components at the time of importation. The issue presented in this dispute is whether the manner in which an importer chooses to structure its imports of parts and

components should change this classification result. In particular, the issue presented is whether customs authorities must assign a different classification to a group of imported parts and components merely because the parts and components enter the customs territory in multiple shipments.

4.139 The measures challenged in this proceeding give effect to China's tariff provisions for "motor vehicles" by defining the circumstances under which China will classify imported auto parts and assemblies as having the essential character of a motor vehicle. These measures are designed to reach the same classification determination without regard to whether the imported auto parts and assemblies enter China in one shipment or in multiple shipments. The measures thereby ensure that the substance of an auto manufacturer's import transactions prevails over their form, and prevent the circumvention of China's tariff provisions for motor vehicles.

4.140 China will demonstrate that the measures at issue are border measures subject to the disciplines of Article II of the GATT 1994. China will further demonstrate that these measures give effect to a proper interpretation of the term "motor vehicles" in China's Schedule of Concessions, and therefore do not result in the imposition of ordinary customs duties in excess of China's bound commitments. The claims advanced by complainants on the contrary assumption that the challenged measures are internal measures subject to Article III of the GATT 1994 are without basis, and the Panel should reject them.

2. The measures

4.141 China's tariff commitments with respect to motor vehicles are set forth in Chapter 87 of its Schedule of Concessions. With limited exceptions, China's bound duty rate for motor vehicles is 25 per cent. Different tariff headings under Chapters 84, 85, and 87 set forth China's commitments with respect to parts and assemblies of motor vehicles. In almost all cases, the bound duty rate for parts and assemblies of motor vehicles is 10 per cent.

4.142 The difference between the higher tariff rates for motor vehicles and the lower tariff rates for parts and assemblies of motor vehicles creates an incentive for auto manufacturers to take a collection of auto parts and assemblies that has the essential character of a motor vehicle under GIR 2(a), export those parts and assemblies to China in multiple shipments, and assemble them domestically into a complete motor vehicle. Auto manufacturers can thereby import a group of auto parts and assemblies that would have been classified as a complete motor vehicle had it entered China in a single shipment, and evade the higher duty rate that applies to motor vehicles. This type of tariff evasion deprives China of duly-owned revenues and undermines the effectiveness of the tariff concessions that China negotiated upon its accession to the WTO.

4.143 As other WTO Members have done under like circumstances, China adopted measures to define the boundary between complete motor vehicles and the parts and assemblies of motor vehicles, and to prevent tariff circumvention. The principal measure that China adopted for this purpose, and that is challenged in this proceeding, is the *Administrative Rules on Importation of Automobile Parts Characterized as Complete Vehicles,* which took effect on 1 April 2005. This measure is known as "Decree 125". Decree 125 is further implemented in Announcement 4, "Rules on Verification of Imported Automobile Parts Characterized as Complete Vehicles".

4.144 The basic objective of Decree 125 is to establish a uniform methodology for determining whether a group of imported auto parts has the essential character of a complete motor vehicle, and to apply that methodology without regard to whether the auto parts in question enter China in a single shipment or multiple shipments. Decree 125 requires every auto manufacturer in China, without regard to the extent of its domestic or foreign ownership, to conduct an evaluation of each vehicle

model that it produces. The purpose of this evaluation is to determine whether the imported parts and assemblies that the manufacturer uses to assemble that vehicle model should be characterized as having the essential character of a complete motor vehicle, based on a series of thresholds set forth in the measure.

4.145 If, as a result of the evaluation, the auto manufacturer determines that a particular vehicle model is assembled from imported parts and assemblies having the essential character of a motor vehicle, the manufacturer must register that model with the CGA. Thereafter, when auto parts are imported for use in the assembly of that model, the importer must declare those parts at the time of importation as parts of a complete motor vehicle. The importer is required to provide a customs bond for those entries, and the parts remain under customs control after they cross the border.

4.146 When the auto manufacturer assembles the imported parts and components in accordance with the declaration made at the time of importation, i.e., as part of a larger group of imported parts and components having the essential character of a motor vehicle, the CGA assesses the imported parts and components at the tariff rate for motor vehicles. This tariff rate applies only to the imported parts and assemblies in the assembled vehicle. The CGA calculates the amount of duty liability on the imported parts and assemblies in accordance with the ordinary customs laws and regulations of China.

4.147 The overall effect of this system is to base the tariff classification of imported auto parts and components on the commercial reality of what the auto manufacturer is importing and assembling. If the auto manufacturer plans to import and assemble parts that, in their quantity and character, have the essential character of a complete vehicle, then it must register that intent in advance and declare those imports accordingly. Auto parts that are imported for this purpose enter China in bond, and the CGA collects the appropriate duties when the imported auto parts are assembled in accordance with the declarations made at the border. These measures ensure that there is no difference in tariff classification or duty liability based solely on how the auto manufacturer structures its imports.

3. Legal argument

(a) The measures are border measures subject to Article II of the GATT 1994

4.148 The threshold issue before the Panel is whether the challenged measures are border measure subject to Article II of the GATT 1994, or whether they are internal measures subject to Article III of the GATT 1994. The Panel must resolve this issue at the outset to determine which provisions of the covered agreements are relevant to its evaluation of the conformity of the challenged measures.

4.149 The challenged measures implement and enforce the provisions of China's Schedule of Concessions relating to "motor vehicles" by defining the circumstances under which China will classify imported auto parts and assemblies as having the essential character of a motor vehicle.

4.150 The measures operate on the basis of a prior determination that an auto manufacturer intends to assemble a particular vehicle model from imported parts and assemblies that have the essential character of a motor vehicle. When an importer subsequently imports auto parts and assemblies into China for the purpose of assembling one of these vehicle models, the declaration that it is required to make at the time of importation imposes a condition upon the entry of goods into China. That condition is that the CGA will assess the imported auto parts and assemblies at the tariff rate for motor vehicles when they are used in the assembly of the designated vehicle model. This condition is secured by the provision of a bond, and the imported auto parts and assemblies remain in a bonded status until they are used in accordance with the declaration.

4.151 These characteristics of the challenged measures result in the imposition of ordinary customs duties on auto parts and assemblies "on their importation" into the customs territory of China, within the meaning of Article II:1(b) of the GATT 1994. Consistent with a proper interpretation of Article II:1(b) under the *Vienna Convention,* and consistent with prior interpretations of this provision, a measure falls within the scope of Article II if it imposes charges that are conditional upon the importation of a product into the customs territory of a Member.

4.152 Contrary to the arguments of the United States and Canada, the conclusion that the challenged measures fall within the scope of Article II is supported, not undermined, by the adopted GATT panel report in *EEC – Parts and Components.* That report interpreted the scope of Article II to include charges that are "imposed conditional upon the importation of a product or at the time or point of importation."[22] As demonstrated by the widespread customs practices of WTO Members, this includes charges that are imposed subsequent to the point at which goods physically cross the border, so long as any such charges objectively relate to a duty obligation that arose as a condition of importation. The challenged measures operate in precisely this way.

4.153 In addition, the anti-circumvention measures that the panel in *EEC – Parts and Components* found to be inconsistent with Article III of the GATT 1994 were materially different than the measures at issue in this proceeding. Following the adoption of the Panel report in *EEC – Parts and Components,* the European Communities significantly revised its anti-circumvention measures to address the concerns identified by that panel and to place the measures squarely within the framework of Article II. The EC has taken the position that its revised measures do not impose internal taxes or charges subject to Article III of the GATT 1994. The measures that China has adopted to prevent circumvention of its tariff provisions for motor vehicles operate on the same basis as the revised EC measures, and do not have the flaw that formed the basis for the panel's findings in *EEC – Parts and Components.*

4.154 For these reasons, the challenged measures are subject to the disciplines of Article II of the GATT 1994, and it is on this basis that the Panel must evaluate the conformity of the challenged measures with China's WTO obligations.

(b) The measures are consistent with Article II of the GATT and do not collect ordinary customs duties in excess of China's bound commitments

(i) China's interpretation of its tariff schedule is consistent with its ordinary meaning, in context and in light of its object and purpose

4.155 The central issue before the Panel is whether the challenged measures give effect to a proper interpretation of the term "motor vehicles" as used in China's Schedule of Concessions. In particular, the interpretive issue is whether the term "motor vehicles" can encompass the importation, in multiple shipments, of auto parts and assemblies that have the essential character of a motor vehicle when assembled. In accordance with the Appellate Body's holding in *EC – Computer Equipment,* the Panel must resolve this interpretive issue in accordance with "the general rules of treaty interpretation set out in the *Vienna Convention*."[23]

4.156 Critical context for the resolution of this interpretive issue is provided by GIR 2(a) of the HS, which states:

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[22] GATT Panel Report on *EEC – Parts and Components*, para. 5.5.
[23] Appellate Body Report on *EC – Computer Equipment*, para. 84.

> Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled.

4.157 The application of GIR 2(a) to the interpretation of the term "motor vehicles" gives rise to several circumstances in which customs authorities should classify auto parts and assemblies as "motor vehicles," and not as parts and assemblies of motor vehicles:

- First, the importation of a completely assembled motor vehicle is clearly the importation of a "motor vehicle," even though it is necessarily composed of the parts and components of a motor vehicle.

- Second, the importation of 100 per cent of the parts necessary to assemble a motor vehicle is the importation of a "motor vehicle," and not the parts of a motor vehicle, regardless of their state of assembly or disassembly. Thus, for example, a completely knocked-down ("CKD") kit is classified as a motor vehicle, not as parts of a motor vehicle.

- Finally, the importation of *less* than 100 per cent of the parts necessary to assemble a complete motor vehicle is the importation of a "motor vehicle," and not the parts of a motor vehicle, provided that the imported parts, when assembled, have the essential character of a motor vehicle.

4.158 As is evident from GIR 2(a) and these examples, there is no clear dividing line between tariff provisions for a complete article (such as motor vehicles) and separate tariff provisions for the parts and components of that article (such as parts and assemblies of motor vehicles). There is necessarily a continuum of circumstances under which the parts and components of an article will be classified as the complete article.

4.159 Further context for the interpretation of the term "motor vehicles" in China's Schedule of Concessions is provided by Note VII of the Explanatory Notes to GIR 2(a), which states that "unassembled components of an article which are in excess of the number required for that article when complete are to be classified separately." As other customs authorities have recognized, the effect of this rule is that a collection of parts is classified, in the first instance, as the total number of complete articles that can be assembled from those parts (including articles that have the essential character of the complete article). Any separate tariff provisions for parts and components therefore encompass the importation of parts other than for the purpose of assembling a complete article from imported parts.

4.160 The challenged measures apply the interpretive rules of GIR 2(a), including Note VII, in two basic respects.

4.161 First, the challenged measures define the thresholds at which China will classify a collection of auto parts as having the essential character of a complete motor vehicle. Because GIR 2(a) provides that something less than 100 per cent of the parts necessary to assemble the complete article can have the essential character of the complete article, regardless of their state of assembly or disassembly, it benefits customs authorities and importers alike to have certainty with respect to the boundary between motor vehicles and the parts and assemblies of motor vehicles.

4.162 Second, the challenged measures apply the interpretive rules of GIR 2(a) to ensure that the substance of an auto manufacturer's import activities prevails over their form. The United States has stated, and China agrees, that it is "a general principle of international customs practice that substance should prevail over the form of a transaction."[24] Consistent with this principle, the challenged measures apply the interpretive rules of GIR 2(a) without regard to whether the imported auto parts and components used to assemble a motor vehicle enter China in one shipment or in multiple shipments. This ensures that tariff classifications do not change based solely on how an auto manufacturer chooses to structure its imports.

4.163 The application of the interpretive rules of GIR 2(a) to multiple shipments of auto parts and assemblies is consistent with the object and purpose of China's Schedule of Concessions and of Article II of the GATT 1994. The Appellate Body has observed that one object and purpose of the WTO Agreement and the GATT 1994 is to "maintain[] the security and predictability of reciprocal market access arrangements manifested in tariff concessions …".[25] The Appellate Body has stated that the interpretation of a Schedule of Concessions must recognize that tariff arrangements negotiated by Members are meant to be "reciprocal and mutually advantageous".[26]

4.164 The difference in tariff rates between motor vehicles and parts and assemblies of motor vehicles is part of the "reciprocal and mutually advantageous" market access arrangements that China negotiated with other WTO Members. It is therefore consistent with the "security and predictability of reciprocal market access arrangements" to interpret China's Schedule of Concessions to prevent the circumvention of this tariff rate difference through the importation and assembly of auto parts that have the essential character of a motor vehicle. At the same time, China continues to give effect to its separate tariff provisions for auto parts and assemblies by classifying parts and assemblies under these headings when they are not used to circumvent the higher tariff rates on motor vehicles. This ensures that the overall balance of market access arrangements with respect to motor vehicles and motor vehicle parts is maintained.

(ii) China's interpretation of its tariff schedule is consistent with the practice of other Members in preventing the circumvention of duties

4.165 Numerous WTO Members, including all three complainants in this proceeding, have adopted measures that prohibit the use of domestic assembly operations as a means of circumventing duties that apply to complete articles, whether they are ordinary customs duties or anti-dumping/countervailing duties. Under Article 31 of the *Vienna Convention,* this practice "constitutes objective evidence of the understanding of the parties" with respect to the distinction between the imposition of duties on complete articles and the imposition of duties on the parts and components of those articles.[27]

4.166 This practice demonstrates that Members have applied the interpretive rules of GIR 2(a) to classify multiple shipments of parts and components as having the essential character of the complete article, and have done so where necessary to prevent the circumvention of duties that apply to the complete article. The common objective of these measures is to ascertain what Canada has referred to as the "commercial reality" underlying multiple imports of parts and components.

[24] GATT Panel Report on *EEC – Parts and Components*, para. 4.37 (describing US argument).

[25] Appellate Body Report on *EC – Chicken Cuts*, para. 243.

[26] Appellate Body Report on *EC – Chicken Cuts (AB)*, para. 243 (quoting *EC – Computer Equipment*, para. 82).

[27] Appellate Body Report on *EC – Chicken Cuts*, para. 255.

4.167 In applying anti-circumvention measures, Members have made the duty liability that arises at the time of importation conditional upon whether imported parts and components are used to assemble complete articles. Members have also adopted measures that track the final use of imported parts and components as a means of determining whether parts and components were imported for the purpose of circumventing duties that apply to the complete article. In connection with these measures, Members have imposed bonding or other security requirements to ensure the collection of any duty liability that applies to the complete article.

4.168 The measures adopted by China to prevent circumvention of its tariff rates for motor vehicles are entirely consistent with these practices of other WTO Members under like circumstances. Under Article 31 of the *Vienna Convention,* this practice demonstrates that China has properly interpreted its tariff provisions for "motor vehicles" to include the importation, in multiple shipments, of auto parts and assemblies that have the essential character of a motor vehicle when assembled.

4.169 Moreover, because these anti-circumvention practices existed at the time of China's accession to the WTO, they constitute circumstances surrounding the conclusion of China's Schedule of Concessions, and therefore bear upon the interpretation of the term "motor vehicles" under Article 32 of the *Vienna Convention*.

(iii) China's interpretation of its tariff schedule is based on the condition of goods at the time of importation

4.170 The measures that China has adopted to prevent circumvention of its tariff rates for motor vehicles are based on the demonstrated and declared intention of the manufacturer to assemble complete motor vehicles from multiple shipments of auto parts and assemblies. As the customs practices of other WTO Members demonstrate, this type of measure is consistent with the general principle that merchandise is ordinarily classified based on its condition at the time of importation.

4.171 The practice of all three complainants in this proceeding demonstrates that there are circumstances under which Members will make a determination of duty liability based on the combination of multiple shipments of parts. This is necessarily an element of preventing the circumvention of duties on complete articles, as reflected in the measures that Members have adopted for this purpose.

4.172 Members have also combined multiple shipments of parts and components for classification purposes in dealing with so-called "split shipments". Under these measures, such as the split shipment regulation recently adopted by the United States, customs authorities can base a tariff classification on the combination of multiple shipments. One circumstance in which customs authorities classify split shipments on this basis is where the importer intends to assemble parts and components into a complete article. This type of measure is necessarily based on an understanding of the "condition as imported" rule that looks beyond the contents of a single import entry, and that rests instead on the stated intention of the importer to assemble separate shipments of parts and components into a complete article.

4.173 These types of measures are consistent with the decision of the WCO that "the questions of split consignments and the classification of goods assembled from elements originating in or arriving from different countries are matters to be settled by each country in accordance with its own national regulations."[28] On this basis, Members have adopted practices under GIR 2(a) that permit the

[28] World Customs Organization, Decisions of the Harmonized System Committee, *Interpretation of General Interpretative Rule 2(a)*, HSC/16/Nov. 95, Doc. 39.600 (CHI-29).

classification of imports based on the combination of multiple entries, including under circumstances in which the importer intends to assemble parts and components into a complete article.

(iv) Any ambiguity concerning the measures should be resolved in China's favour under the principle of in dubio mitius

4.174 China does not believe that there is any ambiguity concerning the interpretation of the term "motor vehicles" as it relates to China's Schedule of Concessions. China considers that the interpretation of the term "motor vehicles" to which the challenged measures give effect is consistent with the ordinary meaning of that term in context and in light of the object and purpose of the GATT, and is also consistent with the practice of other WTO Members under like circumstances.

4.175 However, if the Panel were to identify any ambiguity in the meaning of the term "motor vehicles," or any ambiguity concerning China's authority under Article II of the GATT 1994 to adopt the challenged measures, the Panel should apply the principle of *in dubio mitius* so as to minimize any imposition on the sovereign authority of China to enforce its customs laws.

4.176 The Appellate Body has affirmed that "if the meaning of a term is ambiguous, that meaning is to be preferred which is less onerous to the party assuming an obligation, or which interferes less with the territorial and personal supremacy of a party, or involves less general restrictions on the parties."[29] The application of that principle in this case should lead the Panel to interpret the term "motor vehicles" to preserve for China the same scope of sovereign authority that other WTO Members have exercised to interpret and enforce their customs laws, and to prevent the use of domestic assembly operations as a means of circumventing duties on complete articles.

4. Claimants have failed to demonstrate a violation of Article III of the GATT 1994, the TRIMs Agreement, Part I, Article 7.2 of the Accession Protocol or Part I, Article 7.3 of the Accession Protocol

4.177 China has demonstrated above that the measures challenged in this proceeding are border measures subject to the disciplines of Article II of the GATT 1994. The Panel should therefore evaluate the challenged measures under Article II.

4.178 Because the challenged measures are border measures, complainants' specific claims under Article III of the GATT 1994, the TRIMs Agreement, Part 1.7.2 of the Accession Protocol, and Part I.7.3 of the Accession Protocol, are all without basis. All of these claims are premised on the erroneous assertion that the challenged measures are internal measures.

5. The United States and the European Communities have failed to demonstrate a violation of the SCM Agreement

4.179 The United States and the European Communities contend that China foregoes revenue within the meaning of Article 1.1 of the SCM Agreement by not imposing its tariff rates for motor vehicles on *all* imports of auto parts and components. They further contend that this "foregone revenue" is contingent upon the use of domestic over imported goods, and thus constitutes a prohibited subsidy under Article 3.1(b) of the SCM Agreement.

4.180 The United States and the European Communities claim under the SCM Agreement merely underscores their mischaracterization of the purpose of the challenged measures. The fact that China

[29] Appellate Body Report on *EC – Hormones*, para. 165, n. 154.

has adopted measures to prevent the circumvention of its tariff provisions for motor vehicles does not mean that China must impose the tariff rates for motor vehicles on all imported auto parts. On the contrary, China must continue to give effect to its separate tariff provisions for auto parts, and assess imported auto parts at those rates when they are not used to circumvent the duties that apply to complete articles. The United States and the European Communities claims under the SCM Agreement are therefore without basis.

6. The complainants' claims in respect of China's Accession Protocol and Article XXIII of the GATT 1994 must fail

4.181 In ways that are not entirely consistent with each other, the complainants allege that the challenged measures violate the commitment that China made in paragraph 93 of the Working Party Report, incorporated by reference into the Accession Protocol and the WTO Agreement, concerning separate tariff lines for CKD and SKD kits. In addition, Canada alleges nullification and impairment of tariff benefits under Article XXIII:1(b) of the GATT 1994, also premised upon its interpretation of paragraph 93 of the Working Party Report.

4.182 Paragraph 93 of the Working Party Report states:

> Certain members of the Working Party expressed particular concerns about tariff treatment in the auto sector. In response to questions about the tariff treatment for kits for motor vehicles, the representative of China confirmed that China had no tariff lines for completely knocked-down kits for motor vehicles or semi-knocked down kits for motor vehicles. If China created such tariff lines, the tariff rates would be no more than 10 per cent. The Working Party took note of this commitment.[30]

4.183 Complainants have failed to demonstrate a prima facie violation of this limited and conditional commitment. Complainants have neither alleged nor demonstrated that China has created separate tariff lines for CKD/SKD kits. In fact, it is evident on the face of Decree 125 that China continues to adhere to the rule, established by GIR 2(a), that CKD/SKD kits are classified as complete motor vehicles. Article 2 of Decree 125 states that "automobile manufacturers importing [CKD/SKD] kits may declare such importation to the customs in charged of the area where the manufacturer is located and pay duties, *and these Rules shall not apply.*" This provision exists precisely because there is no doubt as to the proper tariff classification of imported CKD/SKD kits – they are classified as complete vehicles under all circumstances, as complainants have acknowledged in other circumstances and as their own customs practices demonstrate.

4.184 The apparent basis for the United States and Canadian claims under paragraph 93 is their assertion that China had a practice, prior to its accession to the WTO, of classifying CKD/SKD kits as "parts." Even if it were possible to interpret paragraph 93 of the Working Party Report to require China to continue this alleged practice, the sole source of evidence on which they rely to establish the existence of this practice does not support their claim. In fact, it is clear from complainants' own review of China's pre-accession policies that China generally prohibited the assembly of motor vehicles from CKD/SKD kits prior to its accession to the WTO. Moreover, during the only period in which China maintained separate tariff lines for CKD/SKD kits (1992 to 1995), the tariff rates for CKD/SKD imports were the same as the tariff rates for motor vehicles – not the lower tariff rates for parts and assemblies of motor vehicles.

[30] Working Party Report, para. 93.

4.185 For these reasons, the various claims that complainants assert based on their interpretations of paragraph 93 of the Working Party Report are without basis.

7. Any inconsistency with the GATT 1994 is subject to the general exception under Article XX(d)

4.186 The Panel may find, contrary to China's arguments, that the challenged measures are inconsistent with one or more provisions of the GATT 1994, or that particular aspects of the challenged measures are inconsistent with the GATT 1994. Should the Panel make any such finding, China considers that the challenged measures are justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with China's customs laws.

4.187 The challenged measures secure compliance with China's customs laws and regulations by preventing the importation and assembly of auto parts as a means of circumventing China's tariff provisions relating to motor vehicles. They are therefore within the purview of Article XX(d).

4.188 Applying the balancing test that the Appellate Body most recently articulated in *Dominican Republic – Import and Sale of Cigarettes,* the challenged measures are "necessary" because, *inter alia,* they further China's substantial interest in collecting tariff revenues and preserving the effectiveness of its negotiated tariff concessions. The measures contribute to the realization of these interests by ensuring that tariff classifications are based on the substance of what an auto manufacturer imports and assembles, and not the form of the shipments. Moreover, the challenged measures have little or no restrictive impact on international trade, as their only purpose is to ensure that the correct tariff rates are collected. The fact that the challenged measures had had no impact on trade and investment has been noted by several of the world's largest auto manufacturers and auto parts suppliers.

4.189 For these reasons, and in the event that the Panel finds that one or more aspects of the challenged measures is inconsistent with the GATT 1994, China has provisionally demonstrated that any inconsistency between the challenged measures and China's GATT obligations is subject to the general exception under Article XX(d).

8. Conclusion

4.190 For the reasons set forth in China's first written submission, as summarized herein, China requests the Panel to reject the claims raised by the European Communities, the United States, and Canada.

E. ORAL STATEMENT BY THE EUROPEAN COMMUNITIES AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

1. Introduction

4.191 The co-complainants have already in their written submissions co-ordinated positions to facilitate the proper conduct of these panel proceedings. This is also the case today so we will be relatively brief in order to avoid unnecessary repetition. In this opening statement, the European Communities will present its main claims. The European Communities will demonstrate that the contested measures violate the *TRIMs Agreement* and Article III of the GATT 1994. Subsequently the European Communities will also address the key elements that come up in China's first written submission with regard to Article II of the GATT 1994 and the SCM Agreement. The European Communities reserves of course its full position on China's first written submission to its formal written rebuttal submission. In particular, the European Communities will address China's alternative

defence based on Article XX(d) of the GATT 1994 in its rebuttal submission although the European Communities associate itself with the observations the United States and Canada will make in a moment.

4.192 However, before turning to the details of the case and in order to understand the issues in their proper context the European Communities must first say a few words about China's industrial policy in the automotive sector.

4.193 China has a history of imposing charges on imported auto parts depending on the amount of domestic content in complete vehicles in order to promote local production of vehicles and auto parts in China. Before WTO accession, China imposed higher charges on imported auto parts used in the domestic production of vehicles if the manufacturer importing these parts did not meet certain domestic content in the final vehicle produced. This policy was based on its 1994 Automotive Industry Policy, which China had to remove as part of its Accession Protocol to the WTO.

4.194 China has now decided to reintroduce its old policy despite its explicit commitment not to do so. It has adopted the contested measures that impose again local content requirements on vehicles manufactured in China.

4.195 This case is based on simple and largely undisputed facts.

4.196 In its Schedule of concessions, China has committed to a tariff rate of 25 per cent for complete vehicles and of 10 per cent for auto parts. Previously this difference was even greater. However, in 2004, China again decided to stimulate the local production of auto parts. According to Article 4 of Policy Order 8, China's objective is to

> "Nurture a group of relatively strong auto-parts manufacturers to achieve large-scale production such that they are able to participate in the global auto parts supply chain as well as be internationally competitive."

4.197 In order to foster this objective, China introduced measures that in many cases impose charges on imported auto parts that equal the full tariff rate on complete vehicles, i.e. 25 per cent instead of 10 per cent. This results in an additional charge equal to the difference between the rates for vehicles and parts, typically 15 per cent. These charges are imposed after the manufacture of the parts into vehicles and provided that the vehicles do not contain sufficient local content. Domestic auto parts are exempt from these charges. The effect of the measures is to discourage manufacturers from importing auto parts and, thus, to afford protection to domestic production.

4.198 In sum, this case is about measures that China introduced to protect its local auto parts industry from imports through a local content rule. This case is about discrimination, and not – as China would like to present it – about tariff circumvention.

4.199 Although based on very simple and largely undisputed facts that consist essentially of the text of the measures, this case is very important since it is about the very core principles of the WTO system, namely the principles of non-discrimination and the security and predictability of the multilateral trading system. Without adherence to these principles the system established by the WTO Agreement would lose most of its meaning. As a Member of the WTO, China has to adhere to these principles.

2. China's failure to respond to a prima facie case

4.200 The European Communities and its co-complainants have established a prima facie case of inconsistency between the Chinese measures and Article 2 of the TRIMs Agreement and Article III, paragraphs 2, 4 and 5 of the GATT 1994. According to established principles on the burden of proof, it is now for China to attempt to provide the arguments and the proof to the contrary.

4.201 However, in its first written submission China has decided to largely ignore these claims of the complainants and insists that the Panel must first decide as a "threshold issue" whether the measures are "border measures" or not. We wonder if and when China will address our main claims.

4.202 This is all the more remarkable since an analysis, in particular under the TRIMs Agreement, very clearly requires no preliminary assessment as to whether a measure is a "border measure" or an "internal measure". The European Communities is of the view that the approach taken by China risks to unduly delay these panel proceedings and compromise due process. This would be regrettable.

3. The TRIMs Agreement and Article III of the GATT 1994

4.203 The European Communities considers that the Chinese measures are inconsistent with the TRIMs Agreement and Article III, second, fourth and fifth paragraph of the GATT 1994. Let me very briefly set out why.

(a) The TRIMs Agreement

4.204 The measures are inconsistent with Article 2 of the TRIMs Agreement.

4.205 First, the measures are "investment measures". They aim at the development of a local manufacturing capability for auto parts and finished motor vehicles in China. In addition to the provision quoted in the introduction, this objective is reflected in numerous other provisions of Policy Order 8, of Decree 125 and of Announcement 4. It is inherent to this objective that the measures have a significant impact on investment in this sector. The whole investment strategy of both local and foreign vehicle and part manufacturers is governed by the constraints laid down by the measures.

4.206 Secondly, the measures are "trade-related" because they apply and relate only to imported parts.

4.207 Finally, the measures fall squarely within the description of paragraphs 1 (a) and 2 (a) of the Illustrative List annexed to the TRIMs Agreement.

4.208 In other words, the measures are trade-related investment measures that

- contain local content requirements, and
- restrict the importation of products used in local production.

4.209 China's response to the analysis by the European Communities is limited to the statement that its measures are border charges and, therefore, do not fall under the TRIMs Agreement. This is remarkable since an analysis under the TRIMs Agreement does not require any preliminary position as to whether the measures are internal or border measures. Therefore, the European Communities can only underline the position it has taken in its first written submission and assume that China considers the measures as otherwise indefensible under Article 2 of the TRIMs Agreement.

4.210 As the measures are precisely of the kind that China specifically undertook to eliminate and cease to enforce as a condition of its accession to the WTO, they are also in breach of China's Accession Protocol and in particular Part I, Article 7.3 thereof.

(b) Article III of the GATT 1994

4.211 As with the TRIMs Agreement, China bases its entire defence strategy on the premise that the measures are border measures and therefore not "internal" within the meaning of Article III of the GATT 1994. The European Communities cannot agree with this position.

4.212 First, the Chinese measures impose charges on imported auto parts depending on whether they are actually assembled and manufactured into complete vehicles that do not have sufficient local content. Thus, they are not "imposed on or in connection with the importation" within the meaning of Article II(1)(b) of the GATT 1994. In other words, their application depends on how the parts are used after importation and, in particular, whether they are assembled in China into vehicles with an insufficient level of local content as set out by the measures.

4.213 Secondly, the measures impose charges on auto parts not at the time of importation, but only after they have been manufactured.

4.214 The internal nature of the measures is further illustrated by the fact that they apply directly only to vehicle manufacturers, rather than to the importers of the auto parts. Thus, manufacturers have to pay charges even if they purchase parts on the Chinese internal market from suppliers that previously imported them. This follows clearly from Article 29 of Decree 125.

4.215 Contrary to China's argument, the declaration of imported goods under Article 15 of Decree 125 does not make the charges border measures. First, the declaration is only one in a series of acts manufacturers have to accomplish under the measures. Secondly, the declaration itself does not concern the imported parts as presented at the border but a prediction about their future role in vehicles that are yet to be manufactured. Thirdly, the verification application under Article 19 of Decree 125 that is decisive for which charges are imposed only occurs after the imported parts have been assembled and manufactured into whole vehicles.

4.216 China also argues that the measures should be categorized as border measures because they are administered by the customs authorities, classified as "ordinary customs duties" under Chinese law and because imported auto parts are "not in free circulation" within China. In this respect, the European Communities would like to remind China of its own position in its first written submission according to which this case "*concerns the relationship between substance and form*". If the formal categorisation of a charge as a customs duty and the formal treatment of imported parts under domestic law were sufficient to establish a connection with importation, WTO Members could determine themselves which GATT provisions apply to their charges. The Panel in *EEC – Parts and Components* set out that "*with such an interpretation the basic objective underlying Articles II and III, namely that discrimination against products from other contracting parties should only take the form of ordinary customs duties imposed on or in connection with importation and not the form of internal taxes, could not be achieved*".[31]

4.217 Consequently, the Chinese measures are internal measures within the scope of Article III of the GATT 1994.

[31] GATT Panel Report, on *EEC – Parts and Components*, para. 5.7.

4.218 The European Communities regrets that China refuses to address the remainder of its arguments under Article III of the GATT 1994. Again, the European Communities can only assume that China considers its measures otherwise indefensible under Article III of the GATT 1994. Therefore, the European Communities will only give a very cursory overview of its arguments which are set out in greater detail in its first written submission.

4.219 Domestic and imported auto parts are "like" products both under paragraphs 2 and 4 of Article III of the GATT 1994 since the only distinction the measures make is on the basis of the origin of the products. The consistent WTO jurisprudence is clear on this point: the mere origin of the good cannot make an imported good "unlike" the domestic good.

4.220 The measures are inconsistent with Article III:2 of the GATT 1994 since they impose internal charges on certain imported auto parts, but not on like domestic parts. Therefore, the charges applied to imported auto parts are necessarily "in excess of" the charges applied to like domestic products.

4.221 In respect of Article III:4, the European Communities underlines that only imported auto parts may become subject to the charges and the cumbersome procedural requirements described in detail in its first written submission. Such conditions are bound to adversely modify the conditions of competition between domestic and imported auto parts on the internal Chinese market. This occurs exclusively to the detriment of the imported parts. Consequently, the European Communities is of the view that the measures are inconsistent with Article III:4 of the GATT 1994.

4.222 Furthermore, the measures are also inconsistent with Article III:5. They constitute an "internal quantitative regulation" because they are concerned with the amounts and proportions of domestic and imported auto parts in manufactured vehicles. As vehicle parts are "products", which are processed and used during the assembly and manufacture of vehicles, the measures also relate to the "mixture, processing or use of the products" within the meaning of paragraph 5. Finally, the measures also fulfil the third element of Article III:5, first sentence. They require that specified amounts or proportions of vehicle parts used in the assembly and manufacture of vehicles are not imported and instead of domestic origin. Vehicle manufacturers have to obtain domestic parts if they want to remain within the thresholds laid down by Articles 21 and 22 of Decree 125. Consequently, the measures are inconsistent with Article III:5, first sentence of the GATT 1994.

4.223 With regard to the claims under the second sentences of Article III:2 and III:5, the European Communities refers to its first written submission.

4. The "anti-circumvention theory" of China under Article II of the GATT 1994

4.224 China's whole defence strategy is based on the position that the measures should exclusively be examined under Article II of the GATT 1994. Although the European Communities would have no difficulty in confronting China under Article II of the GATT 1994, it is systemically very important not to accept China's premise for the analysis. The categorisation of the additional charges and the cumbersome procedural requirements as part of China's custom clearance process would seriously undermine the scope and effectiveness of the TRIMs Agreement and Article III of the GATT 1994.

4.225 However, as China will no doubt continue to insist on the premise of its defence, it is necessary to demonstrate the fundamental flaws that its position has even under Article II of the GATT 1994.

4.226 As mentioned already before, China's schedule of concessions provides generally for a 25 per cent tariff on complete vehicles and 10 per cent or less on automotive parts. In addition, there are very important intermediary categories, which generally are also subject to the lower 10 per cent tariff. China conveniently ignores these intermediary categories as they entirely undermine China's defence strategy.

4.227 According to their very explicit wording, the measures deem imported auto parts as complete vehicles if certain combinations or proportions are used in the manufacture of a vehicle. In such a case, all imported auto parts of that vehicle will be subject to the 25 per cent duty on complete vehicles. To put it in customs language: auto parts are classified as complete vehicles. It is therefore not the product as presented at the border that decides the tariff classification but rather its internal use after manufacture.

4.228 It is undisputed that the basic standard for interpreting Members' schedule of concessions is the test under Article 31 of the *Vienna Convention*. This test requires an analysis of the ordinary meaning of China's schedule of concessions in their context and in the light of their object and purpose. It is also undisputed that the HS and the rules for its interpretation provide important context for the analysis.

4.229 China pays only lip service to Article 31 of the *Vienna Convention*. In truth, it simply fails to examine the relevant tariff headings under this test.

4.230 As regards the ordinary meaning of the relevant tariff headings, China simply shrugs this obvious complication for its position off with a couple of blatantly erroneous statements such as "the details of the specific tariff headings and tariff rates at issue are not relevant to the disposition of the claims before the Panel".[32] The obvious intention is to draw attention away from the wording of the relevant tariff headings because they simply do not support China's position.

4.231 When it comes to a contextual analysis, China tries to trick us again by drawing our attention to GIR 2(a) of the Harmonised System. China conveniently jumps over GIR 1, according to which the terms of the headings and any relative Section or Chapter Notes are the first consideration in determining classification.

4.232 As regards the object and purpose of tariff commitments, China makes anti-circumvention the main issue. It is this "anti-circumvention theory" to which I shall now turn. According to China, auto parts may be classified as complete vehicles in order to counter an alleged practice of circumventing the tariff rates for vehicles.

4.233 The European Communities profoundly disagrees with the whole premise of China's first written submission. There simply is no conspiracy to undermine China's customs tariffs on motor vehicles. The only so-called evidence that China presents for its theory is a statement that the value of imported parts and components may have increased since China became a member of the WTO[33]. Even if this were the case, the only thing that this could prove is that the multilateral trading system is functioning as it should. It is China that has chosen to commit itself to a difference between the applicable tariff rates for vehicles and their parts.

4.234 As the whole premise of China's defence is profoundly flawed, the European Communities would in principle not wish to enter its logic. However, this would have the potential of leading to a

[32] China's first written submission, para. 15.
[33] China's first written submission, para. 21.

total impasse where the parties refuse to address each others' claims. Therefore, the European Communities will address the main elements of China's defence even if it carries the risk of entering a logic that rests on a fundamental flaw.

4.235 In describing the measures, China attempts to paint a picture of neutral tariff classification where "the substance of a series of import transactions prevails over their form".[34] The measures are allegedly targeted against importers that "circumvent the higher tariff rate on the complete article", even though, according to China "the commercial reality is that the manufacturer intends to assemble the complete article from imported parts and components".[35]

4.236 The simple reply to this is: No, there is nothing that is circumvented when a vehicle part is declared as a part when imported even when it, after manufacture ends up in a new complete vehicle. Manufacturing a vehicle out of imported parts does not amount to circumvention. The complete vehicle and its parts are subject to different tariff headings. This is normal; there is nothing that is circumvented.

4.237 A rule that requires classification of parts depending on how they are used in the final product would have drastic consequences for the present and future state of international trade, dominated by global production chains where the production process is broken down into a multitude of steps and intermediate products produced by several companies in several countries.

4.238 However, before dealing with the arguments of China any further it is necessary to address what China fails to address, namely that its allegedly neutral anti-circumvention measures are in reality enforcing local content requirements in the finished vehicle.

4.239 On the basis of the theories that China presents in its first written submission, the crucial criterion in its view is the intended end use of the product, not its objective characteristics as presented at the border. Indeed, China refers to "demonstrated intention of the auto manufacturer" as a basis for tariff classification.[36] Of course China does not use the words local or domestic content.

4.240 A simple example is sufficient to demonstrate how the measures apply in reality: Let's take an example of 100 brake cylinders that are packaged and shipped together to China. Of these, 30 will be used as spare parts, 40 will be fitted into complete vehicles that attain the necessary level of domestic content while the remaining 30 will be fitted into complete vehicles that do not attain the necessary level of domestic content.

4.241 Of these brake cylinders 70 out of the 100 will under the measures be subject to the lower tariff on parts. To the 30 spare parts one has to add the 40 brake cylinders that are used in complete vehicles attaining the necessary domestic content. Only the 30 that will be used in complete vehicles that do not attain the necessary domestic content will be subject to the higher duty on complete vehicles. Of course, under a correct tariff classification all 100 brake cylinders should be classified as parts.

4.242 There is nothing neutral about these rules even under the false logic that China presents in its first written submission. The real criterion is the level of domestic content.

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[34] China's first written submission, para 3.
[35] China's first written submission, para. 18.
[36] China's first written submission, para. 7.

4.243 However, China goes even much further. It is of the view that even if the 100 brake cylinders would be imported to China in, say, 20 different shipments at different times and would arrive to different ports from different parts of the world and be imported by different and unrelated importers (e.g. vehicles manufacturers, parts importers, after-sales maintenance companies etc.). China would still insist on applying its anti-circumvention theory. In other words, it will still verify whether the brake cylinders will be used in a complete vehicle or not and whether the complete vehicle will contain sufficient local content before deciding whether to apply an additional charge on the products after they have already been manufactured in China.

4.244 It is important to underline that there is no basis in China's tariff schedule or in the interpretative rules of the HS that would allow for such a drastic measure that undermines the whole system of tariff classification.

4.245 Indeed, China uses the general rules for the interpretation of the HS in a very selective if not abusive manner. The HS rules simply do not contain the "anti-circumvention rule" that China suggests in its first written submission. China completely jumps over the most important rule of the HS, that is, GIR 1 according to which the terms of the headings and any relative Section or Chapter Notes are the first consideration in determining classification. If there is no doubt about the classification of a product on the basis of GIR 1, the other rules simply do not apply. This is the case in the overwhelming majority of situations.

4.246 China repeatedly refers to GIR 2(a) of the HS. However, it is remarkable how selectively China refers to this rule. First of all, China ignores the fact that the relevant chapter of the HS nomenclature, that is, Chapter 87 contains a specific application of that rule with very precise examples that cannot even remotely be compared to the situations foreseen by the contested measures. The European Communities has examined this rule already in its first written submission.

4.247 However, what is perhaps even more remarkable is that China uses even the general formulation of GRI 2(a) in a very selective manner. It is worth to quote GIR 2(a) to see this clearly. GIR 2(a) states:

> Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, <u>as presented</u>, the incomplete or unfinished article has <u>the essential character of the complete or finished article</u>. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled. [emphasis added]

4.248 China ignores the two basic principles in this rule, that is, the words "as presented" and "the essential character of the complete or finished article".

4.249 In other words, the "anti-circumvention theory" presented by China ignores the fact that the tariff classification of a product is to be made as presented to customs at the border. The measures completely disregard this by classifying the product after it has been used in manufacturing and irrespective of the fact that no other parts were presented to the customs at the same time. This amounts to tariff classification at will.

4.250 As regards the essential character criterion, the European Communities would like to draw the attention of the Panel to the example China itself uses in its first written submission, at paragraph 19 concerning alleged tariff circumvention. China states: "a specific example illustrates the problem".

This is perhaps the only sentence with which the European Communities can agree. This example indeed illustrates the problem. A simple calculation will suffice:

4.251 To recall, according to Article 21(2) of Decree 125, all imported parts will be automobile parts characterized as complete vehicles if any of the following combinations of assemblies are deemed imported:

1. the two main assemblies (the vehicle body and engine)

2. either of the two main assemblies as well as three of more other assemblies

3. five or more assemblies, other than the main assemblies.

4.252 Let us now combine some of the relevant percentages in the table under paragraph 19 of China's first written submission on the basis of the criteria of Article 21(2) of Decree 125:

1. The two main assemblies i.e. the vehicle body and the engine would amount to 29 per cent of the value of the vehicle;

2. One of the main assemblies i.e. the vehicle body and three other assemblies i.e. the non-driving axle, the steering system and the braking system would amount to 21 per cent of the value of the vehicle

3. five other assemblies i.e. the non-driving axle, the driving axle, the frame (or chassis), the steering system and the braking system would amount to 17 per cent of the value of the vehicle.

4.253 These very simple calculations on the basis of the example that China itself provided demonstrate that China applies the full vehicle duty to all imported parts if the vehicle contains certain imported assemblies that constitute only 17-29 per cent of the value of the complete vehicle. In other words, a combination of certain parts that amount to 17 per cent of the total value of the vehicle will be sufficient to classify all imported parts in that vehicle as a complete vehicle. And this irrespective of when, from where and by whom these parts were imported.

4.254 It goes without saying that a combination of parts, which may have been imported to China at different times, from different parts of the world and been subject to internal transactions in China between importers of parts and the vehicle manufacturer and, which represent 17 to 29 per cent of the total value of the vehicle, cannot even remotely have the essential character of a complete vehicle within the meaning of GIR 2(a) of the HS as it is applied under Chapter 87 according to the very explicit chapter notes.

4.255 There is also another very simple way of demonstrating how manifestly erroneous China's position is. It is sufficient to read tariff line 87.06 entitled "chassis fitted with engines" together with its interpretative note. A chassis fitted with engines would under the contested measures always be classified as the complete vehicle despite it being subject to a specific heading and normally subject to the lower 10 per cent duty. The details have been set out in paragraphs 255 to 260 of the European Communities' first written submission.

4.256 The European Communities is therefore of the view that even under the entirely false premise on which China bases its defence, the arguments presented simply do not hold any water. Although the European Communities would comfortably be prepared to confront China even under the terms

China wishes to argue the case, it is systemically very important not to allow China to escape the main claims brought forward by the complainants. In any event, China's measures are inconsistent with Article II of the GATT 1994.

5. Inconsistency of the Chinese Measures with the SCM Agreement

4.257 With regard to Article 3 of the SCM Agreement, China argues that its measures do not constitute a prohibited subsidy. According to China, it does not forego revenue when it applies the tariff rate for complete vehicles only to those parts which, in China's perception, circumvent this tariff rate. China argues that the tariff rate for complete vehicles cannot serve as the appropriate benchmark for parts in general because its Schedule of concessions prevents it from imposing it on all parts.

4.258 The truth is that China's Schedule of concessions prevents China from imposing the duty for complete vehicles on any parts. If China were allowed to impose the complete vehicle duty on certain parts, it would still be prevented from making this dependent on the local content in the final manufactured vehicles. As China does not impose the duty for complete vehicles on parts manufactured into vehicles that satisfy the local content requirements, it is foregoing revenue otherwise due.

6. Conclusion

4.259 The European Communities is firmly of the view that the measures under scrutiny in this case threaten the very basic structures of the multilateral trading system. These Measures circumvent China's core obligations under the covered agreements.

4.260 For these reasons, all specified in detail in its first written submission, the European Communities requests that the Panel find that China has acted inconsistently with its obligations under the relevant covered agreements.

F. ORAL STATEMENT BY THE UNITED STATES AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

4.261 For two reasons, the United States initial comments in its oral statement will be brief. First, the United States and our two co-complainants have already submitted extensive written submissions, and both the European Communities and Canada are presenting oral statements. And second, although China's first submission contains a considerable amount of material, very little of that material is relevant to the issues in this dispute. Most notably, China presents an extensive discussion of the complainants' practices with regard to circumvention of antidumping duties, but this dispute has nothing to do with dumping. And conversely, aside from the threshold issue, China does not even dispute the inconsistency of its measures with core obligations of Article III. Indeed, China in fact appears to concede that one key aspect of its measures is inconsistent with Article III.

4.262 As discussed in our first submission, China has adopted measures that favor domestic auto parts over imported parts, so as to afford protection to the domestic production of auto parts. These measures include a substantial charge – over and above customs duties – on imported auto parts, with no comparable charge on domestic auto parts. China's measures further favor domestic parts in that the additional charge only applies if domestically-produced autos include an amount (in volume or value) of imported auto parts that exceeds specified thresholds. And the measures include extensive record-keeping, reporting, and verification requirements that apply if and only if domestic automobile manufacturers make use of imported auto parts.

4.263 These measures amount to clear and straightforward inconsistencies with China's national treatment obligations under Article III of the GATT 1994. In particular, these measures impermissibly result in internal charges on imported parts in excess of those applied on domestic parts (Article III:2); the measures accord treatment less favorable to imported parts with respect to requirements affecting internal sale, purchase, distribution, and use (Article III:4); and the measures directly or indirectly require that specified amounts or proportions of auto parts used in vehicle manufacturing must be supplied from domestic sources (Article III:5).

4.264 China's defence is twofold – its measures all involve customs duties, and those customs duties are consistent with Article II. As the EC in particular outlined in its first submission, and as all the complainants will return to today, China's Article II argument is utterly without merit. Were China to charge an import duty on imported auto parts of 25 per cent, China would be in outright breach of its Article II tariff bindings.

4.265 But the clearly unfounded nature of China's Article II argument must not distract from a far more important point. Namely, China does not impose a simple import duty of 25 per cent on auto parts. To the contrary, China's measures are *far more pernicious* than the simple breach of a tariff binding. Rather, the measures set up a complex, internal regulatory regime – the primary effect of which is to discriminate against imported auto parts, encourage the use of local content and pressure foreign parts manufacturers to re-locate their facilities and technology to China. These pernicious aspects of discrimination would be present whether or not the level of China's charges on auto parts were above their specific bindings on auto parts. Thus, it is of extreme importance to the United States that the findings in this dispute address China's serious breaches of Article III.

4.266 With one caveat, most of what China presents as a defence does not even respond to the Article III inconsistencies inherent in its auto parts regime. I would like to highlight this point by departing from the usual order of an Article III discussion. That is, I will first address Article III:4 and Article III:5, and then return to Article III:2.

4.267 Turning first to Article III:4, the Appellate Body has identified three distinct elements required to establish a breach: (1) the imported and domestic products are "like products;" (2) the measure is a law, regulation, or requirement affecting the internal sale, purchase, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product.

4.268 The first element, the determination of "like products" is easily met here. The only distinction between imported and domestic auto parts is their origin, and China does not dispute that imported and domestic auto parts are "like products" for purposes of Article III.

4.269 The second element of an Article III:4 analysis is that the measures affect the internal sale, purchase, distribution or use of the like products. In this instance, China's Policy Order 8, Decree 125 and Announcement 4 work together to create an incentive to purchase domestic auto parts. First, the system levies a charge based on the types and total value of imported parts used in the automobile. Second, the system imposes burdensome administrative recording requirements when imported parts are used in the manufacturing of vehicles. These aspects of its measure established a disincentive to purchase, use and distribute imported auto parts. Thus the measures meet the second element of an Article III:4 analysis. China also does not dispute this element.

4.270 The third and last element for determining a breach of Article III:4 is to assess whether the measures accord less favorable treatment to imported products relative to the domestic product. Here,

the measures treat foreign parts less favourably than domestic parts by creating different competitive conditions for the parts. This is done in two, or perhaps three, ways.

4.271 First, the level of China's charge on auto parts depends on the types and value of imported parts used in a complete vehicle. If the thresholds are exceeded, then an additional charge is applied to each and every imported part included in the vehicle. In other words, leaving aside whether the <u>absolute level</u> of the charge is consistent with China's GATT obligations, the point here is that the level of that charge on say, Part *A*, changes based on whether Part *B* is imported or sourced domestically. Thus, automobile manufacturers in China, independently of any question of the absolute level of China's customs duties, have a strong disincentive to make use of imported auto parts. The measures accordingly alter the conditions of competition by creating a significant incentive to include domestic parts over imported parts. And, China does not dispute that this system provides less favorable treatment for imported parts.

4.272 The second method by which the measures treat foreign parts less favourably than domestic parts is through the imposition of burdensome administrative reporting requirements on any manufacturer who chooses to use imported auto parts in building an automobile in China. These requirements include;

– a "self-evaluation" to determine the number of imported parts used in the assembly of a particular vehicle model, involving a catalogue of all the parts of each model it manufactures, and calculations of the thresholds for each assembly system and the overall price percentage of imported parts in the model;

– a registration of the vehicle model, including the annual production plan for the vehicle model; a list of all domestic and foreign suppliers; and a detailed list of all imported and domestic parts used in the model being filed;

– a requirement to constantly update the registration to take into account changes in the source and relative price of various parts of every automobile model, as well as changes to individual automobiles;

– monthly payments of charges, accompanied by the verification report, the previous month's total production figures, and a list of parts and components used by the manufacturer in the prior month to assemble completed vehicles;

– and a requirement for the manufacturer to maintain – with respect to all parts not imported by the manufacturer itself – records regarding the importer of record, and any evidence of duties and value-added taxes paid.

4.273 None of these burdensome reporting requirements are necessary for manufacturers who choose to use only domestic auto parts to manufacture automobiles in China. Such administrative requirements thus create different and less favorable competitive conditions for the imported parts. And, China does not dispute that these aspects of its measure provide less favorable treatment to imported parts.

4.274 Third, in describing its measures, China asserts that imported auto parts "are not in free circulation in the customs territory of China."[37] As noted in the US's first written submission, China's measures appear to require burdensome "in-bond" requirements on all imported auto parts, but these

[37] China's first written submission, para. 46.

measures do not appear to be enforced. China, in its first submission, however, appears to claim otherwise. If indeed all imported parts in fact are subject to burdensome "in-bond" requirements that render them "not in free circulation," then for this additional reason China is providing less favorable treatment to imported parts than to domestic parts. Again, this breach of Article III:4 is independent from any question of tariff rates allowed under China's Article II tariff bindings.

4.275 To summarize, we have just gone through a straightforward Article III:4 analysis. China's measures plainly meet each one of the three elements needed to establish a breach of Article III:4. And, China in its submission has not disputed any of these elements. Moreover, with one caveat, the primary defense presented in China's first submission – namely, that its charges are customs duties and that imported parts may be classified as complete vehicles – does not even implicate any issue which might provide a defense to this plain breach of Article III:4.

4.276 To elaborate on this point, even if China's charges were considered "customs duties," and even if China were correct that it was entitled under its tariff bindings to charge a duty of 25 per cent on all imported parts, China's measures would still constitute a breach of Article III:4. The Article III:4 breach, as just discussed, is based on the fact that the charge on any particular auto part will change depending on the types and value of <u>other</u> imported parts used in a complete vehicle, a system which creates a strong disincentive to the purchase and use of imported parts. Similarly, the administrative burdens applicable <u>only</u> to users of imported auto parts, and the burdens relating to the bonded status of imported auto parts, are inconsistent with Article III:4, regardless of whether or not China's charges are considered "customs duties". These breaches of Article III:4 would exist regardless of any issue related to Article II; indeed, these breaches would exist even if China had not bound at all its tariff duties on auto parts.

4.277 China's measures are also inconsistent with Article III:5 of the GATT 1994. And again, with one caveat, China's defense in its first submission does not touch on any issue related to Article III:5. China's measures at issue impose additional charges and burdensome administrative requirements if, among other things, the types and values of imported parts and components used by a car manufacturer exceed specified thresholds. Given that these provisions are expressed in quantitative terms, they are by their nature "quantitative regulations" under Article III:5. Moreover, given that their terms specify the quantitative amounts of imported parts that would result in the charges and reporting requirements being applicable, the measures are also quantitative regulations that relate "to the mixture, processing or use of products in specified amounts or proportions" under Article III:5, and require that a specified amount or proportion of an automobile be supplied from domestic sources or else a penalty in the form of an additional charge is assessed. In its submission, China does not dispute this fundamental Article III:5 analysis.

4.278 Furthermore, as for the breach of Article III:4, this breach of Article III:5 exists regardless of any issue with respect to China's tariff bindings, or with respect to whether or not the extra charge imposed by China is an internal charge or a customs duty.

4.279 Unlike in the case of Article III:4 and Article III:5, China's first submission does discuss a possible defense to the breach of the Article III:2 obligations. This defense, however, is unavailing. Moreover, China even appears to concede that at least some aspects of its measures are inconsistent with Article III:2.

4.280 A determination of an internal charge's inconsistency with Article III:2, first sentence is a two step process: First, the imported and domestic products at issue must be "like". As explained in the US's first written submission, imported and domestic auto parts are like parts for the purpose of Article III:2. China does not contest this. Second, the internal charge must be applied to imported

products "in excess of" those applied to the like domestic products. In this case, when the types or value of the imported parts used in the assembly of a vehicle in China exceed the thresholds established in the measures, the measures impose an internal charge on all imported parts in the vehicle. Domestic parts are exempt. Thus, the internal charge applied to imported parts is "in excess of" any charge imposed on domestic parts, resulting in a plain breach of Article III:2. Again, China does not contest this.

4.281 China's only defense to this plain breach of Article III:2 is to argue that its charges are customs duties instead of internal charges under Article III:2. This defense is totally without merit.

4.282 As discussed in the US's first written submission, the distinction between internal charges and customs duties has been addressed in prior panels under the GATT 1947. In one of the first GATT 1947 reports, *Belgian Family Allowances*, the Panel examined whether a particular charge should be treated as an "internal charge" within the scope of Article III:2 of the GATT 1994 or an "import charge" within the scope of Article II. The Panel concluded that because the charge (a) "was collected only on products purchased by public bodies for their own use and not on imports as such" and (b) "was charged, not at the time of importation, but when the purchase price was paid by the public body," the charge constituted an internal charge. In other words, because the charge depended on the internal use of the product, it could not be considered a border charge.

4.283 The issue was again addressed in *EEC – Parts and Components*. In that dispute, the GATT 1947 Panel examined whether charges imposed to allegedly prevent the circumvention of anti dumping duties should be analysed as customs duties or internal charges. In making its determination, the Panel focused on "whether the charge is due on importation or at the time or point of importation or whether it is collected internally." The Panel noted that the duties were levied on finished products assembled or produced in the EEC and were not imposed at the time or point of importation. Accordingly, the Panel concluded that the EEC charges qualified as "internal charges" under Article III.

4.284 As in *Belgian Family Allowances* and *EEC – Parts and Components*, China's charges at issue in this dispute are internal ones, not border charges. China's charges are not imposed at the time of, or as a condition to, the entry of the parts into China. Indeed, the measures at issue do not impose charges on all imported parts, but only on parts used by manufacturers in the assembly of new vehicles that exceed the thresholds established by China's measures.

4.285 Instead of being border measures, China's measures at issue in this dispute are internal measures, the application of which turns on the details of the post-importation manufacturing operations conducted within China. All of the following factors lead to this conclusion:

– The determination of whether imported parts constitute "features of a complete automobile" is made based on the details of the operations of an internal assembly process, rather than on the conditions of the parts at the time of entry.

– Under the measures, all of the parts of a completed vehicle are combined for the determination of whether the 25 per cent charge applies, regardless of the countries from which those parts originate, when or where they entered the territory of China, or who imported them. Even if a part has been imported by a supplier, and even if the supplier has already paid customs fees and duties, the part is nonetheless grouped together with parts imported by the manufacturer itself when making the determination.

– The 25 per cent charge is imposed not on the importer, but on the manufacturer – whether or not the manufacturer is actually the importer of the part in question.

4.286 China's first submission contains what appears to be an important concession on the part of China with respect to its argument that its measures impose customs duties, not internal charges. In particular, footnote 20 of its first written submission provides:

> In some cases, a manufacturer may assemble a vehicle using a certain number of imported parts and components that it has purchased from a third party in China. In those cases, the manufacturer is liable for any difference between the amount of duty that was assessed on the imported parts at the time of importation and the amount of duty that should have been assessed based on their use in the assembly of a complete imported vehicle. As discussed in Part IV.G [of China's first written submission], this provision is necessary to prevent the use of third-party importers as a means of circumventing the tariff provisions for complete motor vehicles.

Part IV.G, referred to by China in this footnote, is the section in China's first written submission stating that any breaches of other GATT articles are justifiable under Article XX(d) of the GATT 1994. Thus, the way the United States reads this footnote, and we think it is fair, is that China is conceding that the imposition of a charge on a part imported by a third party is an internal charge – not a customs duty – inconsistent with Article III, but that China nonetheless has an Article XX(d) defense.

4.287 This is a key concession. The consideration of, and application of charges on, parts imported by third parties are not incidental aspects of China's measures. Rather, they are an integral part of China's measures. The number or value of parts imported by third parties can be determinative of whether charges are imposed on <u>all</u> imported parts used in a domestically produced vehicle. Furthermore, and more fundamentally, under China's analysis, there really is nothing to distinguish the charge imposed on parts imported by third parties and parts imported by the manufacturer. If, as China appears to concede, the charge on the parts imported by a third party is an internal charge, the charge on the parts imported by manufacturers must be as well.

4.288 In its first written submission, China tries to distinguish *Belgian Family Allowances* and *EEC – Parts and Components*, but its efforts are unsuccessful. First, China argues that the measures involved in those two cases are different from its measures. But the measures in every dispute are different. The point here is that in both those cases, like in the present dispute, the charge was imposed upon the internal sale of the product, not upon importation. Consequently, regardless of the label applied to the charge, the charge was an internal one subject to Article III disciplines.

4.289 Second, China argues that its measure is different because it is imposed for the purpose of collecting customs duties. But this type of argument was explicitly considered and rejected in EEC - *Parts and Components*. To quote from that report: "[T]he Panel first examined whether the <u>policy purpose of the charge</u> is relevant to determining the issue of whether the charge is imposed in 'connection with importation' in the meaning of Article II:1(b). ... The relevant fact ... is not the policy purpose attributed to the charge but rather whether the charge is due on importation or at the time or point of importation or whether it is collected internally."

4.290 Applying that reasoning here, whether or not, as China claims, its charge is adopted for the policy purpose of collecting an amount equal to a customs duty to which China believes it is entitled, that charge is an internal one, subject to Article III disciplines.

4.291 To summarize the Article III discussion, the United States has established breaches of Article III:2, III:4, and III:5. China's defense – that the charge under its measure is a customs duty consistent with Article II bindings – relates only to the Article III:2 breach, and even then China appears to concede that its measures breach Article III with respect to those parts imported by a third party.

4.292 I would now like to turn to the "caveat" that I have mentioned several times. That is, the caveat to the statement that nothing in China's first written submission even touches on a possible defense to its Article III violations. At most, all of the discussion in China's first written submission about the proper classification of imported auto parts and its Article II bindings appears to be an attempt to invoke an Article XX(d) exception to its Article III breaches, as sketched out vaguely in the last section of China's first written submission.

4.293 As a result, the United States submits that the proper mode and order of analysis in this dispute should be as follows. The Panel should first examine China's measures under Article III disciplines, and – as the United States has shown, find them to be inconsistent with those obligations. To the extent that China's discussion of tariff classification and Article II bindings have any relevance in this dispute, it would be as part of China's attempt to meet its burden of establishing an Article XX(d) defense to its Article III breaches.

4.294 In the United States' view, any Article XX(d) defense by China would be tantamount to the following argument: that China wishes to breach Article II, and is thus justified to commit a primary breach of Article III. In other words, the United States submits that China does not even have the beginnings of an Article XX defense to its Article III breaches.

4.295 Turning now to China's tariff classification argument, the United States submits it is completely without merit. The argument is based only on GRI 2(a), but China misreads it, and ignores other interpretive notes as well as the entirety of China's schedule of tariff commitments.

4.296 GRI 2(a) has two parts, neither of which amounts to anything approaching China's interpretation. First, GIR 2(a) provides that incomplete products may be classified as complete ones, if they have their essential character. It does not come close to allowing, as China contends, for China, for example, to classify a brake cylinder as a complete automobile.

4.297 Second, GIR 2(a) allows importers to present an unassembled product for tariff treatment as the assembled product. The key idea here, which is confirmed by the interpretive notes cited by China itself, is that the importer "presents" the unassembled product to the customs authority. There is no notion in GIR 2(a) that a customs authority is supposed to seek out all entries of diverse parts, by different importers, from different suppliers, and even of different national origin, and then proceed to collect them into some fictitious unassembled product, to then be classified as the assembled product.

4.298 China also ignores the very first General Rule of Interpretation for the HS, GIR 1. That rule provides that "classification should be determined according to the terms of the headings and any relative section or chapter notes." In addition, China ignores the HS chapter headings specific to auto parts, and its own schedule of tariff commitments containing detailed descriptions of various auto parts and auto assemblies and subassemblies. It is impossible to read China's schedule, with all its detailed descriptions of auto parts, and to conclude that nonetheless all auto parts used for manufacturing purposes must be classified as complete autos. Rather, as both a matter of simple logic and as an application of GIR 1, auto parts and auto assemblies imported into China must be classified in accordance with the specific tariff headings listed in China's schedule.

4.299 Consider, for example, an automobile radiator. China's schedule has a specific subheading for radiators (87089100). There is no basis under China's schedule or the GIRs for China to classify a shipment of radiators as "unassembled vehicles," instead of under the tariff line provided in China's schedule specifically for radiators.

4.300 China's Working Party Report further confirms that China may not try to classify auto parts as complete vehicles. Part I.1.2 of the Accession Protocol provides that the Protocol, which includes the commitments referred to in paragraph 342 of the Working Party Report, shall be an integral part of the WTO Agreement. Paragraph 342 of the Working Party Report includes China's commitment reproduced in paragraph 93 of the Working Party Report. As a result, China's commitment in paragraph 93 of the Working Party Report is an integral part of the WTO Agreement. China does not appear to dispute this.

4.301 Paragraph 93 of the Working Party Report provides,

> Certain members of the Working Party expressed particular concerns about tariff treatment in the auto sector. In response to questions about the tariff treatment for kits for motor vehicles, the representative of China confirmed that China had no tariff lines for completely knocked-down kits for motor vehicles or semi-knocked down kits for motor vehicles. If China created such tariff lines, the tariff rates would be no more than 10 per cent. The Working Party took note of this commitment.

4.302 This paragraph shows that Members were concerned about the tariff treatment of CKDs and SKDs kits, and wanted to ensure that they were subject to a duty of no more than 10 per cent. China's interpretation of this paragraph, as set out in its first submission, does not withstand even limited scrutiny. According to China, Members did not really care about the tariff treatment of CKD and SKD, kits but only cared about the tariff treatment of these items if they had a separate tariff line, and that China is thus free to charge a much higher rate of duty so long as China classified those items in some existing subheading. China can present no reason why any Member in any circumstance would have such an intention, and there is no reason. In short, the only reasonable interpretation of the Working Party Report is that China committed to imposing no greater than a 10 per cent duty on CKD and SKD kits.

4.303 The existence of this commitment on CKD and SKD kits highlights the untenable nature of China's assertion that it is entitled to impose 25 per cent duties on all imported parts when certain thresholds are met. These thresholds are triggered when far fewer imported parts than in CKD and SKD kits are included in the assembly of the complete vehicle.

4.304 China also has no basis for asserting, as it does in its first written submission, that many other WTO Members have put in place measures in any way similar to China's regime for imported auto parts. For example, China cites a US regulation (Exhibit CHI-27) regarding "multiple conveyances" as somehow being supportive of China's proposed interpretation of GIR 2. But, to the contrary, the regulation shows precisely the opposite. As explained in the regulation, it covers entities which, due to their size and nature, cannot be shipped in a single conveyance, and instead must be imported in an unassembled or disassembled condition. The rule was adopted for the convenience of importers, who wanted their products classified as the complete product under GIR 2, but could not previously do so because the entity was too large to fit on a single conveyance (usually meaning a single ship). The rule eases customs regulations to allow a disassembled product to benefit from GIR 2 even if the product must be imported on more than one ship. Nothing in this rule is anything like China's auto parts regime, which requires that separate shipments of parts must receive the tariff treatment of a complete vehicle. Indeed, the US regulation goes out of its way to assure importers that they "may, of

course, continue to file a separate entry for each portion of an unassembled or disassembled shipment as it arrives, if they so choose."[38]

G. ORAL STATEMENT BY CANADA AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

1. Introduction

4.305 As we have set out in our submissions, and as just highlighted by our co-complainants, China has failed to comply with its basic obligation, pursuant to Article III of the GATT 1994, to afford national treatment to automobile parts imported for use in the production of Chinese automobiles. It has also established domestic content requirements that stand in clear conflict with the TRIMs Agreement. And it has failed to abide by commitments it made in its accession to the WTO, including that with respect to the tariffs applicable to parts and complete and semi knock-down kits.

4.306 China mischaracterizes its measures as consistent with its Schedule of Concessions and thereby consistent with Article II of the GATT 1994, which China does in place of dealing squarely with its violation of Article III.

4.307 To begin by setting this dispute in context, China is a rapidly growing economy. Its government has clear strategies for the development of key industrial sectors, including automobile production. As a result, China has become one of the world's largest automobile producers in only a few short years. It is a remarkable economic success story.

4.308 Foreign suppliers to this sector have sought to benefit from the growth in Chinese automobile production. They have invested in the Chinese market, have expanded production as the industry has expanded, and as required have extended global supply chains to provide the capacity and technology that the market demands. These business decisions, and the economic benefits to China that have flowed from them, have come as a direct result of the elimination of protectionist measures on China's accession to the WTO. These protectionist measures included preferential treatment for vehicles manufactured in China that met certain domestic-content thresholds. Unfortunately, with the introduction of the measures, those domestic-content thresholds have returned.

4.309 Automobile production is a complex industrial process. Massive amounts of capital and materials are required to develop, produce and sell automobiles. One new family sedan represents many years of investment in design and development, as well as long input chains with many, sometimes overlapping suppliers.

4.310 Automobile parts are shipped according to exacting logistical requirements. In many cases, a single part – say, a fastener – will move from one supplier to another, undergoing various transformations en route to its final inclusion in a finished vehicle. And, for many parts, these supply chains move them not only from factory to factory, but from country to country.

4.311 Of course, in such a complex manufacturing process, where thousands of individual parts make up a finished vehicle, many parts are not ascribed to the production of specific vehicles. Instead, they are bought and sold in large volumes and shipped as required to production facilities. China ignores this complexity in an effort to justify its measures as a necessary solution to a simple problem of what it calls "circumvention".

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[38] Exhibit CHI-27, at 31,922, emphasis added.

4.312 The nature of the dispute is, however, simple. At issue is the well-established obligation of national treatment. WTO Members may not discriminate between products imported into their territory and like domestic products. And China's measures, in violation of this obligation, are merely domestic-content requirements that deny national treatment to imported automobile parts.

4.313 In its submission, China has done an admirable job of obfuscating this fact. It has attempted to establish as a basic premise that the essential nature of automobile parts imported into China may not be assessed with any certainty on their presentation at the border. And, importantly, it has suggested, without substantiation, that much of the trade of these parts is aimed at avoiding Chinese tariffs, and that this avoidance is illegitimate.

4.314 There are clear rules in international trade for assessing goods on importation. These rules recognize that there must be flexibility on importation at the border to allow for the effective administration of customs laws and regulations. Canada and other WTO Members recognize this flexibility in their laws and regulations. But, Canada does not accept that this gives Members the freedom to define importation as it suits them, and thereby undermine the commercial certainty afforded by the principle of national treatment. China does not address in any meaningful way the clear relationship of its measures to the obligations set out in Article III of the GATT 1994 and fails even to answer the basic case against it.

4.315 In its Article XX defence, China presents no compelling evidence that such measures are necessary. It also fails completely to answer the claim that the measures amount to anything other than a disguised restriction on internal trade.

2. Legal issues

(a) China has not answered the case under Article III of the GATT 1994

4.316 Canada agrees with China that this case presents the question of whether Article II or Article III applies to charges imposed on imported parts used in Chinese manufacturing. Where we differ, and significantly, is how that question must be answered. The charges at issue are internal, as Canada's first written submission describes in detail, and therefore subject to the disciplines set out in Article III.

4.317 China argues that its measures are somehow distinct from those considered in previous GATT and WTO decisions. This argument rests on China's faulty claim that a charge it describes as a customs duty under its domestic law must therefore be a customs duty within the meaning of Article II. To give effect to this fiction, China notionally determines that imported automobile parts are "in bond", until such time as it applies a final, internal charge to them. And China only applies this final charge once the part is included in a vehicle produced in China.

4.318 China gives two purported justifications for treating imported auto parts this way. First, it argues that there is no clear dividing line between parts and a complete article made up of those parts. Its second and related claim is that a difference in classification, and a resulting difference between the tariffs assigned for parts and the complete article, results in what China calls "circumvention".

4.319 Regarding the first purported justification, there may indeed be instances when an article is an incomplete or unfinished product on importation, but has all of the essential characteristics of a complete or finished product. The HS permits customs officials to classify such a product as a whole product, provided that classification is based on presentation at the border. For example, the HS specifically permits a vehicle otherwise complete but missing its engine to be classified as an

automobile. Likewise, the practice of many customs authorities is to classify a kit, presented in one unit at the border, and consisting of *all* parts necessary to construct a whole vehicle, under the six-digit tariff sub-heading for whole vehicles.

4.320 Let us leave aside the fact that such kits are often further categorized at the eight-digit level under a separate, and lower, tariff rate. In most cases, parts shipped together will properly be classified either as parts or as an intermediate category provided for in the HS. For example, a chassis to which is attached an engine, a drive and non-drive axle, brakes, and steering – in other words, a good that has all of the essential characteristics of a whole vehicle except for the body – even if already assembled, cannot properly be classified as a whole vehicle under the HS.

4.321 Instead, such a combination has its own category, namely chassis with engines attached, under tariff line 87.06.[39] Significantly for this case, China's bound tariff rate for this intermediate category is the same rate as for parts, and not the much higher rate for whole vehicles. The fact that the intermediate category is bound at the parts rate is presumably the reason that China ignores this category, while suggesting that a Member has great discretion under the HS to classify various combinations of parts as whole vehicles. That the intermediate category exists at all is clear evidence that there is no such discretion.

4.322 The determination of whether a good has the essential characteristic of a different, finished good occurs on importation – that is, when it first passes the border. At that point, a "snapshot" is taken of the product. A Member's customs laws and regulations should provide for an objective determination of how that snapshot is taken, and how related duties are assessed. Those laws and regulations, in accordance with internationally accepted principles, may include flexibility to allow for payment of duty at a date after importation, or permit importers to challenge the accuracy of classification decisions. They may also provide for the testing of goods where the accuracy of the classification is at issue.

4.323 While customs practices include procedures that may apply after the snapshot is taken and the products have entered the customs territory of a Member, Members do not take new snapshots at their discretion. They certainly do not, or should not, take a snapshot of an imported good *after* it has been transformed during manufacturing.

4.324 Article II of the GATT 1994 allows Members to apply tariffs on importation "subject to the terms, conditions or qualifications set forth" in their Schedules. As the written submissions of the complainants have established and the jurisprudence makes clear, border charges can only be applied based on presentation of goods *at the border*. A Member may impose conditions at the time of presentation, but only if the Member's Schedule so provides. Nowhere in China's Schedule is there any term, condition or qualification that permits what the measures accomplish. Nowhere is there a justification for a condition allowing for a determination, contrary to established classification practice, that an automobile part in China's internal market is something other than what the snapshot at the border clearly showed it to be.

4.325 A few useful conclusions may be drawn from the application of the measures:

- The levy of a 15 per cent additional charge on parts bears no relation to the snapshot of the condition of the parts as presented at China's border. Two identical imported parts will be treated differently based upon what happens to them within China.

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[39] Exhibit JE-2.

- The measures are not restricted to the situation where a single manufacturer imports all the parts necessary to manufacture a vehicle from a single foreign supplier, or even from a single foreign country. They apply to arm's-length parts manufacturers in China that import parts to manufacture a product that, in turn, will be used by a variety of other arm's-length parts manufacturers. All of this occurs before the transformed parts are finally sold to a vehicle manufacturer.

4.326 For all of China's attempts to confuse the issue, the *EEC – Parts and Components* decision makes clear that the measures apply internally and do not fall under Article II of the GATT 1994.[40] In that case, the panel found that the EEC's measure, which imposed a charge on certain parts, based on a claim that such a charge was necessary to avoid circumvention of anti-dumping duties on manufactured vehicles, was inconsistent with Article III of the GATT 1994 and could not be justified under Article XX. That conclusion applies even more strongly to China's measures, which impose a charge on *all* imported parts, regardless of origin, regardless of who purchases them, and not based on an earlier investigation.

4.327 China returns again and again to its misrepresentation of the language of the panel in *EEC – Parts and Components*. It points to the general administrative flexibility held by customs officials that allows them to review and challenge previous assessments of goods. Nothing in *EEC – Parts and Components* suggests that a classification review can be used to deny national treatment. The invocation, out of context, of the customs practices of other Members only serves to confuse the real issue. Whatever flexibility exists in customs tariff classification, it does not extend to tracing imported parts in the manufacturing process and classifying those parts as the finished product into which they are incorporated. That is an internal measure.

4.328 The measures not only track and reclassify goods well after importation, but they also link that classification to the use of domestic products. That is, discrimination is linked intrinsically to the investment measures established by Decree 125 and Announcement 4[41], and to China's express preference for domestic over imported parts. These measures, and the charges that they impose, apply *only* to imported parts. They are, then, trade-related, in violation of Article 2 of the *TRIMs Agreement*, and inconsistent with China's *Accession Protocol*. These points and those relating to China's violations of GATT Articles III:2, III:4 and III:5 are explored in Canada's written submission.

(b) China's GATT Article XX defences

4.329 This recourse is both explicit and implicit.

4.330 How is this so? China makes a clear, albeit passing reference to Article XX(d). This is its first, and express recourse to Article XX. Yet China's primary argument, made ostensibly under Article II of the GATT 1994, is merely a reinvention of what is, for all intents and purposes, the same Article XX defence.

4.331 China justifies its measures by arguing that they are required to prevent importers from taking what China characterizes as efforts to "circumvent" customs duties. Canada agrees with the observations made by the European Communities in respect of this flawed "anti-circumvention" theory, and would add the following. In order to defend against this alleged problem, China suggests that importation can be made on a "conditional basis", that condition being the overall use of domestic

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[40] GATT Panel Report on *EEC –Parts and Components*, para. 5.8.
[41] Exhibits JE-27 and JE-28, respectively.

content. But such conditions are not permitted by Article II, nor, as China would have it, does the panel in *EEC – Parts and Components* suggest that they are.

4.332 China needs to invent this concept of "importation subject to conditions", as it is not assessing charges on products at the time of their importation. Instead, it is imposing an internal charge on the theory that such a charge is necessary to prevent "circumvention" of customs duties. Just as in *EEC – Parts and Components*, such a charge cannot be defended on the basis that it is really a customs charge. As a result, China's only recourse is to Article XX.

4.333 As the Appellate Body noted in *Dominican Republic – Import and Sale of Cigarettes*, the analysis of a measure under Article XX is two-tiered.[42] The measure at issue must be provisionally justified under the specific exception in Article XX, in this case Article XX(d). The onus of that justification is on China. China must then satisfy the requirements of the chapeau of Article XX. That is, the measure cannot be applied in a manner constituting an arbitrary or unjustified discrimination, or a disguised restriction to trade.

4.334 To rely on Article XX(d), China must prove two elements: the measures must be designed to "secure compliance" with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994; and the measures must be "necessary" to secure such compliance. Whether a measure is "necessary" involves a balancing of factors, notably the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports. A measure cannot be necessary if a more reasonable alternative is available, assessed in the light of those three factors.

4.335 China's measures are neither designed to secure compliance, nor necessary. They *cannot* be necessary. A Member cannot qualify or reduce commitments, such as that made in respect of Article III of the GATT 1994, in order to apply its Schedule. Yet, China has made clear that, in its view, the measures are necessary to "implement and enforce" its Schedule. China's defence here appears to be founded on the following logic:

- The measures concern parts imported into China;
- if those parts were shipped together in one shipment, they could under the HS have been classified as a whole vehicle;
- vehicle manufacturers are "evading" the tariff on whole vehicles by shipping parts separately; and, therefore,
- China is justified in imposing an internal charge on those parts to impede this "evasion".

4.336 China's defence ignores the fact that parts are imported both by vehicle and parts manufacturers, are sold and undergo further processing in various locations by various independent parts manufacturers within China. More fundamentally, China's defence fails to identify a problem that makes the measures necessary. At paragraph 19 of its first written submission, China cites the example of shipments from company Z in Korea as an illustration of the problem supposedly inherent in trade in automobile parts. Even if one accepts that the company Z example represents a classification issue, which Canada does not, this example shows only that a large portion of imported

[42] Appellate Body Report on *Dominican Republic –Import and Sale of Cigarettes*, at paras. 64-70.

parts were used in a vehicle that was assembled in China. It offers no evidence concerning the timing of shipments, or their frequency, or anything else that relates to the core issue of the condition of the goods on presentation at the border. That is, it offers no evidence of any tariff "evasion".

4.337 China maintains a theory that all imported parts used in automobile manufacturing in China can be classified as a finished product. According to this definition of evasion, it is difficult to imagine any discipline on the application of customs rules where a higher rate of duty can be found to apply to an imported product. In that context, *any* classification could be justified as "necessary" under Article XX, by virtue of reliance on different classifications set out in a Member's Schedule.

4.338 In terms of the *chapeau* of Article XX, the application of the measures results in an arbitrary and unjustifiable discrimination against imported parts, and a clear restriction on trade. The measures are not targeted at specific companies that have been found to "evade" tariffs. Nor are they restricted in their impact to vehicle manufacturers, which are the only ones that, under China's theory, could be perpetrating this "evasion". This is quite aside from whether imported parts exceeding the thresholds set out in the measures could even constitute a whole vehicle under the Harmonized System.

4.339 This is quite aside from whether imported parts exceeding the thresholds set out in the measures could even constitute a whole vehicle under the HS. It is perhaps because of that arbitrariness that China elects to distinguish between the notion of commonly understood bonding requirements, the application of which are limited in scope, and the expansive security deposit system that is applied to parts imported into China.

3. Conclusion

4.340 Articles III and II of the GATT 1994 are mutually supporting, that is true. Yet they are entirely distinct obligations: Article II relates to the charges that a WTO Member may apply to imported goods at its border; Article III relates to what a WTO Member does after those products pass the border. Consequently, a violation of Article III cannot be justified merely by invoking Article II. A WTO Member may justify internal measures that violate Article III on the basis that they are necessary to secure compliance with customs law, and are therefore defensible under Article XX(d). But China in this case has not met its burden for establishing such a defence.

4.341 An otherwise-internal measure cannot become a border measure just because a Member says it does. The jurisprudence makes that clear. China has provided oblique and irrelevant references to Member practice to confuse this issue, but it has not provided a justification for the inconsistency of its domestic-content requirements with its WTO commitments. Decree 125 and its related measures amount, simply, to a violation of China's obligation to provide national treatment to imported auto parts under Articles III:2, III:4 and III:5 of the GATT 1994, as well as a violation of Article 2 of the TRIMs Agreement. As a result, the measures constitute a clear violation of the essential principle of non-discrimination in international trade.

H. ORAL STATEMENT BY CHINA AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

1. Introduction

4.342 This disputes concerns China's sovereign right to enforce its tariff schedule, and to obtain the benefit of the reciprocal and mutually advantageous market access arrangements that it negotiated in connection with its accession to the WTO. Under the Schedule of Concessions that China negotiated with other WTO Members, it is entitled to maintain a higher rate of duty on motor vehicles than the rate of duty on parts of motor vehicles. This tariff rate difference has important revenue and market

access implications for China. The question presented in this dispute is whether China can adopt measures to enforce its tariff schedule and preserve the value of the market access arrangements that it negotiated when it joined the WTO.

4.343 The position of the complainants in this dispute is that the difference in tariff rates between motor vehicles and parts of motor vehicles in China's Schedule of Concessions is effectively unenforceable. Let me provide the Panel with a specific example. As China demonstrated in its first written submission, there is an auto manufacturer in China that imports 90 per cent of the parts and components to assemble a particular vehicle model. It imports these parts and components from its own affiliates, and from a single country. There is no question that China could properly classify these parts and components as a motor vehicle if they were to enter China in a single shipment. According to the complainants, however, the auto manufacturer can evade the higher rate of duty that applies to motor vehicles merely by importing these parts and components in separate shipments.

4.344 China does not agree that the Schedule of Concessions that it negotiated is effectively unenforceable. Nor does China believe that this result is consistent with maintaining the security and predictability of tariff concessions. The measures that China has adopted to enforce its tariff schedule are consistent with its obligations under Article II of the GATT 1994, and consistent with the commitments that it made when it joined the WTO.

2. The issue presented in this dispute

4.345 It suits the complainants' purposes to make this dispute appear significantly more complicated than it is. The question presented to the Panel is really quite simple: Can China, consistent with its WTO obligations, classify multiple shipments of auto parts and components based on their substance, instead of their form? The complainants' position is, in effect, that the GATT requires China to give effect to form over substance. In their view, importers have unfettered discretion to structure their imports of parts and components as they see fit, and the GATT prohibits national customs authorities from looking behind that structure to discern the commercial reality of what the importer is bringing into the country.

4.346 If we look at a continuum of possible imports, we can see where the complainants' logic leads, and what this case is actually about:

- Let's begin with the case of a completely assembled motor vehicle. No one would reasonably dispute that this is a "motor vehicle," even though it is necessarily comprised of the parts of motor vehicles.

- What if we removed the tires, the seats, and the doors? Clearly, no one is going to drive anywhere in this vehicle, and yet it is nonetheless a "motor vehicle" under GIR 2(a) of the HS because it has the essential character of a motor vehicle.

- Now let's imagine that we take all of the parts necessary to assemble a particular motor vehicle and place them, entirely unassembled, in a shipping container. Under GIR 2(a), this is still a "motor vehicle," because GIR 2(a) encompasses unassembled parts and components of the complete article, provided that the parts and components, when assembled, have the essential character of the complete article.

- Finally, let us suppose that we place *less* than 100 per cent of the parts necessary to assemble a motor vehicle in our shipping container. Let's imagine, for example, that

we take out the radiator, the windows, the tires, the battery, the seats, and the doors. It would still be a motor vehicle under GIR 2(a), provided that the parts and components in the shipping container have the essential character of a motor vehicle when assembled.

- So now we come to what this dispute is all about: What if we take our shipping container of parts and components that have the essential character of a motor vehicle, and divide them into, for example, four shipping containers? And instead of importing these shipping containers in a single consignment, what if we import them in four separate consignments over four consecutive weeks? Did we import a motor vehicle, or did we import parts and components of a motor vehicle? Most importantly, should we be entitled to pay the lower duty rate that applies to parts and components of motor vehicles simply because we took our single shipping container and divided it into four shipping containers? That is the issue presented in this case.

4.347 The necessary consequence of the complainants' position is that an auto manufacturer that assembles the same vehicle model from the same imported parts and components can avoid the higher duty rate on motor vehicles solely by importing the parts and components in several shipments instead of one shipment. Nothing in Article II of the GATT 1994, nothing in China's Schedule of Concessions, and nothing in the HS supports this arbitrary result.

3. The challenged measures interpret and enforce China's tariff provisions for motor vehicles

4.348 China has demonstrated in its first written submission, and will continue to demonstrate throughout these proceedings, that the measures challenged in this dispute implement and give effect to a proper interpretation of China's tariff provisions for motor vehicles. China has interpreted the term "motor vehicles" in its Schedule of Concessions to encompass the importation of auto parts and components that have the essential character of a complete motor vehicle, without regard to whether those parts and components enter China in one shipment or in multiple shipments. This interpretation is entirely consistent with ordinary methods of treaty interpretation under the *Vienna Convention.*

4.349 Without reviewing all of the interpretive arguments set forth in China's first written submission, China would like to emphasize two points. First, the interpretation of the term "motor vehicles" that China has adopted is consistent with the object and purpose of the GATT. The Appellate Body has recognized that "a basic object and purpose of the GATT 1994, as reflected in Article II, is to preserve the value of tariff concessions negotiated by a Member with its trading partners, and bound in that Member's Schedule."[43] The Appellate Body has likewise observed that the tariff concessions negotiated by Members are intended to be "reciprocal and *mutually* advantageous."[44]

4.350 Preserving the value of reciprocal and mutually advantageous tariff concessions is necessarily a two-way street. It is fully consistent with this object and purpose for China to preserve the value, from both a revenue and market access perspective, of the higher bound duty rates that it negotiated for motor vehicles. It is *not* consistent with this object and purpose to conclude that auto manufacturers can evade the higher tariff rates on motor vehicles by importing parts and components in multiple shipments, when those parts and components would have been classified as a motor vehicle had they entered China in a single shipment.

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[43] Appellate Body Report on *Argentina – Textiles and Apparel*, para. 47.
[44] Appellate Body Report on *EC – Chicken Cuts*, para. 243 (emphasis added).

4.351 The second point that China would like to emphasize is that it is entirely consistent with international customs practice for China to apply GIR 2(a) to multiple shipments. The WCO has specifically affirmed that the classification under GIR 2(a) of goods assembled from multiple shipments of imported components is a matter to be resolved by each country in accordance with its national laws and regulations. This means that the interpretive principles of GIR 2(a) can be applied to multiple shipments of parts and components on the basis of the importer's demonstrated practice of assembling imported parts and components into a complete article.

4.352 This application of GIR 2(a) is confirmed and reinforced by the subsequent practice of WTO Members in classifying multiple shipments of parts and components on the basis of the importer's demonstrated practice of assembling those parts and components into a complete article. One of the circumstances in which Members have done this is where it is necessary to prevent the circumvention of duties that apply to complete articles.

4.353 Once it is recognized that there is no absolute and inviolate rule against applying GIR 2(a) to multiple shipments, much of the complainants' case against the challenged measures simply falls away. A necessary consequence of applying GIR 2(a) to multiple shipments is that customs authorities need some form of administrative process to keep track of how companies import and assemble parts and components into complete articles. That is what the challenged measures do. What the complainants characterize as an internal measure is nothing more than the process that China has adopted for establishing the intention of an auto manufacturer to import and assemble parts and components that have the essential character of a complete motor vehicle, and to keep track of the parts and components that the auto manufacturer imports for this purpose.

4. The threshold issue before the Panel: Interpreting the scope of Article II

4.354 This brings China to the critical threshold issue before the Panel: Whether the measures challenged in this dispute are border measures subject to Article II of the GATT 1994, or whether they are internal measures subject to Article III of the GATT 1994. The Panel must resolve this issue at the outset to determine which set of disciplines is relevant to its evaluation of the challenged measures.

4.355 The relationship between Article II and Article III is of critical systemic importance to the operation of the GATT, and yet there is little in the text of the GATT itself to define the boundary between these two sets of disciplines. Given how important these two articles are to the functioning of the international trade system, it is also surprising that there is little GATT or WTO jurisprudence concerning the relationship between Article II and Article III.

4.356 There are two general points that are relevant to this threshold issue. First, it is evident from the context of the GATT, as well as from its object and purpose, that the relationship between Article II and Article III is binary. That is, a measure is either a border measure subject to Article II or an internal measure subject to Article III, but it cannot be both simultaneously.

4.357 The second general point is that the classification of a measure under Article II or Article III is necessarily independent of an evaluation of whether the measure is consistent with the relevant set of disciplines. The classification of the measure logically precedes the determination of conformity.

4.358 With these two general points in mind, we can examine the scope of Article II. Article II:1(a) states that "each contracting party shall accord *to the commerce* of the other contracting parties treatment no less favourable than that provided for" in the relevant Schedule of Concessions. In the context of an article that concerns the imposition of customs duties, it is reasonable to interpret the

term "commerce" to be synonymous with "imports." Thus, in broad terms, we know that Article II concerns charges that Members impose upon imports of products from other countries.

4.359 Article II:1(b) states that the products of other Members "shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein." Thus, measures that fall within the scope of Article II are measures that Members (1) impose upon the products of other Members "on their importation" into the customs territory, and (2) concern the imposition of "ordinary customs duties" set forth in the Member's Schedule of Concessions.

4.360 It is evident from the arguments of the parties that much of the disagreement concerning the classification of the challenged measures ultimately relates to the meaning of the term "on their importation" in Article II:1(b). Much of the dispute before the Panel comes down to whether the challenged measures do or do not impose charges on motor vehicles "on their importation" into the customs territory of China.

4.361 What does it mean for a measure to impose duties on products "on their importation" into a Member's customs territory? We know that the term "on their importation" is not limited to the imposition of customs duties at the exact point in time and space at which products from another country cross the border. We know this because there is probably not a single national customs system in the world that operates on this basis. As China demonstrated in its First Written Submission, national customs authorities routinely make classification determinations and impose customs duties long after the point at which goods have crossed the border.

4.362 If the scope of Article II is not defined by the time or place at which the charge is collected, then how is it defined? The GATT Panel in *EEC – Parts and Components* considered that a measure is within the scope of Article II if it imposes charges "*conditional upon* the importation of a product *or* at the time or point of importation."[45] The panel did not elaborate upon what it means for a charge to be imposed "conditional upon the importation of a product …" Nor did it discuss the textual or contextual basis for its interpretation. But we can use the panel's interpretation in *EEC – Parts and Components* as at least the beginning of a proper interpretation of Article II under the *Vienna Convention*.

4.363 Let us recall, in this regard, that Article II concerns the manner in which Members impose customs duties and other types of border charges on imports from other Members. It is consistent with this context to interpret the term "on their importation" to encompass charges that Members impose as a condition of the importation of products from other countries. In the specific context of Article II:1(b), first sentence, the condition of importation must relate to the obligation to pay an ordinary customs duty of a type set forth in the Member's Schedule of Concessions.

4.364 Interpreting the term "on their importation" to include measures that Members impose "conditional upon the importation of a product" is likewise consistent with the object and purpose of the GATT. As I have already noted, the Appellate Body has stated that a basic object and purpose of the GATT is to preserve the value of tariff concessions negotiated by Members. It is consistent with this object and purpose to interpret Article II to encompass conditions that Members impose upon the entry of products into their customs territory, and that serve to preserve the value of its negotiated tariff concessions.

[45] GATT Panel Report on *EEC – Parts and Components*, para. 5.5 (emphasis added).

4.365 These considerations inform the Panel's assessment of what it means for a charge to be imposed "conditional upon" the importation of products into a country. China agrees with the panel in *EEC – Parts and Components* that the manner in which a Member characterizes a particular charge cannot determine whether the charge is one that is "conditional upon" the importation of a product. Rather, consistent with the context of Article II and the object and purpose of the GATT, China considers that a charge is "conditional upon" the importation of a product if the charge bears an objectively ascertainable relationship to the fulfillment of a customs liability.[46] For the reasons that China has explained, the time or place at which the charge is assessed is not determinative; what matters is whether the charge objectively relates to a duty obligation that arose as a condition of the importation of the product.

5. The challenged measures are border measures within the scope of Article II

4.366 The measures challenged in this dispute are within the scope of Article II because they bear an objective relationship to the fulfillment of a customs liability. The measures ensure that the importation and assembly of auto parts and components receives the same customs treatment without regard to whether the parts and components enter China in one shipment or in multiple shipments. The measures thereby give effect to China's tariff provisions for motor vehicles, and preserve the value of the tariff concessions that China negotiated in connection with its accession to the WTO.

4.367 The relationship between the charges that China imposes under Decree 125 and the fulfillment of a customs obligation is objectively ascertainable from the manner in which the measures operate. China has provided a detailed description of how the measures operate in its First Written Submission, but it is important to highlight several key features:

- First, the auto manufacturer determines whether it will assemble a particular vehicle model – let's call it the X900 – from imported parts and components that China would classify as having the essential character of a motor vehicle if they were to enter China in a single shipment. Let's assume for the sake of illustration that the X900 meets one or more of the thresholds under Decree 125 for a complete motor vehicle.

- Thereafter, when the auto manufacturer imports parts and components to assemble the X900, it must: first, enter parts and components for the X900 separately from parts and components for other vehicle models; second, declare at the time of importation that the parts and components are part of a larger collection of imported parts and components that, when assembled together, have the essential character of a motor vehicle; and third, provide a customs bond for those entries.

- The X900 parts and components that the auto manufacturer imports on this basis remain in a bonded status. The Customs General Administration of China collects the applicable customs duties on these parts and components when the auto manufacturer fulfills its stated intention to assemble them into an X900 – a motor vehicle that the manufacturer has previously verified as having the essential character of a complete motor vehicle. The Customs General Administration assesses the applicable duties only on the imported auto parts and components in that vehicle, and in accordance with ordinary methods of customs valuation.

[46] The European Communities has referred to this as the "objectively ascertainable purpose of a levy." EEC Comments on the Panel Report on *EEC –Parts and Components*, L/6676 (16 May 1990) at 2.

4.368 These conditions that China attaches to the importation of auto parts and components provide the administrative mechanism for applying the interpretive rules of GIR 2(a) to multiple shipments. These are the conditions of importation that allow China to ascertain the commercial reality of whether an auto manufacturer has assembled a vehicle from imported parts and components that have the essential character of a motor vehicle. China has already demonstrated that it is consistent with GIR 2(a) to classify multiple imports of parts and components on the basis of the importer's practice of assembling those parts and components into a complete article. The conditions that China attaches to the importation of auto parts and components do nothing more than establish and give effect to that intention.

4.369 For these reasons, the charges that China imposes under the challenged measures bear an ascertainable relationship to the fulfillment of a duty obligation that arose as a condition of importation. Unlike the measures at issue in *EEC – Parts and Components,* the charges that China imposes under the challenged measures relate back to a condition that attached at the time of importation. That condition is that when the auto manufacturer fulfills its stated intention to import and assemble parts and components that have the essential character of a motor vehicle, it will be obligated to pay the applicable duty rate for motor vehicles, just as if it had imported those parts and components in a single shipment.

4.370 It is simply not the case, as the complainants have suggested, that no determination of duty liability is ever based on what happens to an imported article after the point of importation. There are many situations in international customs practice in which this happens. China will focus on one such instance: The US inward processing regime that it calls "Temporary Importation Under Bond," or "TIB".

4.371 Under the US TIB rules, an importer can enter articles into the United States conditionally free of duty if the importer intends to alter or process that article and export it from the United States within a period of one year. The importer pays no duty at the time of importation, but is required to provide a bond. The importer declares at the time of importation that it intends to alter or process the article and re-export it within one year. If the importer does *not* alter or process the article within one year, it is, of course, liable for the duty that it would have paid had it not entered the article on the condition of re-exportation.

4.372 The US TIB system involves a determination of duty liability that is based on what happens to the article after the point of importation – was it altered or processed and re-exported, or did it remain within the United States after a period of a year? However, the fact that the determination of duty liability is contingent upon what happens to the imported article does not mean that any duties that the United States thereby imposes are "internal" charges under Article III. Rather, they are border charges because they relate back to a condition that attached at the time of importation. The importer declared that it was going to use the imported article for a particular purpose, and provided a bond to secure that commitment. The final determination of duty liability is deferred until the condition that attached at the time of importation is either fulfilled or not fulfilled. Even though this occurs after the point of importation, any charge that the United States imposes under these rules bears an objectively ascertainable relationship to the satisfaction of a duty liability. It is therefore a border measure.

4.373 The measures challenged in this dispute are border measures for the same reason that the US TIB rules, and other examples like it, are border measures – all of these measures objectively relate to the fulfillment of a customs obligation. In the case of the measures challenged here, that obligation is to pay the applicable duty rate for motor vehicles on imports of parts and components that have the essential character of a motor vehicle.

6. The challenged measures do not impose excess customs duties

4.374 Once it is properly established that the challenged measures are border measures within the scope of Article II of the GATT 1994, the question then becomes whether these measures result in the imposition of ordinary customs duties in excess of those set forth in China's Schedule of Concessions. China perceives only three possible arguments that the challenged measures result in the imposition of excess customs duties. Each one of these arguments is without basis.

4.375 The first argument is the argument advanced by the European Communities in its first written submission, to the effect that China's tariff rates for motor vehicles apply only to imports of complete motor vehicles.[47] We know this is wrong, because GIR 2(a) plainly provides that something less than 100 per cent of the parts and components of an article can be classified as the complete article provided that they have the essential character of the complete article, and without regard to their state of assembly or disassembly.

4.376 The second possible argument is that the challenged measures result in the imposition of excess customs duties because, as Canada puts it, "the only relevant factor" in customs classification is what is in the shipping container when it crosses the border.[48] We know this is wrong, among other reasons, because the WCO has stated that the classification of articles assembled from multiple shipments of imported parts and components is a matter to be determined under national law, and because there are numerous circumstances in which WTO Members combine multiple shipments for classification purposes, including when necessary to prevent the circumvention of duties that apply to the complete article.

4.377 The third possibility is that the complainants simply disagree with where China has drawn the line for purposes of the essential character test.[49] As China illustrated in its first written submission, GIR 2(a) necessarily gives rise to a continuum of parts and components that could be said to have the essential character of a complete article. If the complainants are of the view that China has drawn the line at the wrong point along this continuum, the complainants must identify, either to this Panel or to the HS Committee of the WCO, the specific combinations of parts and components that, in their view, do not have the essential character of a motor vehicle. This determination can only be made on the specific facts of each combination. China does not consider that the complainants have made any such showing. In any event, even if the complainants were able to demonstrate that the challenged measures result in the imposition of excess customs duties when applied to a specific combination of parts and components, this would not mean that the measures result in the imposition of excess custom duties in all cases.

7. Conclusion

4.378 China has thus demonstrated, first, that the challenged measures are border measures subject to Article II of the GATT 1994. It follows that the complainants' claims based on the contrary assertion that the measures are internal measures subject to Article III of the GATT 1994 are without basis. The complainants' claims under the TRIMs Agreement and China's Accession protocol must fail for the same reason. Secondly, China has demonstrated that, as border measures, the challenged measures do not result in the imposition of ordinary customs duties in excess of those set forth in China's Schedule of Concessions. The measures therefore do not violate China's WTO commitments under Article II of the GATT 1994.

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[47] The European Communities' first written submission, para. 245.
[48] Canada's first written submission, para. 115.
[49] See, e.g., Canada's first written submission, para. 143.

4.379 In conclusion, China would respectfully suggest that, as these proceedings continue, the Panel keep the following questions in mind:

- First, what is the specific interpretive basis under Article 31 of the *Vienna Convention* for the complainants' position that China is not allowed to classify multiple shipments of auto parts and components on the basis of the manufacturer's demonstrated practice of assembling those parts and components into a complete motor vehicle? In particular, where is this prohibition to be found (1) in the GATT 1994, (2) in China's Schedule of Concessions, (3) in the Harmonized System, or (4) in relevant decisions of the WCO?

- Second, how do the complainants believe that it is consistent with the security and predictability of tariff concessions that were meant to be mutually advantageous to conclude that importers can pay a lower rate of duty based on nothing other than the fact that they import parts and components in multiple shipments instead of one shipment?

- Third, with respect to the scope of Article II, how does the complainants' interpretation of the term "on their importation" comport with ordinary methods of treaty interpretation, including the object and purpose of the GATT and the subsequent practice of WTO Members? Is it a practical and workable interpretation, and does it recognize the realities and complexities of contemporary customs practices?

- Finally, when the complainants seek to distinguish their own customs practices or the customs practices of other WTO Members from the measures that China has adopted, have the complainants explained how those alleged distinctions detract from the *relevance* of those practices to the interpretive issues in this dispute? It should not be sufficient for the complainants to assert that they undertake certain customs practices, such as classifying multiple shipments of parts and components on a combined basis, only in what they perceive to be different contexts – the question is whether those alleged differences in context *matter* to whether it is relevant subsequent practice under Article 31 of the *Vienna Convention*. In short, are these distinctions that make a difference, or are they distinctions that are merely convenient?

4.380 China believes that the complainants' answers to these questions will help to narrow and focus the issues in this dispute. China looks forward to questions from the Panel and to the parties' discussions of these matters.

I. SECOND WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

1. Introduction

4.381 China has conceded on the detailed arguments made by the European Communities under Article 2 of the TRIMs Agreement and Article III of the GATT 1994 since it does not even begin rebutting the prima facie case brought by the complainants. Instead, its entire defence strategy is based on the premise that the majority of the measures should only be examined under Article II of the GATT 1994 and on the basis of an unprecedented interpretation of the Harmonised System. The arguments put forward by China put in question the very basic principles of the WTO Agreement and the GATT 1994.

2. Factual background

4.382 China portrays a fundamentally flawed and unrealistic image of the automotive industry which "conspires" to circumvent China's tariff rates on whole vehicles. In reality, vehicle production is a highly complex process, involving a constant inflow of parts from various origins through long supply chains to manufacturing facilities where complex technologies are integrated. One single vehicle model can contain thousands of different parts from all over the world. Many of these would be used interchangeably in several different models if China's Measure did not require an artificial *ex ante* identification of their destination in a particular model.

4.383 After requiring manufacturers to artificially identify all the parts used in a specific vehicle model and to declare imported parts as complete vehicles (which in reality are just parts), China now boldly uses this as "evidence" of a circumvention conspiracy. This "anti-circumvention theory" was invented *ex post* to justify measures which were actually adopted to "[n]urture a group of relatively strong auto-parts manufacturers" (Article 4 of Policy Order 8). It also ignores that nothing is circumvented if vehicle manufacturers decide to import auto parts and manufacture them into vehicles in China.

3. Legal argument

(a) The violation of the TRIMs Agreement and the Accession Protocol of China relating to the TRIMs Agreement

4.384 The measures are inconsistent with Article 2 of the *TRIMs Agreement* in conjunction with paragraphs 1(a) and 2(a) of the Illustrative List and China's Accession Protocol to the WTO. Contrary to China's only defence in this respect, these claims do not require any *ex ante* determination of whether the measures are "internal" or not.

4.385 The European Communities reiterates that the measures are "investment measures" and "trade-related". For the reasons already set out in the first written submission of the European Communities, they are covered by paragraphs 1(a) and 2(a) of the Illustrative List to which Article 2.2 of the TRIMs Agreement refers. Therefore, they must be considered to be inconsistent with Articles III:4 and XI:1 of the GATT 1994 and, consequently, Article 2.1 of the TRIMs Agreement. China also violated its commitments in Part I, Articles 1.2 (in connection with paragraphs 203 and 342 of the Working Party Report) and 7.3 of its Accession Protocol.

(b) The violation of Article III of the GATT 1994

4.386 China has, in spite of the prima facie case established by the complainants and explicit requests from the Panel, still not responded to the claims under Article III of the GATT 1994. Instead, it bases its entire defence strategy, as for the claims under the TRIMs Agreement, on the premise that the measures are not "internal". China's obstructive silence with regard to the essence of the main claims in these proceedings can only mean that it concedes the inconsistency of its measures with Article III of the GATT 1994.

(i) The "internal" nature of the measures

4.387 Contrary to China's view, the measures do not impose "ordinary customs duties" within the meaning of Article II: 1(b), first sentence of the GATT 1994.

4.388 "Ordinary customs duties" are financial charges in the form of a tax and imposed on products "on their importation into the territory". They need to be distinguished from internal charges under Article III:2 that are imposed on products already "imported into the territory". In a temporal sense, the term "on importation" means that ordinary customs duties are normally collected "at the time or point of importation" (see Interpretative Note *Ad* Article III). The term "on importation" also has a material aspect limiting it to charges due because of importation of the product, and not because of other events or criteria, e.g. the amount of local content in products into which the imported product is subsequently assembled.

4.389 China's attempts to extend the scope of the term "on importation" to cover an indefinite "process of importation" and all charges that "*bear[] an objective relationship to the administration and enforcement of a valid customs liability*" find no support in the wording, context and purpose of Article II:1(b), first sentence.

4.390 The charges imposed on imported auto parts under the measures are no ordinary customs duties, but internal charges. They are not collected at the time or point of importation, but internally after assembly and manufacture. This is not affected by the declaration and the duty guarantee to which China refers, *inter alia* since both focus on the way in which the imported parts will be used internally within China, rather than on the contents of a consignment upon importation.

4.391 Furthermore, the charges under the measures are not due because of importation of the auto parts. Their imposition rather depends on whether the imported auto parts are verified as automobile parts characterized as complete vehicles which in turn depends on whether the imported parts are assembled into vehicles with an insufficient level of local content. Irrespective of how auto parts are presented "on importation", charges are imposed on the basis of how the auto parts are used after importation in China.

4.392 For Article 29 of Decree 125, which provides for charges even if manufacturers purchase auto parts on the Chinese internal market from suppliers that previously imported them, China had to implicitly acknowledge that these are "internal" charges (allegedly justified under Article XX(d) of the GATT 1994). The European Communities considers that Article 29 of Decree 125 cannot be isolated in that respect from the remainder of the measures.

(ii) The violation of Articles III:4, III:2 and III:5 of the GATT 1994

4.393 As set out in detail in the first written submission of the European Communities, imported and domestic auto parts are "like" within the meaning of Articles III:4, III:2 and III:5 of the GATT 1994. The measures constitute generally applicable "laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution, or use" within the meaning of Article III:4 and treat imported auto parts "less favourably" than like products of Chinese origin. As regards Article III:2, the internal charges applied to imported auto parts are "in excess of" those applied to the like domestic products. The measures are also inconsistent with Article III:5 since they constitute an "internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions" which "requires … that any specified amount or proportion" of auto parts used in the assembly and manufacture of vehicles "must be supplied from domestic sources" and not imported.[50]

[50] In the alternative, the measures are inconsistent with the second sentences of Articles III:2 and III:5 respectively.

(iii) Accession Protocol

4.394 China also acted inconsistently with its obligations under the *WTO Agreement* as set out in its Accession Protocol, in particular Part I, Article 7.2 of the Accession Protocol by introducing non-tariff measures that are inconsistent with Article III, paragraphs 2, 4 and 5 of the GATT 1994 and not justified under the provisions of the WTO Agreement.

(c) Alternatively: the measures are inconsistent with Article II:1 (a) and (b) of the GATT 1994

4.395 It is important to emphasise from the outset that China's arguments do nothing less than undermine the whole system of tariff classification and the object and purpose of the WTO agreement and the GATT 1994 namely "the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade".[51]

(i) The HS in the context of WTO law

4.396 In the context of this case there is a rare point of agreement between the parties: the HS is relevant and constitutes *context* for purposes of interpreting tariff commitments in the WTO Members' Schedules. This has been confirmed by the Appellate Body.[52] The European Communities considers that the HS could also fulfil the criteria in Article 31(3)(c) of the *Vienna Convention* as a "relevant rule[] of international law applicable in the relations between the parties".

4.397 However, there is considerable disagreement on how the relevant parts of the Chinese tariff schedules should be interpreted. More fundamentally, there is considerable disagreement on the very basic rules on which the HS is founded.

4.398 It is of paramount importance to underline that when goods are classified in the HS it is always done on the basis of the objective characteristics of the product at the time of importation, that is, as imported and presented to customs on a shipment-by-shipment basis. The intentions of the importer and differing duty rates are irrelevant. With the exception of China, this is the position shared by all parties to this dispute, including the third parties that have addressed Article II of the GATT 1994 in their submissions. More importantly, this position was confirmed by the Appellate Body in *EC – Chicken Cuts:*

> We agree with the Panel that, in characterizing a product for purposes of tariff classification, it is necessary to look exclusively at the "objective characteristics" of the product in question when presented for classification at the border.[53]

(ii) GIR 1: Motor vehicles vs. parts thereof

4.399 GIR 1 is the backbone of the application and interpretation of the HS and, hence of the tariff schedules of most WTO members such as China's. The overwhelming majority of tariff classification situations are decided on the basis of GIR 1, which reads as follows:

> The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes classification shall be determined according to the terms of

[51] Appellate Body Report on *EC – Chicken Cuts*, para. 243.
[52] Appellate Body Report on *EC – Chicken Cuts* para. 199.
[53] Appellate Body Report on *EC – Chicken Cuts* para. 246.

> the headings and any relative Section or Chapter notes and, provided such headings or Notes do not otherwise require, according to the following provisions. (emphasis added)

4.400 GIR 1 is very clear: there is a clear hierarchy between the rules. If the classification can be determined according to the terms of the headings and any relative Section or Chapter notes, other rules are simply not applicable.

4.401 At the level of China's tariff schedules, there is no ambiguity on where complete vehicles, intermediate products and parts of complete vehicles should be classified. They are very clearly subject to different tariff headings.

4.402 Therefore, the other rules and in particular GIR 2(a) on which China bases its entire defence strategy are simply not applicable at the level of the tariff headings and without considering a very specific shipment as presented to customs at the border.

4.403 This means also that in the overwhelming majority of cases it is a simple task to interpret the notions of "motor vehicle" and "parts"[54] of such motor vehicles under Article 31 of the *Vienna Convention* as the European Communities has demonstrated in its first written submission. It is important not to lose sight of the simplicity of this case from the point of view of tariff classification at the level of China's tariff schedules: the fundamental difference between the ordinary meanings of the words in the tariff headings is confirmed by their context and object and purpose.

(iii) The exceptional situations in casu subject to GIR 2(a)

4.404 China bases its entire defence strategy on GIR 2(a). The European Communities considers that GIR 2(a) is of extremely limited relevance for the present case. Recourse to GIR 2(a), which is one of the "following provisions" within the meaning of GIR 1, can only be relevant in very specific individual cases "as presented" to customs, and not at the level of China's tariff schedules generally as China insists.

4.405 Apart from the very limited relevance of GIR 2(a) for the present case, the European Communities wishes to stress that China's defence strategy is based on an unprecedented reading of GIR 2(a). China has in the course of the proceedings put forward a wide range of evolving and often inconsistent arguments.

4.406 The European Communities considers that the "multiple shipments" theory invented by China ignores the plain wording of GIR 2(a), in particular that the classification must be determined on the basis of the article "as presented", and is not supported by the WCO Decision to which China refers. China also ignores the "essential character" element contained in GIR 2(a). Furthermore, China obviously construed its "multiple shipments" theory *ex post* since nothing in the wording of the measures refers to GIR 2(a). It is also worth noting that China appears to apply its "multiple shipments" theory exclusively in the automobile sector, and only since 2004 – which happens to coincide with the moment in which China decided to "[n]urture a group of relatively strong auto-parts manufacturers".[55] (Article 4 of the Automotive Policy Order). Furthermore, China's "multiple

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[54] China continuously insists that the key question before the Panel is to interpret the notion of "motor vehicle" in China's tariff schedules. This is not correct as a proper analysis requires to examine the relevant words in all relevant tariff headings starting with "parts and accessories" of motor vehicles, "chassis fitted with engines" etc.

[55] Article 4 of Policy Order 8.

shipments" theory is not supported by any alleged anti-circumvention practice of WTO Members. The European Communities considers also that China's arguments on the importer's intention are contradictory and irrelevant for the case. Finally, the application by China of GIR 2(a) to CKD and SKD kits in a systematic way is not consistent with that rule, which is to be applied *in casu*.

(iv) Conclusion

4.407 The European Communities has demonstrated that under each of the criteria in Article 57 of Policy Order 8, Article 21 of Decree 125 and Article 13 of Announcement 4, the measures require to classify auto parts as complete vehicles in violation of the HS nomenclature and, as a result, impose on auto parts the higher 25 per cent duty on complete vehicles instead of the bound duty rate of 10 per cent for auto parts.

4.408 This establishes that the measures are as such inconsistent with China's obligations under Article II of the GATT 1994. The mere fact that there may be exceptional individual instances where a large combination of parts as presented to customs at the border in a single consignment would qualify as a complete vehicle pursuant to GIR 2(a) of the HS and in the light of the Chapter note to Chapter 87 cannot exempt the Chinese measures from being, as such, incompatible with Article II of the GATT 1994 when it has been established that their application will necessarily result in WTO violations.

(d) No justification under Article XX(d) of the GATT 1994

4.409 China has not established that the violations of the GATT 1994 are justified under Article XX(d) of the GATT 1994. The measures fall neither under paragraph (d), nor do they satisfy the requirements of the chapeau of Article XX.

4.410 Contrary to China's allegation, the measures are not necessary to secure compliance with "China's tariff schedule relating to imports of 'motor vehicles'". The measures explicitly do not intend to secure compliance with China's tariff schedule, but to develop the Chinese auto parts industry. A justification of the Article II infringement is excluded since measures providing treatment less favourably than the schedule cannot secure compliance with the latter. The justification of the Article III infringement also fails. China has not demonstrated a real problem of tariff evasion. The measures are unsuitable to enforce the schedule since they impose charges amounting to complete vehicles tariffs in cases where there are no imports of complete vehicles. China has also failed to show that measures less burdensome than the local content requirements, administrative procedures and internal charges under the measures, for example investigations in individual instances of alleged evasion, would be insufficient to secure compliance with its tariff schedule.

4.411 China has not even attempted to show that its measures satisfy the chapeau of Article XX and consequently failed in its burden of proof. In any event, they do not since they result in both arbitrary and unjustifiable discrimination and also constitute a disguised restriction on trade. The primary purpose of the measures is to afford protection to domestic industry from imported competition.

(e) The measures are inconsistent with Article 3 of the SCM Agreement

4.412 Were the Panel to find that the measures fall under Article II of the GATT 1994 and that China is entitled to impose the tariff rate for vehicles on the imports of auto parts, *quod non*, the measures would in any case be a prohibited subsidy pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement.

4.413 The measures constitute a financial contribution within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. Imported auto parts satisfying the local content requirements of the measures are charged at 10 per cent. The revenue "otherwise due" follows from the "definitive, normative benchmark" of Article 28 of Decree 125 which charges 25 per cent on imported auto parts that do not satisfy the local content requirements. China's statement that the 25 per cent duty and the 10 per cent duty treatment "are not the same 'fiscal situations' for purposes of making a proper comparison" is not further substantiated.

4.414 The measures also confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement and are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement.

4. Conclusion

4.415 The measures are inconsistent with Article 2 of the TRIMs Agreement, Articles III:4, III:2 and III:5 of the GATT 1994 and China's *Accession Protocol*, and are not justified under Article XX(d) of the GATT 1994. In the alternative, they violate Article II of the GATT 1994 or Article 3 of the SCM Agreement.

J. SECOND WRITTEN SUBMISSION OF THE UNITED STATES

1. Introduction

4.416 China's measures amount to clear and straightforward inconsistencies with China's national treatment obligations under Article III of the GATT 1994. In particular, these measures impermissibly result in internal charges on imported parts in excess of those applied on domestic parts (Article III:2); the measures accord treatment less favorable to imported parts with respect to requirements affecting internal sale, purchase, distribution, and use (Article III:4); and the measures directly or indirectly require that specified amounts or proportions of auto parts used in vehicle manufacturing must be supplied from domestic sources (Article III:5). For the same reasons, China's measures amount to a domestic content requirement that is inconsistent with China's obligations under Article 2.1 and Paragraph 1(a) of Annex 1 of the TRIMs Agreement.

4.417 China's defense is twofold – its measures all involve customs duties, and those customs duties are consistent with Article II. In the event the Panel agrees with the United States and its co-complainants that China's measures are subject to Article III of the GATT 1994 and the TRIMs Agreement, China has not even attempted to assert a defense – aside from a vague reliance on Article XX(d) - to these plain breaches of its WTO obligations.

4.418 Moreover, the defense under Article II is based not on the text of China's schedule of tariff commitments. To the contrary, China does not dispute that its measures impose a charge on imported parts that is higher than the rate set out in China's schedule. Rather, China's defense is based on a single rule of interpretation (GRI 2(a)) of the Harmonized System, and on the explanation that its measures are required to prevent the "circumvention" of classification under GIR 2(a) through the ruse of "split shipments" of pre-organized kits of automotive parts.

4.419 The United States will address and refute the two main assertions – one factual and one legal – that underlie China's defense of its measures. As discussed in the next section below, the importation of bulk shipments of parts is routinely undertaken by automotive plants around the world, and such bulk shipments cannot be analogized to China's hypothetical case of the "split shipment" of a

pre-organized kit. As discussed in the last section, the HS has only limited, specific relevance to the interpretation of WTO obligations, and even then, GIR 2(a) does nothing to support China's measures.

2. China's analogy between the routine import of auto parts for manufacturing purposes and the hypothetical case of a kit separated into "split shipments" is fundamentally flawed

4.420 China's defense is built on a simple paradigm: that of a kit (either an SKD or CKD) containing all parts of a single automobile, or at least all parts of what amounts to something with the essential characteristics of an automobile. Under China's customs laws, China argues, it treats such kits as complete automobiles. Now, China asks rhetorically, should an importer be allowed to change the tariff treatment of the kit by the simple expediency of splitting that kit into two boxes? Of course not, asserts China. China simply and reasonably has adopted a measure to address that problem of "circumvention."

4.421 This dispute, however, does not turn on questions of split shipments of kits. The reason is that China's measures – although purportedly adopted to prevent importers from splitting kits to circumvent duties on whole cars – is vastly broader than that. It sweeps in not just a kit broken into two separate boxes, but all modes of parts supply used by modern manufacturers. That is, it sweeps together all imported parts from different suppliers, from different countries, purchased at different times, and even parts produced within China if such parts have insufficient local content. All this is done without any evidence of intent on behalf of the importer to "circumvent" the whole vehicle duty. Thus, there is no match between the measure actually adopted, and China's paradigm of the kit split into separate boxes.

4.422 In response, China further argues that collections of imported parts – even if sourced from different places at different times – are conceptually the same as a kit. After all, in both cases, at some point, the parts will be used to make an automobile.

4.423 This is the point at which China's argument, based on the paradigm of a kit in split shipments, completely falls apart. In commercial realities, a kit is totally different from the streams of parts used in manufacturing operations. An operation that assembles kits is different than a full-fledged, automobile manufacturing plant with full logistical capabilities to handle bulk shipments of parts. And most auto manufacturing plants are not in the business of assembling discrete kits.

4.424 Rather, manufacturing plants assemble automobiles using parts held in their inventories. The parts are sourced from around the world. They arrive at different times in different quantities. Some parts are defective. Some are damaged in assembly. Some are used for testing. Some parts are common to multiple models. In these normal commercial operations, there is never a box or "kit" containing all the imported parts used in a single vehicle.

4.425 Moreover, it would be fantastically expensive for a commercial manufacturer to create and use such a box of parts. To do so, the manufacturer would have to build or employ a warehouse in a location outside of China. The manufacturer would need to import and/or ship bulk shipments of parts to the warehouse, and then unpack all parts from various sources. The manufacturer would need to hold inventories. The manufacturer would then have to make kits by collecting one of each part used in a vehicle. All parts would then need to be repacked. When the kit arrived at the factory in China, the kit would have to be broken back into parts. The parts to be used in that plant would need to be resorted and placed in inventory for use on the assembly line. And the parts to be assembled by other operations in China would need to be repacked, for a second time, and then shipped to the parts producer. No commercial operation would ever work this way.

4.426 In short, China has no basis for comparing the streams of parts used by a manufacturing plant to the conduct of purported "circumvention" involved in splitting a kit before import. The imported parts used by manufacturing plants are not and cannot be put into kits. This is the commercial reality, and does not, as China asserts, raise any issue of "circumvention." Thus, the purported goal of China's measures – merely to stop "circumvention" in the form of splitting preorganized kits – is in no way consistent with actual scope and operation of China's measures. Rather, contrary to China's argument about "circumvention", the measures as actually constructed impose a local content requirement on all automobiles manufactures in China, and thus are plainly intended to encourage the growth of the domestic parts industry by discriminating against imported auto parts.

3. China cannot rely on GIR 2(a) as the basis for the defense of its measures

(a) GIR 2(a) only relates to the interpretation of China's obligations under its schedule of tariff commitments and not to the interpretation of other WTO obligations

4.427 China's defense to all of the claims of the United States are based on GIR 2(a). That interpretive rule, however, has only limited relevance to the legal issues in this dispute. In particular, the rule is only relevant with regard to the interpretation of China's schedule of tariff commitments. The rule is not relevant to the consideration of China's obligations under Article III of the GATT 1994, or to the question of whether China's additional charges on imported parts are to be considered either as "ordinary customs duties" under Article II:1(b), or as internal charges under Article III:2.

4.428 In *EC - Chicken Cuts*, the Appellate Body made the limited finding that the HS Convention could be "context" for interpreting a Member's tariff schedule with respect to agricultural products. The Appellate Body's reasoning was that GATT Contracting Parties agreed that the HS was to be used for the basis of Uruguay Round tariff negotiations for agricultural products, and that this agreement in turn served to qualify the HS as "context" under Article 31(2)(a) of the *Vienna Convention* in interpreting Member's schedules of tariff commitments in this specific regard. The Appellate Body made no finding that the HS was context for the interpretation of the GATT 1994, or for any other elements of the WTO Agreement.

4.429 China's extensive reliance on GIR 2(a) seems to imply that China believes that the interpretive rule, although relevant for interpreting China's tariff schedule, also has some sort of spill-over interpretive effect with regard to meaning of other WTO obligations. Any such view, however, is without basis and directly contrary to the text and the longstanding interpretation of the GATT 1994.

4.430 In particular, the content of a Member's tariff schedule cannot be used as a defense to breaches of the GATT 1994 obligations (aside of course from questions of breaches of tariff bindings under Article II). And, *a fortiori*, if a Member's tariff schedule is not a defense to a breach of other GATT 1994 obligations, neither may a document (such as GIR 2(a)) used as "context" for interpreting the schedule be used as a defense to a breach of the GATT 1994 obligations. As explained by the GATT panel in *US - Sugar*:

> Article II gives contracting parties the possibility to incorporate into the legal framework of the General Agreement commitments additional to those already contained in the General Agreement and to qualify such additional commitments, not however to reduce their commitments under other provisions of that agreement. . . . [T]he Panel found that Article II:1(b) does not permit contracting parties to qualify their obligations under other provisions of the General Agreement and that the provisions in the United States GATT Schedule of Concessions can consequently not

> justify the maintenance of quantitative restrictions ... inconsistent with the application of Article XI:1

4.431 The Appellate Body reaffirmed this principle in its report on *EC-Export Subsidies on Sugar*. Accordingly, any question with regard to whether China's measures are consistent with its schedule of tariff commitments, and any materials used to interpret those commitments, are distinct from – and not relevant to – the issue of whether or not China's measures are consistent with other obligations of China under the WTO Agreement.

(b) The dispositive issues in this dispute do not turn on GIR 2(a) or any other issue of tariff classification

4.432 GRI 2(a) also provides no support for China's defense because the dispositive issues in this dispute do not turn on any issues of tariff classification. In particular, the United States has shown that China's measures are in breach of Article III of the GATT 1994, the TRIMs Agreement, and the SCM Agreement, and that questions of tariff classification and tariff bindings under Article II are not relevant to those claims.

4.433 Turning first to Article III:4, the Appellate Body has identified three distinct elements required to establish a breach: (1) the imported and domestic products are "like products;" (2) the measure is a law, regulation, or requirement affecting the internal sale, purchase, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product. In its first submission, the United States explained that China's measures plainly meet each one of the three elements needed to establish a breach of Article III:4. Questions of tariff classification play no role in the Article III:4 analysis, and China in its submissions has not otherwise disputed any of the elements which establish a breach of Article III:4.

4.434 Moreover, China's main argument – that its charges are customs duties and that imported parts may be classified as complete vehicles – does not even implicate any issue which might provide a defense to this plain breach of Article III:4. In other words, even if China's charges were considered "customs duties," and even if China were correct that it was entitled under its tariff bindings to charge a duty of 25 per cent on imported parts used for manufacturing purposes, China's measures would still constitute a breach of Article III:4. The Article III:4 breach is based on the fact that the charge on any particular auto part will change depending on the types and value of other imported parts used in a complete vehicle, a system which creates a strong disincentive to the purchase and use of imported parts. Similarly, the administrative burdens applicable only to users of imported auto parts are inconsistent with Article III:4, regardless of whether or not China's charges are considered "customs duties."

4.435 China's tariff classification defense is also not applicable to China's breach of Article III:5 of the GATT 1994. And, as for the breach of Article III:4, this breach of Article III:5 exists regardless of any issue with respect to China's tariff bindings, or with respect to whether or not the extra charge imposed by China is an internal charge or a customs duty.

4.436 Finally, turning to China's breach of the first sentence of Article III:2, China in its first submission does present a defense. As will be explained below, this defense is without merit, and GIR 2(a) – as for China's other breaches (other than with respect to the alternative claim of a breach of Article II:1(a)) – again is not relevant to the analysis.

4.437 At the outset, however, the United States notes that China has not disputed that China's extra 15 per cent charge on imported parts (above and beyond ordinary customs duties) is inconsistent with Article III:2 if – as the United States submits – the charge is an internal one, and not an ordinary customs duty.

4.438 Turning to whether the additional charges are "ordinary customs duties" or internal charges, under the finding set out in *Belgium Family Allowances* and *EEC – Parts and Components*, China's charges at issue in this dispute can only be considered as internal ones. China's charges are based not on the goods as entered, and not even on the importer's declaration at the time of importation, but instead on the goods as finally manufactured – within China – into whole vehicles. As the United States emphasized at the first substantive meeting, China imposes at the border a revenue bond based on the 10 per cent duty rate for parts, and applies the extra charge only if an imported part (1) is actually used in the manufacture of a vehicle, and (2) only if that vehicle fails to meet the domestic content requirements set out under China's measures. As in *EEC – Parts and Components,* the charge must be evaluated based on its substance – not its title – and a charge which is assessed based on the level of local content contained in an internally manufactured product can only be considered an internal charge under Article III:2.

4.439 In its first submission, China tries to distinguish *Belgium Family Allowances* and *EEC – Parts and Components*, but those efforts are unsuccessful. China argues that its measures are different because its measures are imposed for the purpose of collecting customs duties. As an initial matter, China's argument is circular – the whole issue is whether or not the charges are in fact "ordinary customs duties" under Article II; China's argument simply assumes the conclusion. Furthermore, this type of argument about the purpose of the charge was explicitly considered and rejected in EEC – *Parts and Components*. To quote from that report: "[T]he Panel first examined whether the policy purpose of the charge is relevant to determining the issue of whether the charge is imposed in 'connection with importation' in the meaning of Article II:1(b). . . . . The relevant fact . . . is not the policy purpose attributed to the charge but rather whether the charge is due on importation or at the time or point of importation or whether it is collected internally."

4.440 The United States would also emphasize that, again, issues of tariff classification and the meaning of GIR 2(a) have no relevance to the question of whether China's additional charges are internal charges or instead are ordinary customs duties. That question turns only on the text and interpretation of Article II and Article III of the GATT 1994. In contrast, questions of tariff classification, and issues concerning the meaning of GIR 2(a) and its relevance to the interpretation of China's schedule of tariff commitments, only arise if China's additional charges are considered ordinary customs duties under Article II.

4.441 Finally, the United States notes that its additional claims – under Article 2.1 and Paragraph 1(a) of Annex 1 of the TRIMs Agreement, under Articles 3.1(b) and 3.2 the SCM Agreement, and under Parts I.7.2 and I.7.3 of the Accession Protocol and paragraph 203 of the Working Party Report – again do not turn on any issues of tariff classification or the meaning of GIR 2(a).

4.442 To summarize, the United States has established breaches of Article III:2, III:4, and III:5 of the GATT 1994, of the TRIMs Agreement, and of the SCM Agreement. China's only defense – that its classification of imported parts as whole vehicles is correct under the principles set out in GIR 2(a) – is not even relevant to analysis under those provisions of the WTO Agreement.

(c) GIR 2(a) would not provide China with a defense under Article II of the GATT 1994

4.443 As the United States has explained, China's additional charges on imported auto parts are internal charges, subject to obligations under Article III:2 of the GATT 1994, and not "ordinary customs duties" under Article II of the GATT 1994. Even aside from this fact, GIR 2(a) of the Harmonized System would not provide a defense to China's plain breach of its tariff commitments (if the charges are considered tariffs) in its schedule.

4.444 Before proceeding to a consideration of GIR 2(a) itself, the United States emphasizes that China's entire defense under Article II is based on GIR 2(a). In other words, China does not contest that its measures apply tariffs on auto parts that are higher than the 10 per cent rate generally applicable to auto parts under China's schedule of tariff commitments. Rather, China's only defense is that under its tariff schedule, when read in conjunction with GIR 2(a), China reserved itself the right to treat imported parts used for manufacturing purposes as if those parts were complete vehicles.

4.445 In addition, the United States notes its disagreement with China's contention that GIR 2(a) should be considered as "context" for the purpose of interpreting China's schedule of tariff concessions. The United States takes note of the Appellate Body findings in *EC - Computer Equipment* and *EC - Chicken Cuts*. Those two reports, however, are quite careful and limited in their reasoning, and do not express an across-the-board rule that the HS is "context" for the purpose of every part of every Member's schedule of tariff commitments. In *EC - Computer Equipment*, the Appellate Body found that the Panel should have examined the Harmonized System (including Explanatory Notes), but the Appellate Body did not specify whether the HS fit under the customary rules of interpretation reflected in Article 31 or under Article 32 of the *Vienna Convention*. In *EC - Chicken Cuts*, the Appellate Body did find that the HS was "context" under the customary rules of interpretation reflected in Article 31(2)(a) of the *Vienna Convention*, but the reasoning in that report was carefully limited to the facts and circumstances of that particular dispute. In particular, the Appellate Body emphasized that during the Uruguay Round, tariff negotiations for agricultural products were based on the HS, and the Appellate Body refers to a "Modalities" document – applicable only to agriculture – which confirmed this understanding of the negotiators. The Appellate Body reasoned that these particular facts and circumstances established an "agreement" among all parties that the HS would be used in the interpretation of scheduled commitments on agricultural products. In short, these findings in *EC-Chicken Cuts* regarding the HS are only directly applicable to schedules negotiated during the Uruguay Round, and only with respect to agricultural products.

4.446 Accordingly, the findings and reasoning in *EC - Chicken Cuts* do not apply directly to the present dispute, because this dispute does not involve a schedule negotiated during the Uruguay Round and does not involve agricultural products. And, China has presented no basis for finding that there was a comparable "agreement" (like the one during the Uruguay Round on agricultural products) among WTO Members concerning China's tariff negotiations on industrial goods.

4.447 The United States does agree, however, that the HS can certainly be relevant in the interpretation of China's schedule. In particular, under the customary rules of interpretation reflected in Article 32 of the *Vienna Convention*, the HS can be a "supplementary means of interpretation". Given that China's schedule is plainly based on the HS nomenclature, the HS Convention can in appropriate cases amount to "preparatory work and the circumstances of conclusion" with regard to the negotiation of China's tariff schedule.

4.448 Turning now to China's tariff classification argument based on GIR 2(a), the argument does not withstand scrutiny. GIR 2(a) states in full:

> Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled.

4.449 Two aspects of GIR 2(a) are apparent on its face. First, although China has based its case entirely on a "circumvention" theory, nothing in this rule of interpretation mentions anything about "circumvention." Second, the rule uses the language "as presented" and "presented," which makes clear that customs authorities are to classify the goods in the condition as presented to customs upon importation. There is no notion in GIR 2(a) that a customs authority should seek out all entries of diverse parts, by different importers, from different suppliers, at different times, and even of different national origin, and then proceed to collect them into some fictitious unassembled product, to then be classified as the assembled product. To the contrary, if China's interpretation of GIR 2(a) were adopted, the words "as presented" and "presented" would be rendered absolutely without meaning.

4.450 China also ignores the object and purpose of the HS Convention. In relevant part, the Preamble to the Convention provides:

> THE CONTRACTING PARTIES TO THIS CONVENTION, established under the auspices of the Customs Co-operation Council,
> DESIRING to facilitate international trade,
> DESIRING to facilitate the collection, comparison and analysis of statistics, in particular those on international trade,
> DESIRING to reduce the expense incurred by redescribing, reclassifying and recoding goods as they move from one classification system to another in the course of international trade and to facilitate the standardization of trade documentation and the transmission of data,
> CONSIDERING the importance of accurate and comparable data for the purposes of international trade negotiations,
> CONSIDERING that the Harmonized System is intended to be used for the purposes of freight tariffs and transport statistics of the various modes of transport, . . .
> CONSIDERING that the Harmonized System is intended to promote as close a correlation as possible between import and export trade statistics and production statistics . . . .

4.451 Two aspects of the object and purpose of the Convention, as set out above, are notable for the purpose of this dispute. First, nowhere is there any mention of "circumvention" or any other similar concept. Indeed, the notion of "circumvention" is not set out anywhere in the Convention.

4.452 Second, two key objects and purposes of the Convention are (i) to establish uniform tariff nomenclature rules for the purpose of comparing trade statistics (between exports and imports, and between different parties to the Convention), and (ii) to facilitate international trade. China's interpretation of GIR 2(a), however, is totally at odds with these express objects and purposes of the Convention. Under China's interpretation, every party to the Convention must classify bulk imports of manufacturing parts as whole products, based on criteria to be developed and applied by each party. If this were true, the comparability of trade statistics collected by different members would be destroyed. Also, the comparability between import and export statistics would be destroyed – China's measures apply only to imports, and do not appear to require that China perform a similar "automobile parts characterized as complete vehicles" analysis for exports of auto parts.

4.453 China's interpretation of GIR 2(a) is also at odds with the object and purpose of facilitating trade. Under China's measures, goods are not classified as imported at the border, but only after the goods have been used in manufacturing, and only after the manufacturer has completed and verified a complex analysis of the local content of the final product. This intricate, complicated system for classification destroys the certainty and predictability of tariff classification, and can only serve as a serious impediment to trade.

4.454 China's submissions also wrongly ignore that the Convention is an international agreement that imposes obligations on its Members; the Convention does not, as China implies, serve as some sort of instrument that provides "permission" to WTO Members to depart from WTO obligations or to classify products at will. The pertinent obligations in the Convention are as follows:

> Article 3: Obligations of Contracting Parties
>
> 1. Subject to the exceptions enumerated in Article 4:
> (a) Each Contracting Party undertakes, except as provided in subparagraph (c) of this paragraph, that from the date on which this Convention enters into force in respect of it, its Customs tariff and statistical nomenclatures shall be in conformity with the Harmonized System. It thus undertakes that, in respect of its Customs tariff and statistical nomenclatures:
>> (i) it shall use all the headings and subheadings of the Harmonized System without addition or modification, together with their related numerical codes;
>> (ii) it shall apply the General Rules for the interpretation of the Harmonized System and all the Section, Chapter and Subheading Notes, and shall not modify the scope of the Sections, Chapters, headings or subheadings of the Harmonized System; and
>> (iii) it shall follow the numerical sequence of the Harmonized System.

4.455 These obligations require parties to the Convention to "use all the headings and subheadings of the HS without addition or modification, together with their related numerical codes," and to apply the GIRs. As the United States and its co-complainants have pointed out, China in its submissions ignores the most fundamental of the GIR's: GIR 1 provides that "classification should be determined according to the terms of the headings and any relative section or chapter notes." The United States submits that the reason China in its submissions has ignored GIR 1 is plain: China's measures are directly contrary to GIR 1. In particular, the HS has headings specific to auto parts, but instead China under its measures classifies auto parts as whole vehicles.

4.456 Furthermore, the fact that the application of the GIRs is obligatory undercuts China's arguments. That is, if China is right that GIR 2(a) provides for the classification of bulk auto parts used in manufacturing as the complete, manufactured product, then the obligation to classify parts in this manner would apply to each and every party to the Convention. Yet, China has failed to provide any evidence that any other party to the Convention has adopted measures at all comparable to China's measures on auto parts. Moreover, China has conceded that even China itself does not use similar classification schemes for parts other than auto parts. In sum, *either* (*a*) every party to the Convention, and China itself with respect to all goods except auto parts, is acting inconsistently with the obligations under the Convention to apply the GIRs (including GIR 2(a)), *or* (*b*) GIR 2(a) – as it plainly states in the text – applies to goods "as presented," and China's treatment of auto parts is inconsistent with GIR 2(a). For the reasons stated above, the United States submits that (*b*) – GIR 2(a) applies to goods as presented upon importation – is the only possible answer.

K. SECOND WRITTEN SUBMISSION OF CANADA

1. Introduction

4.457 China has attempted to turn a dispute respecting the consistency of the measures with China's WTO obligations into a dispute where the main issue is the interpretation of a single, and non-binding, WCO document.

4.458 China has skirted a number of key issues in its defence. It has not disproved that the measures give rise to clear domestic-content requirements. It has not provided any evidence that "tariff circumvention" even exists as a legal concept, nor explained how the simple process of importation can last for as long as the measures provide. However, China agrees that the volume and value thresholds in the measures can be applied to products imported into China by a third-party supplier even though China admits those parts should be the subject of national treatment. This demonstrates how arbitrary and discriminatory the measures truly are.

4.459 Canada emphasizes that it is the WTO Agreement that is at issue in this dispute. China is strictly bound by the negotiated concessions for auto parts, as understood at the time of its accession. Members cannot manipulate tariff concessions so as to undermine the certainty afforded to traders by the GATT discipline of non-discrimination, which China does by relying incorrectly on Article II of the GATT 1994 so as to reduce the scope of its obligation under Article III of the GATT 1994. Canada demonstrates this by reference to the principles of treaty interpretation. China also cannot justify its measures under Article XX(d) of the GATT 1994.

2. Importation and the scope of national treatment

(a) China ignores the principle of non-discrimination in international trade

4.460 The principle of non-discrimination informs Articles I, II and III of the GATT 1994. However, China has failed completely to reconcile its manipulation of negotiated tariff concessions with the very object and purpose of the GATT's non-discrimination provisions. Article II of the GATT 1994 cannot be read in isolation. It forms part of the universe of non-discrimination provisions that support the very legal and commercial certainty that the measures undermine. Article III exists to prevent discrimination against imported products, by protecting expectations of an equal competitive relationship between imported and domestic products.

4.461 While China insists that it is merely "enforcing" undisputed tariff lines, the heart of this dispute remains the limited extent to which ordinary customs duties imposed in accordance with Article II:1(b) may impinge on the broad protection against discrimination provided by Article III of the GATT 1994, and China's failure to provide that protection.

(b) Ordinary customs duties may only be imposed based upon the physical state of products as they arrive at the border

4.462 Ordinary customs duties can be imposed on imported products "on their importation", meaning based upon the state of a product as presented at the border. The reference to "on" emphasizes a single event. The ordinary meaning of "importation" refers to the physical act of products being brought across the border into a country, an interpretation supported by the GATT 1994 generally, GATT *acquis*, the WTO Appellate Body and even the WCO.

4.463 Border charges other than ordinary customs duties have a greater (although still temporally limited) period during the "importation" stage during which they can be assessed. This is evident from the difference in language used to describe when such charges may be imposed ("in connection with" the importation; or "at any time on the importation"). But once a product has entered the territory of a Member and is available for internal use within a Member, any charges on the *imported* product based on its state must comply with the national treatment obligations of Article III, and Article II is in no way applicable.

4.464 As China alleges that its measures impose ordinary customs duties, any flexibility during the "importation" stage is not relevant to this dispute. Regardless, the measures apply well after the process of importation is complete and therefore must be internal measures.

4.465 Even if there were some flexibility to defer assessments of ordinary customs duty on a product past the point of its physical entry into China (which Canada says there is not), none of China's justifications withstand scrutiny.

4.466 China says that the charges are really applied at the border because vehicle manufacturers are required to self-evaluate whether a vehicle is deemed imported prior to importing parts for that vehicle. But that self-evaluation amounts only to a *prediction* of what will happen in the manufacturing process. Self-evaluation is therefore nothing more than a mechanism for the administration of an internal charge, whether or not at the border.

4.467 China suggests that products may be in "customs control", and by necessary implication not in the internal market, by the simple expedient of imposing financial security and bookkeeping requirements. This suggestion is without merit, as the "bonding" in the measures does not restrict the internal use of the products.

4.468 The measures do not impose charges based on the state of products as they arrive at the border, as is demonstrated by an examination of the ordinary meaning of Article II of the GATT 1994, read in the context of Article III of the GATT 1994 and in the light of the object and purpose of China's Schedule. Therefore, they are not ordinary customs duties, nor are they other charges permitted by Article II of the GATT 1994. As a result, the measures can *only* be internal charges applied in violation of Article III and the TRIMs Agreement.

(c) China misapplies the HS and its Explanatory Notes in imposing charges to auto parts as presented at the border

4.469 The HS of classification and its Explanatory Notes, as they were used in negotiating a Member's Schedule, are to be taken into account as context for the interpretation of the meaning of that Schedule. Contrary to China's suggestion, there is no discretion to ignore selected Explanatory Notes.

4.470 Classification is relevant in interpreting the obligation in Article II:1(b) of the GATT 1994 not to charge duties greater than the amount set out in China's Schedule, because classification of the proper category of a product is an essential first step for assessing duty.

4.471 In order to classify properly a product as it is presented at the border, it is first necessary to look to the appropriate headings. Significantly for this dispute, a "chassis fitted with engine" (87.06) is clarified in that heading's Explanatory Note as covering "*motor vehicles without bodies*".

4.472 The measures ignore these headings and impose three separate thresholds for domestic content, all of which are inconsistent with China's WTO obligations.

4.473 **Article 21(1)** of Decree 125 considers that parts imported as CKD and SKD kits are automobile parts characterized as complete vehicles. China's Accession Protocol requires that such parts be charged at a 10 per cent rate, regardless of classification.

4.474 **Article 21(2)** of Decree 125 considers that parts in a vehicle are Automobile parts characterized as complete vehicles if a certain number of Assemblies are Deemed Imported. These thresholds present two violations of Article II of the GATT 1994. First, deemed imported assemblies are classified based upon the number or value of key parts even though for the most part there is no heading for such assemblies, and despite the thresholds being very selective. Second, even assuming that all the parts in a Deemed Imported Assembly are imported and contained in a single shipment, the thresholds do not accurately classify parts.

4.475 **Article 21(3)** of Decree 125 considers that parts used in a vehicle are automobile parts characterized as complete vehicles if they constitute more than 60 per cent of the value of all parts used in manufacturing the vehicle. There is nothing in any part of the HS that suggests that value may be used to classify products. As a result, the application of Article 21(3) inevitably leads to duties imposed based on an incorrect classification, and consequently violates Article II of the GATT 1994.

4.476 As it is the general practice of customs authorities to classify goods based on their state as presented at the border, it is not necessary to look to the isolated customs cases cited by China. But, in any event, China has not shown a pattern of acts showing subsequent practice of other Members that: (1) is common, consistent and discernible; and (2) must imply agreement among WTO Members to support key controversial aspects of the measures. Notably, China has not shown that:

- a WTO Member may deem that parts have the "essential character" of the complete vehicle based on the volume thresholds contained in the measures; nor that
- value thresholds can be used as a classification tool.

4.477 The only feature of the measures that could be accepted customs classification is the classification of parts as a complete vehicle where those parts, contained in a single shipment, have the essential character of a whole vehicle (CKD or SKD kits). Ironically, such parts have been exempted from coverage under the measures, so the only use of the measures has been to classify parts contrary to Article II:1(b).

(d) Article II of the GATT 1994 does not allow Members to impose higher ordinary customs duties on separate shipments of auto parts on the theory that they can be classified as a whole vehicle

4.478 China also claims that it may classify as one product multiple shipments of parts from different exporters to different destinations and at different times. Again, China has not demonstrated a common, consistent and discernible practice among WTO Members that ordinary customs duties permitted under Article II of the GATT 1994 may be applied to separate shipments classified as if they arrived together.

4.479 In the absence of any subsequent practice, China has relied heavily on a passing statement by the HS Committee to the effect that split shipments are permitted under national law. But that reference to split shipments was not included in the GIRs or the Explanatory Notes, was based on

isolated practice that did not include motor vehicles or their parts, specifically was not intended to cover parts used for the manufacturing process, has not been shown to have been relied upon when negotiating China's tariff commitments, and was not reflected in Member practice at the time of China's accession.

4.480 China has also cited the anti-dumping practice of the European Communities and the United States. However, that practice cannot be evidence of subsequent practice to interpret Article II:1(b), first sentence, nor China's Schedule.

(e) Regardless of classification, China is required by its commitments on accession to charge unassembled or partially assembled vehicles a duty rate of 10 per cent

4.481 All parties agree that paragraph 93 of the Working Party Report creates binding obligations on China.

4.482 The ordinary meaning of that paragraph, read in the light of its object and purpose, would be ignored if China were at liberty simply never to introduce a separate tariff line for CKD and SKD kits. Further, since the purpose of the paragraph is to address the particular concern of Members to maintain preferential treatment for CKD and SKD kits, a good-faith interpretation, based on the understanding of Members at the time of China's accession, requires China to apply the 10 per cent rate to these products.

4.483 This understanding is confirmed by the circumstances surrounding the conclusion of the Accession Protocol. Prior to its accession, China provided preferential tariff treatment to parts with the essential character of whole vehicles in two ways: classifying them as parts, or classifying them in a separate tariff line at a lower rate than for assembled vehicles.

4.484 The understanding of the parties at the time of China's accession was that the 25 per cent duty for complete vehicles would apply only to vehicles imported *in assembled condition*. As a result, China's denial of a 10 per cent rate of duty to parts, imported together in one shipment with the essential character of a whole vehicle, is a violation of paragraph 93 of the Working Party Report.

(f) Non-violation nullification and impairment

4.485 If the Panel finds, contrary to Canada's submissions, that paragraph 93 of the Working Party Report allows China both to classify CKD and SKD kits as whole vehicles and to charge them a duty of 25 per cent, this must constitute a non-violation nullification and impairment under Article XXIII:1(b) of the GATT 1994 of Canada's legitimate expectation to a 10 per cent tariff rate for CKD and SKD kits.

3. The measures cannot be justified under Article XX(d) of the GATT 1994

(a) China has mischaracterized a Article XX(d) of the GATT 1994 defence to an Article III violation as a defence under Article II

4.486 China concedes that it must rely on Article XX(d) to defend all aspects of the measures which are internal. However, it suggests that auto parts imported directly by vehicle manufacturers may be covered by the measures pursuant to Article II. In truth this argument is simply an Article XX(d) defence to a violation of Article III of the GATT 1994 and the TRIMs Agreement: that it has enacted the measures to "enforce" China's Schedule to prevent "tariff circumvention". China's whole defence

to Canada's complaint could only validly be brought under Article XX(d) if China showed an independent GATT-consistent law or regulation that the measures are designed to enforce.

4.487 Further, even if any aspect of the measures is properly considered to be ordinary customs duties (which Canada disputes), the measures violate Article II by providing less favourable treatment for auto parts than required under China's Schedule. Again, China can only defend that violation if it can establish that Article XX(d) applies.

(b) Test for justifying measures under Article XX(d)

4.488 GATT Article XX(d) allows a Member to enact a WTO-inconsistent measure if it is necessary to enforce WTO-consistent laws, including laws relating to "customs enforcement". China must show both that the measures are provisionally justified under paragraph (d) and that they are applied in a manner consistent with the requirements imposed by the chapeau of Article XX. China has not and cannot do so.

(c) The measures are not justified under of Article XX(d)

4.489 When read collectively, in the light of Policy Order 8 and on their face, the measures are clearly designed to promote China's domestic auto parts industry. Only in rare cases do the thresholds under the measures apply to what are properly classified as whole vehicles. As such, they cannot be designed to secure compliance with China's Schedule.

4.490 The measures are also not "necessary", as is demonstrated by reference to the various factors that establish the necessity for GATT-inconsistent measures. China says that tariff arbitrage constitutes "circumvention", but that is not a recognized concept in customs practice and China has not explained why importers should not be able to take advantage of tariff rates mutually agreed to by Members. In any case, China has presented no evidence that this "tariff circumvention" is happening. There is no legal foundation to the claim that tariff arbitrage is improper. China has presented no real evidence that this arbitrage, even if styled as "tariff evasion", actually occurs with any frequency, let alone with any intent. And China simply alleges that it should be receiving additional tariff revenues. The measures cannot contribute to rectifying a problem that does not exist.

4.491 Further, the measures are significantly trade-restricting. They apply to all imported auto parts based on arbitrary thresholds that *presume* tariff arbitrage in all instances. Not only must companies plan to avoid importing parts at levels that approach the threshold limits, but the measures also require auto parts manufacturers that import auto parts to sign contracts with vehicle manufacturers guaranteeing levels of domestic content in the parts they supply. In sum, it is clear that the measures are not necessary to secure compliance, do not protect vital or common interests, and are excessively trade-restricting.

(d) The measures do not satisfy the requirements of the chapeau of Article XX

4.492 The measures result in both arbitrary and unjustifiable discrimination. They are rarely, if ever, applied to imported parts that could properly be classified as complete vehicles. Equally important, China has failed to give any justification for the discrimination against imported auto parts, aside from *ex post facto* rationalizations that the measures are appropriate because some vehicle producers apparently use imported parts that exceed the thresholds in the measures.

4.493 The measures are also a disguised restriction on trade. China has admitted the measures apply to auto parts that are in internal trade. There is no question that the application of the measures

adversely affects the conditions of competition between imported and domestic parts. And, as noted above, the primary purpose of the restriction is to afford protection to the domestic automotive industry from imported competition.

L. SECOND WRITTEN SUBMISSION OF CHINA

1. Introduction

4.494 China considers that the parties' submissions and statements to the Panel have significantly narrowed the scope of the parties' disagreements concerning the challenged measures.

4.495 First, the complainants can no longer deny that there is a legitimate issue of customs administration concerning the relationship between motor vehicles and parts of motor vehicles.

4.496 Second, the complainants now appear to acknowledge that there are circumstances in which the importation of parts and components in multiple shipments can constitute a form of tariff evasion. The complainants also appear to acknowledge that customs authorities can undertake "investigations," and consider "evidence," to determine whether multiple shipments of parts and components have the essential character of the complete article.

4.497 Third, the parties now appear to agree that the time and place at which a charge is collected is not the determinative consideration in evaluating whether that charge is subject to the disciplines of Article II or Article III. Rather, the issue is whether the charge is one that a Member is allowed to impose by reason of the importation of the product, or, alternatively, whether the charge relates to the status of a product after it has been imported.

4.498 Finally, China considers that the complainants' submissions have revealed their true position on when China's higher bound duty rates for motor vehicles would apply. The answer is "never."

4.499 As China will demonstrate in this rebuttal submission, China considers that this re-framing of the issues and claims before the Panel leads to the conclusions that (1) the challenged measures must be analysed in the light of China's rights and obligations under Article II of the GATT 1994; and that (2) so analysed, the challenged measures give effect to a proper interpretation of China's tariff commitments for "motor vehicles" and do not result in the imposition of ordinary customs duties in excess of those set forth in China's Schedule of Concessions.

2. The challenged measures do not impose ordinary customs duties in excess of those set forth in China's Schedule of concessions

4.500 In particular, China considers that the central issue before the Panel is whether China can interpret the term "motor vehicles" to include the importation, in multiple shipments, of auto parts and components that have the essential character of a motor vehicle within the meaning of GIR 2(a).

4.501 The Panel has now had the benefit of extensive discussion of GIR 2(a) by the parties. The complainants have challenged two distinct aspects of how China has interpreted and applied GIR 2(a) in the context of Decree 125. First, the complainants have challenged where China has drawn the line for purposes of the essential character test under GIR 2(a), an issue of parts vs. wholes. Second, the complainants have challenged China's application of GIR 2(a) to classify multiple shipments of parts and components on the basis of their common assembly into a finished article, an issue of form vs. substance.

4.502 GIR 2(a) provides the rules by which customs authorities define the boundaries between complete articles and parts of those articles, i.e., between parts and wholes. At the outset of this dispute, the EC took the position that there is a "clear separation" between motor vehicles and parts of motor vehicles. This argument leads to the conclusion that China's tariff rates for motor vehicles apply in only one circumstance: When the importer imports a completely finished motor vehicle, fully assembled, with absolutely no parts missing. The absurdity of this position is apparent. In this regard, the complainants do not agree among themselves.

4.503 China draws the Panel's attention to this apparent disagreement among the complainants because it illustrates two important points concerning the application of GIR 2(a). First, the complainants cannot reasonably take the position that there is a "clear separation" between complete motor vehicles and parts of motor vehicles. Second, this apparent disagreement among the parties highlights the critical context that GIR 2(a) provides in resolving the relationship between complete articles and parts of those articles.

4.504 For China's tariff provisions for motor vehicles to have any meaning whatsoever, it is self-evident that China *must* apply GIR 2(a) to resolve the relationship between parts and wholes. The complainants' case against the challenged measures therefore cannot arise from the fact that China has drawn a line between motor vehicles and their parts. Rather, the complainants' case against the challenged measures must concern *where* China has drawn the line.

4.505 China considers that the principal issue in this dispute is whether customs authorities may classify multiple shipments of parts and components on the basis of their common assembly into a single article.

4.506 In China's view, the resolution of this form vs. substance issue is informed by three considerations: (1) the interpretation of the term "as presented" in GIR 2(a); (2) the complainants' own practice and admissions in respect of the application of GIR 2(a) to multiple shipments; and (3) the practices of the complainants and other WTO Members in respect of measures to prevent the evasion of higher duty rates that apply to complete articles.

4.507 Specifically, the interpretive issue is whether the term "as presented" allows customs authorities to base a classification determination upon evidence that a shipment of parts and components is related to other shipments of parts and components through their common assembly into a single article. As early as 1960s, the Nomenclature Committee of the Customs Cooperation Council (the precursor to the WCO) decided that the application of GIR 2(a) to goods assembled from multiple shipments of parts and components, including parts and components arriving from different countries, was a matter "to be settled by each country in accordance with its own national regulations." In 1995, the HS Committee reaffirmed this prior interpretation of GIR 2(a) within the context of the HS.

4.508 Under Article 8 of the HS Convention, any "advice on the interpretation of the Harmonized System and recommendations to secure uniformity in the interpretation and application of the Harmonized System" that the HS Committee adopts are "deemed to be approved" by the WCO if no member objects to its adoption within a specified period. The 1995 decision concerning the interpretation of GIR 2(a) was unanimously adopted by the HS Committee, and no member objected to its adoption within the specified period. It is therefore an authoritative interpretation of GIR 2(a) adopted by the WCO.

4.509 As China explained in its answers to Panel questions, the Appellate Body has specifically affirmed the relevance of decisions adopted by the HS Committee, and by the WCO itself, concerning

the interpretation of the General Interpretative Rules. In this case, the WCO has adopted an interpretation of GIR 2(a) that is directly relevant to the interpretive issue before the Panel. The necessary consequence of the WCO's decision is that the term "as presented" does not preclude consideration of whether the parts and components in a particular shipment are related to other shipments of parts and components through their common assembly into a complete article.

4.510 Indeed, without some means of enforcing the boundaries between parts and wholes that customs authorities establish in accordance with GIR 2(a), an importer could choose its preferred tariff classification even in respect of a *single* shipment of parts and components. GIR 2(a) would serve no effective purpose within the HS.

4.511 China does not consider that the complainants have offered a plausible alternative interpretation of the term "as presented" that is consistent with the interpretation adopted by the WCO, or that is consistent with the purpose of the rule within the HS. Not surprisingly, their preferred strategy is to try to avoid the implications of the WCO's interpretation by dismissing it as "not legally binding." These attempts to dismiss the significance of the WCO's interpretation of GIR 2(a) miss three important points. First, as explained above, the Appellate Body has expressly referred to interpretations of the GIRs adopted by the HS Committee and the WCO as relevant to a panel's assessment of how the GIRs affect the interpretation of a Member's Schedule of Concessions. Second, the complainants have failed to take into account Article 8 of the HS Convention, which provides that interpretations of the GIRs adopted by the HS Committee are deemed to be approved by the WCO if no member objects to their adoption. Third, and most fundamentally, their argument misses the point of the decision itself. The nature of the interpretation that the WCO has adopted is not one that would "bind" members of the WCO, in the sense that it would compel them to reach a specific classification determination on the facts of particular cases. The significance of the WCO's interpretation, as pertinent to this dispute, is that the term "as presented" does not *preclude* the application of GIR 2(a) to multiple shipments of parts and components, whether or not a particular WCO member chooses to apply GIR 2(a) in this manner.

4.512 The complainants' second line of defense is to mischaracterize the interpretation of GIR 2(a) adopted by the WCO. Oddly, the complainants focus on the decision of the HS Committee as it relates to split consignments, and pay almost no attention to the decision of the HS Committee as it relates to the "classification of goods assembled from elements originating in or arriving from different countries."

4.513 Despite their best efforts to confuse the issue, the complainants cannot refute the only straightforward reading of the WCO's interpretation of GIR 2(a) – that the classification of goods assembled from multiple shipments of parts and components is a matter to be decided by each country in accordance with its national laws and regulations.

4.514 As China will demonstrate next, the credibility of the complainants' interpretation of GIR 2(a) suffers a further blow when it is compared to their own statements and practice. The complainants' own statements and practices are not fully in accord with their understanding of GIR 2(a) as stated before the Panel in this case.

4.515 As China demonstrated in its first written submission, the measures that it has adopted to prevent the evasion of its higher duty rates on motor vehicles are indistinguishable from measures that other WTO Members, including the complainants, have adopted to prevent the evasion of both ordinary customs duties and anti-dumping duties. It is important to recall the specific purpose for which China cited the practice of WTO Members in respect of measures to prevent the circumvention of anti-dumping duties. The subsequent practice that China established is that WTO Members have

adopted measures to address the circumstance in which a complete article is subject to a higher rate of duty than the rate of duty that applies to parts and components of that article.

4.516 The subsequent practice that China has established, and that no party has disputed, is that WTO Members have adopted measures to ensure that the importation and assembly of parts and components cannot be used to evade the higher rate of duty that applies to the complete article. The only question is whether the validity of this practice, from a WTO perspective, should depend upon the *type* of duty that gives rise to the differential in duty rates between the complete article and parts of that article.

4.517 The complainants' primary assertion is that "anti-dumping duties and the circumvention of such duties are governed by the rules of Article VI of the GATT 1994 and the Anti-Dumping Agreement, not Article II of the GATT 1994." The problem with these contentions is that there are, in fact, no "rules" in either Article VI of the GATT 1994 or the Anti-Dumping Agreement that address the question of whether WTO Members can impose anti-dumping duties on imports of parts and components of a product that is subject to an anti-dumping measure. The suggestion that the "rules" of Article VI and the Anti-Dumping Agreement "legally recognize" this practice, in contrast to the "rules" of Article II, is simply false.

4.518 The complainants also invoke the remedial purpose of anti-dumping duties as a reason why the resolution of the parts vs. whole and form vs. substance issues should be different in the context of anti-dumping duties as compared to ordinary customs duties. This is, in China's view, a curious form of results-oriented reasoning. It is beyond dispute that ordinary customs duties serve a "purpose." The problem with the complainants' "remedial purpose" argument is that they have yet to explain why the *purpose* of anti-dumping duties is more important than the acknowledged *purpose* of ordinary customs duties.

4.519 The United States suggests that there is some meaningful difference between ordinary customs duties and anti-dumping duties because anti-dumping duties are defined by reference to the scope of the investigation, not by reference to tariff lines. This is yet another distinction without a difference. Anti-dumping measures and tariff provisions both refer to specific products.

4.520 Finally, the complainants refer to the *Decision on Anti-Circumvention* adopted at the conclusion of the Uruguay Round to support their view that measures to prevent the circumvention of anti-dumping duties are "different." However, the complainants do not appear to agree on what the significance of this decision is. The European Communities, for its part, states that the *Decision on Anti-Circumvention* "recognises that uniform rules on anti-circumvention of anti-dumping measures *have not been defined*." This would suggest that there are no rules that would either allow or disallow the application of anti-dumping duties to the parts and components of a product that is subject to an anti-dumping measure.

4.521 The complainants have failed to establish why the practices of WTO Members in respect of anti-dumping duties (or countervailing duties, for that matter) are not relevant to the interpretation of China's Schedule of Concessions, and to a consideration of the types of measures that China may adopt to prevent the evasion of the higher duty rate for motor vehicles that it negotiated.

4.522 The Appellate Body has recognized that "a basic object and purpose of the GATT 1994, as reflected in Article II, is to preserve the value of tariff concessions negotiated by a Member with its trading partners, and bound in that Member's Schedule." The Appellate Body has likewise observed that the tariff concessions negotiated by Members are intended to be "reciprocal and mutually advantageous."

4.523 As China has explained, it is consistent with this object and purpose of the GATT 1994 to interpret the term "motor vehicles" in China's Schedule of Concessions in a manner that preserves the value, from both a revenue and market access perspective, of the higher bound duty rates that it negotiated for motor vehicles. On the contrary, the logical conclusion of the complainants' arguments in respect of paragraph 93 of the Working Party Report is that China's tariff provisions for motor vehicles would *never* apply. This conclusion cannot possibly be consistent with the object and purpose of preserving the value of reciprocal and mutually advantageous tariff concessions. The effective resolution of the customs relationship between a complete article and parts of that article does not pose a systemic risk either to the security of tariff concessions under Article II, or to the national treatment disciplines of Article III. As China has explained, the resolution of this issue does not lead to the result that Members may classify articles on the basis of their end-use, and it does not lead to the result that Members may impose discriminatory measures on imported products merely by characterizing the measures as border measures under Article II. China's position is simply that Members may interpret and enforce their Schedules of Concessions in accordance with the rules of the HS, and in accordance with the principle that tariff arrangements should have meaningful effect.

3. The challenged measures are subject to the disciplines of Article II of the GATT 1994

4.524 China believes that the parties have reached substantial agreement on the principles that are relevant to determining whether a particular measure or charge is subject to the disciplines of Article II or to the disciplines of Article III. As China will discuss below, measures and charges that China is allowed to adopt within the framework of Article II cannot be challenged under Article III or the TRIMs Agreement.

4.525 The term "on their importation" in Article II:1(b), first sentence, is not limited to the exact point in time and space at which products from another country cross the border. Because the scope of Article II is not defined by the time or place at which the charge is collected, there must be some other basis to determine whether a particular charge or measure applies to imported products "on their importation" into the customs territory of a Member. Applying this understanding of the term "on their importation," the characterization of a particular charge in relation to Article II will depend upon the *reason* or *event* that triggered the imposition of the charge. If the measures fulfil a "valid customs liability," they are measures that are subject to the disciplines of Article II of the GATT 1994.

4.526 This inquiry returns the analysis to the interpretation of China's tariff provisions for "motor vehicles," and, in particular, to the question of whether China may classify multiple shipments of auto parts and components on the basis of their common assembly into a complete article. An important part of this analysis is the meaning of the term "as presented" in GIR 2(a), and the practice of other WTO Members in resolving the relationship between complete articles and parts of those articles in the context of customs administration. Under Decree 125, the fact that a shipment of auto parts is one of a series of related shipments of auto parts is evident on the face of the customs declaration when the goods are presented at the border. By declaring that a shipment of auto parts is for a registered vehicle model, the manufacturer is declaring (1) that the shipment is one of a series of shipments of auto parts that the manufacturer will assemble into a specific motor vehicle; and (2) that through this series of shipments, the manufacturer will import a group of auto parts and components that, in their entirety, have the essential character of a motor vehicle. For these reasons, the charges that China assesses and collects pursuant to Decree 125 fulfil a valid customs liability.

4.527 The conclusion that the challenged measures are subject to the disciplines of Article II is reinforced by the fact that the challenged measures do not constitute a form of internal regulation, and do not impose internal charges, within the meaning of Article III of the GATT 1994. The delineation between Articles II and III of the GATT 1994 requires an understanding of the terms "importation"

and "imported." Until these customs formalities, under the challenged measure, are complete, the CGA retains customs control over these entries, and the parts and components are not in free circulation within China. Therefore, the customs duties are not charges that China imposes upon auto parts and components from other countries after they are "imported."

4.528 There is a critical threshold issue before the Panel concerning the characterization of the challenged measures in relation to China's rights and obligations under Article II and Article III of the GATT 1994. China has demonstrated above that the challenged measures are subject to the disciplines of Article II because they relate to and impose charges that China is allowed to impose by reason of the importation of products into its customs territory. China has further demonstrated that the challenged measures impose charges on products "on their importation" into its customs territory, and not on "imported" products. If the challenged measures are subject to the disciplines of Article II, China does not consider that the challenged measures can be analysed under Article III of the GATT 1994 or the TRIMs Agreement.

4.529 The United States takes the position that the characterization of the charges that China collects under the challenged measures is irrelevant to whether these charges are subject to the disciplines of Article III. Canada, at a minimum, appears to reject the United States' argument outright. China believes that if a particular measure implements and collects a charge that a Member is *allowed* to impose in accordance with Article II, it cannot be the case that the same charge must be in conformity with the requirements of Article III. The Appellate Body in *EC - Banana III*, which is relied upon by the US, did not find that the *same* aspects of a particular measure can be subject, simultaneously, to the requirements of both Article II and Article III. The Appellate Body report in *EC – Bananas III* confirms the critical importance of identifying the specific purpose of a particular measure or charge in relation to a Member's rights and obligations under Article II and Article III.

4.530 While Canada rejects the United States' claim that the characterization of a charge is irrelevant to whether that charge should be analysed under Article II or Article III, it nonetheless contends that "the *administrative* burdens imposed by the measures on imported auto parts must be assessed under Article III:4." Again, China believes that if a Member imposes a customs procedure to ensure the collection of customs duties that it is allowed to impose under its Article II commitments, those measures are necessarily customs measures. Customs procedures do not violate Article III merely because the importer might consider these procedures to be a burden.

4.531 The European Communities asserts that "the TRIMs Agreement does not require a preliminary assessment as to whether a measure is a 'border measure' or an 'internal measure'." To establish a violation of Article 2 of the TRIMs Agreement, the complaining Member must demonstrate the application of a trade-related investment measure "that is inconsistent with the provisions of Article III or Article XI of the GATT 1994." Neither the EC nor any other party has alleged a violation of Article XI of the GATT 1994. The European Communities' claim under the TRIMs Agreement must therefore rest on its claim that the challenged measures violate Article III of the GATT 1994. To establish a claim of violation under Article III, the European Communities must demonstrate that the measures at issue are "internal measures." China therefore does not perceive any basis for the EC's position that the TRIMs Agreement, unlike the GATT 1994, does not require a threshold determination as to whether the measures at issue are within the scope of Article II or Article III.

4. The complainants have failed to establish a prima facie violation of the commitment that China made in paragraph 93 of the Working Party Report

4.532 The complainants have failed to establish a prima facie violation of the commitment that China made in paragraph 93 of the Working Party Report. A necessary element of this claim is a showing that China has created separate tariff lines for CKD/SKD kits. The complainants have failed to demonstrate that China has created separate tariff lines for CKD/SKD kits. Therefore, this claim must fail. China considers that the Panel should stop its analysis at this juncture, as it is evident that the complainants' claim under paragraph 93 lacks foundation.

5. The complainants have failed to establish a violation of the SCM Agreement

4.533 China does not understand the basis for the claim of the United States and the European Communities concerning revenue foregone under Article 1.1(a)(1)(ii) of the SCM Agreement. The Appellate Body has stated that "the comparison under Article 1.1(a)(1)(ii) of the SCM Agreement must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question." The basic problem with the argument of the United States and the European Communities is that they have failed to "identify and examine fiscal situations which it is legitimate to compare."

6. The challenged measures would be justified under Article XX(d) if the Panel were to identify any violation of the covered agreements

4.534 China considers that the challenged measures properly interpret and give effect to its tariff provisions for motor vehicles, in accordance with the rules of the HS and in accordance with the practice of other WTO Members under like circumstances; and, therefore, are fully consistent with its rights and obligations under Article II of the GATT 1994.

4.535 China has explained that the issue of "circumvention" in this case is a question of ensuring the proper tariff classification of parts and components that have the essential character of a motor vehicle. Canada and the United States, at least, appear to recognize that breaking parts and components into multiple shipments can constitute a form of "tariff evasion".

4.536 China does not consider that WTO Members must have recourse to Article XX(d) of the GATT 1994 in order to interpret and enforce their tariff schedules in accordance with the HS. However, the Panel may nonetheless consider that China needs a separate basis within WTO law to enforce its tariff rate provisions for motor vehicles. The Panel may also find that, contrary to China's explanations, the rules of the HS do not provide a basis for China to give meaningful effect to the higher duty rates that it negotiated for motor vehicles, because these rules provide no basis for China to distinguish between motor vehicles and parts of motor vehicles, whether in one shipment or in multiple shipments. Finally, the Panel may find that one or more elements of the challenged measures result in the imposition of internal charges, or otherwise constitute an impermissible form of internal taxation or internal regulation, in violation of Article III of the GATT 1994 or the TRIMs Agreement. In any such circumstance, or in respect of any other violation of the covered agreements that the Panel may identify, China considers that the challenged measures are justified under Article XX(d) as measures that are necessary to secure compliance with China's customs laws.

4.537 The complainants cannot credibly dispute, at this stage in the proceedings, that there is a legitimate and complex question of tariff classification and customs administration concerning the relationship between motor vehicles and parts of motor vehicles. In addition, China has demonstrated that, in the absence of any means of defining and enforcing the boundary between motor vehicles and

parts of motor vehicles, China's tariff provisions for motor vehicles are essentially unenforceable. If China had no means of looking past these ploys the importers may adopt, the result would be that importers would never have to pay the tariff rates applicable to motor vehicles. In effect, there would be no "motor vehicles" entering China – only "parts".

4.538 China believes that GIR 2(a), as interpreted by the WCO, has already resolved these issues of customs interpretation and enforcement, such as "parts vs. wholes" and "form vs. substance." But if GIR 2(a) did not exist, China (along with other customs authorities) would still need a means of defining and enforcing the boundary between parts and wholes. This is what the challenged measures do – they ensure the effective enforcement of China's tariff provisions for motor vehicles by defining what constitutes a motor vehicle, as distinct from parts of a motor vehicle, and by enforcing that boundary without regard to the manner in which the importer structures or documents its import transactions.

4.539 In its first written submission, China reviewed the jurisprudence concerning the meaning of "necessary" under Article XX(d). To summarize, the Appellate Body has described the term "necessary" as involving a weighing and balancing of: (1) the relative importance of the interests or values furthered by the challenged measure; (2) the contribution of the measure to the realization of the ends pursued by it; and (3) the restrictive impact on international commerce. The challenged measure must be compared to other "reasonably available", WTO-consistent alternatives.

4.540 With respect to the first factor, it cannot be doubted that the collection of tax revenues is an important interest of WTO Members, and especially for developing country members. Likewise, the enforcement of negotiated tariff concessions is also an important objective for Members, and for developing country Members in particular. With respect to the second factor, China has presented clear evidence that the challenged measures further China's objective of ensuring the effective enforcement of its tariff provisions for motor vehicles. China has documented specific motor vehicle models that are assembled in China from imported parts and components that have the essential character of a motor vehicle, and that are imported into China in multiple shipments. In the absence of the challenged measures, auto manufacturers would evade the higher duty rates that apply to motor vehicles because of the manner in which they have structured their imports of parts and components for these and other vehicle models. China has also presented evidence that the specific circumstance referred to by the United States – an auto manufacturer "who is splitting a CKD shipment into two or more separate boxes" – is a specific circumstance to which the challenged measures have responded. While China does not consider that this is the *only* circumstance in which customs authorities can respond to the evasion of higher duty rates that apply to a complete article, it is certainly a circumstance that is addressed by the challenged measures. In respect of the third factor under the "necessary" standard, China has already noted that the measures do not materially affect imports of motor vehicles or motor vehicles parts, other than in the entirely legitimate respect that importers must pay the higher tariff rates for motor vehicles when they import collections of parts and components that have the essential character of a motor vehicle. Notwithstanding the "burden" that complainants claim that the measures impose, major car manufacturers and auto parts manufacturers have reported that the measures have had little or no impact on their operations in China. The only auto manufacturers who are affected are those who assemble motor vehicles in China from imported parts and components that have the essential character of a motor vehicle.

4.541 Finally, in respect of the existence of other reasonably available, WTO-consistent alternatives, China has already explained why the challenged measures are not inconsistent with its rights and obligations under Article II, or with the rules of the HS. As the predicate for this discussion is that the Panel has found otherwise, at least in some respect, China does not believe that there are

other reasonably available alternatives to secure compliance with its tariff provisions for motor vehicles.

4.542 The chapeau to Article XX permits WTO Members to invoke the general exceptions listed in items (a)-(j) "[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade …". The challenged measures do not discriminate between countries where the same conditions prevail. The challenged measures apply equally to all imported auto parts and components, regardless of their origin. The measures entail no discrimination, let alone discrimination that is arbitrary or unjustifiable in relation to countries where the same conditions prevail. Nor do the challenged measures constitute a disguised restriction on international trade.

4.543 In respect of the chapeau to Article XX and the Appellate Body's statement in *US – Shrimp*, China considers that the question before the Panel is whether China has drawn these lines in a manner that preserves the tariff provisions that it negotiated for motor vehicles, while at the same time giving meaningful effect to its separate tariff rates for parts and components of motor vehicles. China submits that the balance it has struck in the challenged measures is a reasonable one, and gives "due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned." China is allowed to give effect to its tariff provisions for motor vehicles, and to ensure that substance prevails over form, while the complainants will continue to export large quantities of auto parts to China that are not in any way affected by the measure, and that are subject to the applicable duty rates for parts.

4.544 Under Article 29 of Decree 125, an auto manufacturer who purchases imported parts and components from a third party in China, and uses these parts and components in the assembly of a registered vehicle model, is liable for the difference between the amount of any duty that the importer has already paid in relation to the importation of those parts and components, and the duty rate applicable to a collection of imported parts and components having the essential character of a motor vehicle. China considers that any charges that it collects pursuant to Article 29 of Decree 125 relate to the administration and enforcement of China's tariff provisions for motor vehicles, as they relate to the proper classification of a specific collection of imported parts and components that, in their entirety, have the essential character of a motor vehicle. China has acknowledged, however, that this aspect of Decree 125 is conceptually different in relation to Article II, because the original importer of these third-party parts and components has, in most cases, already completed the customs formalities in respect of these imports, and the goods are no longer subject to control.

4.545 China considers that Article 29 of Decree 125 is justified under Article XX(d) for reasons that are similar to those set forth above. In the absence of Article 29 of Decree 125, auto manufacturers could evade duty liability for complete motor vehicles by arranging to import parts and components through suppliers. As China explained at the first substantive meeting, this is of particular concern in the automobile industry, in light of the close commercial relationships among auto manufacturers and parts suppliers.

7. Conclusion

4.546 For the reasons set forth in this submission, China requests the Panel to reject the claims raised by the European Communities, the United States, and Canada.

M. ORAL STATEMENT BY THE EUROPEAN COMMUNITIES AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

1. Introduction

4.547 This case is about local content requirements and discrimination against imported products in blatant violation of the TRIMs Agreement and Article III of the GATT 1994. This is not a technical case concerning tariff classification as China would like to have it although even the tariff classification arguments of China entirely fail. This case is about protectionist measures that violate the very core principles of the whole system established by the WTO Agreement.

2. The automotive industry

4.548 As the European Communities has demonstrated already on many occasions[56], China attempts to paint a picture of the automotive industry that has nothing to do with reality. Vehicles and their parts are simply not manufactured in one country and by one company and its affiliates, and then shipped to China in parts for a mere assembly in China with the sole purpose of avoiding China's higher tariff rates for complete vehicles. In the global economy, vehicle manufacturers are simply not able even to consider such a business model. They necessarily have to rely on highly specialised parts manufacturers that are located in almost all parts of the world.

4.549 Because of fierce competition, vehicle manufacturers are obliged to standardise the production of their vehicle models in order to reach volumes of production sufficient to generate economies of scale which are absolutely vital to remain competitive. Many parts fit not only different models of the same manufacturer but different models of different manufacturers.

4.550 The identification of imported parts that belong to a given specific vehicle model is an entirely fictitious condition imposed by the measures. The normal business strategy of a vehicle manufacturer is to order parts in bulk, some of which will be used in the manufacture of different vehicle models, some as spare parts. Under the measures these identical parts will be charged entirely differently depending on their end use in China and in particular whether they are fitted to a vehicle model that contains a certain combination or proportion of Chinese-made parts.

3. The applicable provisions

(a) Is there a threshold issue? The TRIMs Agreement as an answer

4.551 As the European Communities has repeatedly demonstrated, there is no threshold issue in these Panel proceedings for the purposes of examining Article 2 of the TRIMs Agreement. This provision does not require an *ex-ante* analysis as to whether a Measure is an internal or a border measure. On the basis of its clear wording, all it requires is an examination of whether the contested measures are (a) investments measures, (b) trade-related, and (c) fall within the Illustrative List. If they fall – like the Chinese measures – under both paragraphs of the Illustrative List, they must be considered to fall under Articles III:4 and XI:1 of the GATT 1994 and to violate Article 2 of the TRIMs Agreement.

[56] See *inter alia* paragraphs 9 to 17 and 68 to 74 of the first written submission of the European Communities, paragraphs 4 to 8 of the European Communities' response to the question of the Panel and paragraphs 8 to 19 of the second written submission of the European Communities.

(b) Article III vs. Article II of the GATT 1994

4.552 China stated in its rebuttal submission that it believes "that the parties have reached substantial agreement on the principles that are relevant to determining whether a particular measure or charge is subject to the disciplines of Article II or to the disciplines of Article III".[57] This is not true. Whereas China continues to rely on pure formalism, such as the involvement of "customs" authorities, so-called "bonds" and other labels attached under its domestic law, in order to bring its Measures within the scope of Article II of the GATT 1994, the European Communities has demonstrated on the basis of clear substantive criteria why the Chinese measures are internal measures falling under Article III of the GATT 1994, and not ordinary customs duties imposed "on importation".[58]

4.553 First, the charges on imported auto parts are not determined at the time or point of importation, but internally after assembly and manufacture, i.e. at a significantly later stage.

4.554 Secondly, the Chinese measures do not impose charges "on importation" since the charges are not due because of importation of the auto parts, but because of other internal events and criteria. Their imposition depends on whether "the Verification Center, after verifications, concludes that the imported automobile parts should be characterized as complete vehicles" (Article 28 of Decree 125) which in turn depends on whether the imported parts were fitted into vehicles with an insufficient level of local content.

4.555 Thirdly, the internal nature of the measures is further illustrated by the fact that they apply directly only to vehicle manufacturers, rather than to the importers of auto parts.

4.556 However, the fact that the Chinese measures are internal measures falling under Article III of the GATT 1994 does not mean that Article II of the GATT 1994 does not play any role for the resolution of this dispute.

4.557 First, the European Communities considers that the standard treatment of certain CKD and SKD kits under Article 2 of Decree 125 could be examined solely as a violation of Article II of the GATT 1994 while the rest of the measures breach, in addition to Article 2 of the TRIMs Agreement, Article III, paragraphs 2, 4 and 5 of the GATT 1994. Secondly, the European Communities is of the view that the inconsistency of the Chinese measures with China's Schedule of Concessions plays an important role under Article XX(d) of the GATT 1994, which China invokes, albeit in a very superficial manner, as an alternative defence.

4. Article II of the GATT 1994

4.558 The interpretation given by the WCO secretariat on the words "as presented" under point 1 of the reply is materially identical to the position taken by the European Communities in these proceedings and by the Appellate Body in its report in *EC – Chicken Cuts*. Indeed, any other reply would have been highly surprising. According to the WCO secretariat "as presented" refers to "the moment at which the goods are presented to customs or other officials with a view to classifying the goods concerned in the customs tariff or in the trade statistics nomenclatures". The Appellate Body has framed this principle in similar terms as follows: "in characterizing a product for purposes of tariff

[57] China's second written submission, para. 100.
[58] European Communities' second written submission, paras. 35 to 56.

classification, it is necessary to look exclusively at the 'objective characteristics' of the product in question when presented for classification at the border".[59]

4.559 The interpretation of the now so famous decision of the HS Committee in 1995 is also clarified. The reply demonstrates once and for all that China has entirely invented its theory on "multiple shipments". The WCO secretariat has now clarified that the phrase "elements originating in or arriving from different countries" in that decision have absolutely nothing to do with the "multiple shipments" theory China has invented for the purposes of these Panel proceedings.

5. Article XX (d) GATT 1994

4.560 The European Communities is of the view that China's arguments relating to Article II of the GATT 1994 are more appropriately addressed under Article XX(d) of the GATT 1994. This is because in our view there can be no doubt about the fact that the measures violate Article 2 of the TRIMs Agreement and Article III, paragraph 2, 4 and 5 of the GATT 1994.

4.561 China's explicit arguments relating to Article XX(d) of the GATT 1994 are very cursory both in its first and second written submissions. The arguments fall manifestly short of fulfilling China's obligations on the burden of proof and therefore the analysis should stop there. As a matter of principle, it is not for the complaining parties to develop further China's passing references to Article XX(d).

4.562 In any event, China has not shown that there is in reality a problem of tariff evasion that needs to be addressed. Second, in order to be justified under Article XX(d), the measures should be necessary to secure compliance with the 25 per cent duty on complete vehicles. However, as demonstrated by the European Communities in its first and second written submissions, the measures treat imported auto parts less favourably than provided for in China's Schedule. The measures cannot be suitable to enforce China's tariff schedule since they impose charges which directly conflict with China's tariff schedules instead of enforcing them.

4.563 As regards China's passing arguments in relation to the chapeau of Article XX of the GATT 1994, they are made for the first time only in China's second written submission, which is nothing but another demonstration of China's tactics to delay or avoid addressing difficult issues. Therefore and in view of the fact that China entirely fails to meet the first condition of provisional justification under Article XX, a couple of remarks will suffice.

4.564 In *US – Gasoline,* the Appellate Body held that the object and purpose of the chapeau of Article XX is to prevent the misuse or abuse of the exceptions of Article XX.[60] Even a restriction that formally meets the requirements of one of the specific exceptions listed in Article XX, which is not the case here, will constitute an abuse if it is in fact only a disguise to conceal the pursuit of trade-restrictive objectives.[61] This is precisely what China tries to do: to conceal the trade-restrictive objective of its measures, which is apparent in view of the various clear statements in the measures that directly point to the objective of providing protection to domestic production of auto parts.[62]

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[59] Appellate Body Report on *EC – Chicken Cuts*, para. 246.
[60] Appellate Body Report on *US – Gasoline*, para. 22.
[61] Panel Report on *EC – Asbestos*, para. 8.236.
[62] See, for instance, Articles 4 and 52 of the Automotive Policy Order 2004.

N. ORAL STATEMENT BY THE UNITED STATES AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

4.565 China's rebuttal submission, though lengthy, adds very little to the substantive discussion of the issues in this dispute. Rather, China's submission mostly relies on rhetorical devices. First, China relies on rhetorical catch-phrases – such as "substance over form" and "parts versus wholes." These phrases are nowhere contained in the WTO Agreement, or even in the HS, and are not helpful in resolving the issues in dispute. The second rhetorical device used in China's second written submission is to mischaracterize complainants' positions. Most notably, China repeatedly claims that the complainants agree with China on various issues and the issues thus have been "narrowed," and then China proceeds to build arguments based on these false premises.

1. Article III of the GATT 1994 and the TRIMs Agreement

4.566 As the United States has explained, China's measures amount to straightforward inconsistencies with China's national treatment obligations under Article III of the GATT 1994 and to a domestic content requirement that is inconsistent with China's obligations under Article 2.1 and Paragraph 1(a) of Annex 1 of the TRIMs Agreement. China's defense to the Article III issues is based solely on its argument that its measures involve customs duties, and that Article III cannot apply to a measure that involves customs duties. China has not otherwise even attempted to assert a defense – aside from a vague reliance on Article XX(d) – to these breaches of its WTO obligations.

4.567 In its rebuttal submission, China phrases its argument as follows, with the emphasis in the original: "If a particular measure implements and collects a charge that a Member is *allowed* to impose in accordance with Article II, it cannot be the case that the same charge must be in conformity with the requirements of Article III." This statement has no basis in logic or the text of the GATT 1994. In fact, it is routine for a measure to be examined under the obligations set out under various provisions of the WTO Agreement in disputes under the DSU. The fact that a measure is or is not consistent with one obligation does not necessarily determine whether the measure is or is not consistent with a different obligation.

4.568 Perhaps China implies that there is something special in Article II of the GATT 1994 that somehow "allows" (as China puts it) Members to depart from other GATT obligations. But that issue has been considered, and rejected, by prior Panels under the GATT 1947 and by the Appellate Body under the GATT 1994. As found in those disputes, Article II of the GATT 1994 and a Member's schedule of tariff commitments impose additional obligations on a Member, and consistency with those obligations cannot serve as a defense to breaches of other WTO obligations.

4.569 China's charges (whether internal charges or customs duties) are straightforward violations of Articles III:4 and III:5 of the GATT 1994, as well as the TRIMs agreement. This is because the level of China's charges increases if the local content of a vehicle manufactured in China does not exceed certain thresholds. As such, the measures provide less favorable treatment to imported parts with respect to laws affecting their internal sale, purchase, distribution and use under Article III:4, and impose a domestic mixing requirement within the meaning of Article III:5.

4.570 Consider a vehicle manufacturer in China that has imported an auto part; call it Part A. Under China's measures, the importer/manufacturer must post a security for the 10 per cent parts rate. Once Part A enters into inventory, the manufacturer has a decision with regard to what to do with this imported part. The manufacturer may decide to use the imported part in the production of a particular complete vehicle. However, the manufacturer must always be mindful of China's local content thresholds. If the use of Part A in manufacturing would result in a vehicle that exceeds the thresholds,

then all other imported parts used in that vehicle would be subject to the 25 per cent charge. By tying the use of Part A to increased charges on other parts, China's measures serve as a disincentive on the use of Part A in manufacturing. And, this disincentive is in addition to, and separate from, the level of the charge imposed on Part A itself. No comparable regulations affect the use of a comparable domestic Part A. Accordingly, China's measures are a violation of Article III, as a law affecting the use within China of an imported product.

4.571 China is wrong in asserting that customs duties would always constitute "a violation of the non-discrimination principles under Article III." The same type of discrimination does not apply to customs duties regularly imposed by WTO Members. That is, the level of charges on other imported products does not depend on how an imported part is used within the Member's territory.

4.572 This discrimination not only applies to the "use" of the imported product, but also applies to the "internal sale, offering for sale, purchase, or distribution" under Article III:4. If the importer in the above example were instead a parts distributor or a parts producer, then the importer would want to sell or distribute imported Part A to manufacturers within China. Under China's measures, however, a manufacturer in China will have a disincentive to purchase imported Part A from the distributor. Thus China's measures adversely affect the "internal sale, offering for sale, purchase, or distribution" of imported parts, with no comparable effect on domestic parts.

2. Internal charges vs. customs duties

4.573 The additional charges at issue in this dispute are internal charges, not "ordinary customs duties." Under *EEC – Parts and Components*, charges are internal charges subject to Article III:2 of the GATT 1994 when based on the product as manufactured internally, regardless of the label adopted by the implementing Member. In this case, China's charges are based not on the goods as entered but instead on the use of the goods in manufacturing a vehicle within the territory of China. When a part is presented at the border, China imposes a revenue bond based on the 10 per cent duty rate for parts, and applies the extra 15 per cent charge only (1) if the imported part is actually used in the manufacture of a vehicle, and (2) if the amount of imported content in that vehicle exceeds the thresholds set out in China's measures. China's measures are focused on the amount of local content in the final assembled vehicle - the who, what, where, and hows of importation are irrelevant.

4.574 In its second submission, China argues that its charges are just like regular customs duties because: "The classification of the import entry, and the assessment of the applicable duty rate, is based on the status of the auto parts and components when they were entered and declared to the Customs General Administration." This statement, however, is inconsistent with the actual content of China's measures. The charge is based on how the part is actually used internally, and not on the condition of the part as imported.

4.575 As the United States understands it, China's argues in its rebuttal submission that no parts are actually "imported" until the final duties are assessed after manufacturing, because as a formal matter China (in most but not all cases) will not have settled – until after the final manufacture of a complete vehicle – the financial guarantee required upon entry. This argument is not and cannot be correct. Otherwise, a Member could avoid its Article III disciplines by the simple ruse of structuring its customs laws so that no product is actually "imported" – as China proposes the term be interpreted – until after discriminatory internal charges and other discriminatory measures had been applied. Rather, the only sensible way to view "imported" in this context is with its normal meaning, that is, the time when the product enters the Member's customs territory.

4.576 The United States also would note that if the Panel in fact were to agree with China's apparent argument that no parts are to be considered "imported" until after manufacturing, then the measures would amount to import restrictions under Article XI of the GATT 1994, as alleged in the US request for the establishment of a panel. This result would follow from the fact that China's measures are mandatory for vehicle manufacturers who wish to import parts. And, if those measures prohibit the importation of parts until after the completion of a manufacturing operation, the measures would amount to restrictions on the ability of manufacturers to import parts.

3. GIR 2(a) would not provide China with a defense under Article II of the GATT 1994

4.577 China's additional charges on imported auto parts are internal charges, subject to obligations under Article III:2 of the GATT 1994, and not "ordinary customs duties" under Article II:1(a) of the GATT 1994. Even aside from this fact, GIR 2(a) of the HS would not provide a defense to a breach by China of its tariff commitments.

4.578 As the United States has explained, China's tariff classification argument based on GIR 2(a) is entirely without merit. The US explanation includes that China's interpretation of GIR 2(a) is inconsistent with the object and purpose of the HS Convention to establish uniform tariff nomenclature rules for the purpose of comparing trade statistics (between exports and imports, and between different parties to the Convention). In fact, under China's interpretation, the comparability of trade statistics collected by different Members, and between import and export statistics, would be destroyed. China has never responded to this explanation of how China's interpretation is inconsistent with the object and purpose of the HS Convention.

4.579 China's argument that only China's interpretation would allow "substance" to triumph over "form" is meaningless, and completely ignores the reality of modern automobile manufacturing. Manufacturers import bulk shipments of parts because this is the usual and most efficient means of conducting large-scale automobile manufacturing, and not because manufacturers are trying to avoid duties owed on the import of knock-down kits.

4.580 The United States also has three additional points on China's tariff binding argument based on GIR 2(a). First, China's submission repeatedly claims that GIR 2(a) is addressed to the issue of "parts vs. wholes." This characterization of GIR 2(a) is incorrect. Rather, the HS addresses "parts vs. wholes" under the HS tariff nomenclature: that is, whole articles and parts (and assemblies) of articles are classified in separate headings. Accordingly, the general issue of "parts vs. wholes" is governed by GIR 1, which provides that articles must be classified in accordance with the relative headings. In contrast, GIR 2(a) is only addressed to the limited issue of the classification of articles presented unassembled or disassembled, and does not address the classification of bulk parts shipments.

4.581 Second, the United States recognizes that the WCO Secretariat has no formal role under the Convention to provide definitive interpretations of the HS, nor to provide definitive advice to other bodies. The United States does note, however, that the response of the WCO Secretariat to the Panel's questions acknowledges the point made by the United States regarding the phrase "elements originating in or arriving from different countries," as used in the HS Committee decision cited by China. In particular, the Committee's discussion of "elements" from different countries was in the context of discussing the application of rules of origin, and does not in any way indicate that the Committee was considering a measure (such as China's) that would artificially combine bulk shipments of parts from different countries in order to create a fictional collection of parts to be used in the assembly of a complete vehicle.

4.582 Third, the only pertinence of the HS Convention in this dispute is to assist in determining the common intent of WTO Members with respect to China's tariff commitment on specific auto parts, such as radiators and brakes. Regardless of any issues raised by China regarding the precise meaning of HS interpretive notes and WCO discussions of interpretive notes, nothing in the HS Convention could support an interpretation of China's WTO tariff commitments such that bulk shipments of brakes and radiators should receive the same tariff treatment as whole automobiles.

4. China's Article XX(d) defense

4.583 China, as the disputing party asserting an affirmative defense under Article XX(d) of the GATT1994, has the burden of proving each element of the defense. China has not met that burden.

4.584 China's basic argument under Article XX(d) is that its measures are "necessary to secure compliance with laws or regulations" needed to collect the 25 per cent duty that China is permitted under its tariff bindings to collect on the importation of whole vehicles. China uses this language to mean two very different things – neither one of them supports an Article XX(d) defense.

4.585 First, China uses this language to mean that under its domestic tariff schedule, China is to charge a whole-vehicle rate of duty on any imported part, so long as that part is used to manufacture within China a vehicle with a foreign content that exceeds the thresholds under China's measures. As the United States has explained, there is no possible interpretation of China's national treatment obligations under Article III, nor of China's WTO Schedule, that would allow for China to impose a 25 per cent duty on bulk shipments of parts imported for manufacturing purposes. Accordingly, China's purported Article XX(d) defense fails to present any "laws or regulations which are not inconsistent with the provisions of this Agreement," as required by Article XX(d).

4.586 Second, China uses the same language – about ensuring its ability to collect the 25 per cent whole-vehicle duty – to mean something entirely different: namely, that China must be able to address certain limited, though still hypothetical, examples of "evasion" (as China puts it), such as the case of a CKD split into two shipments, or a whole vehicle entered with the tires removed. To be absolutely clear, the United States does not agree, as China claims, that a hypothetical measure intended to address split shipments of kits would be consistent with China's WTO obligations. Rather, China in fact has not adopted any such measures in this dispute, and it is not meaningful for the United States (nor the Panel) to engage in an analysis of hypothetical, vaguely defined measures not actually adopted by China.

4.587 For two reasons, China's asserted rationale fails to meet the requirement of necessity under Article XX(d). First, China has still failed to show a single instance where any importer ever engaged in the specific practices identified by China. In fact, China's course of conduct has shown that it has not been concerned about tariff evasion at all. Rather, Chinese authorities have controlled the tariff process by requiring auto manufacturers to negotiate the rates that would be applicable for all types of kits and parts, with the key factors in the outcome of that negotiation being a manufacturer's commitment to investing in China and using local content in assembling vehicles.

4.588 Second, China's asserted "circumvention" rationale does not match the scope of China's measures. China's measures sweep broadly to cover all imports of bulk parts for manufacturing purposes, not just instances of what China calls "tariff evasion." Given the far broader scope of the measures China has actually adopted, they cannot be considered "necessary" under Article XX(d) to meet China's asserted policy concern with "evasion."

O. ORAL STATEMENT BY CANADA AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

4.589 Canada has explained how the measures are inconsistent with Article III of the GATT 1994: with Article III:2, for applying internal charges on imported auto parts in excess of those applied to domestic auto parts; with Article III:4, for according less favourable treatment to imported parts with respect to requirements affecting internal sale, purchase, distribution and use; and with Article III:5, for requiring specified amounts or proportions of parts for vehicle manufacturing in China to come from domestic sources. This domestic-content requirement leads in turn to a violation of Article 2 of the TRIMs Agreement. China has not addressed these arguments. Its central position remains its Article XX of the GATT 1994 defence presented as an argument under Article II.

4.590 China's mischaracterization of the complainants' arguments does not address the claims before the Panel. The complainants' arguments raise the fundamental issue of how one auto part can become a motor vehicle by virtue of its use in the internal market, when another, identical part does not. China does not deal with this. It alleges that the complainants would deny it the right to apply its motor vehicle tariff because they have asked China to honour its tariff commitments for auto parts. China tells the Panel that everyone does as it does. There is no evidence to support this proposition, which is legally irrelevant even if there were.

4.591 China also alleges that the complainants have selectively ignored the GIRs and its efforts to reframe the complainants' claims under Article II of the GATT 1994. The GIRs, which the complainants have addressed in full *and* in context, are not relevant to this dispute, because this dispute is not about applicable tariffs or Article II, but discrimination against imported auto parts.

4.592 Canada has already demonstrated the nature of China's violation of Article III of the GATT 1994 and the TRIMs Agreement, and will examine in more detail four persistent problems with China's defence: (1) the serious systemic implications of China's Article II claim; (2) basic inconsistencies in China's argument; (3) the inconsistency of China's defence with accepted customs practices; and (4) the absence of any Article XX defence for the measures.

4.593 China's argument concerning the flexibility that GIR 2(a) should afford to a Member to interpret its Schedule would, if accepted, allow Members to justify with impunity the circumvention of the national treatment obligation in Article III. According to China, whenever a Member's tariff commitments for parts are lower than those for complete products, that Member may presume that the difference will lead to tariff circumvention and consequent economic loss. This would legitimize the application of domestic-content thresholds linked to the imposition of the tariff rate for a completed product to parts used to produce that product.

4.594 Following China's logic, imported auto parts can only receive the benefit of a parts tariff in two circumstances. One is where those parts are never used to manufacture a complete product (as in the case of spare parts). The other is where enough domestic content is incorporated in the complete product so that imported parts after further processing no longer have the "essential character" of the completed product.

4.595 China has not presented any evidence of a problem with competition, and, even if there was a problem, such a problem is appropriately resolved by specific means for which specific disciplines exist, such as safeguards and anti-dumping duties, and not through additional illegal tariffs.

4.596 In its rebuttal submission, China erroneously claims that the complainants would deny it the opportunity to enforce its tariff rate for motor vehicles. Canada is happy for China to apply its tariff rate for motor vehicles to *actual* motor vehicles as understood in the HS, instead of to alternators or

steering wheels. China's argument relies on GIR 2(a), while ignoring the express language of Article II of the GATT 1994 and the context for the operation of the GIRs as demonstrated by the complainants.

4.597 The Appellate Body has said clearly that the broad purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. To realize that purpose, we apply the tests set down in, for example, *Japan – Alcoholic Beverages II* so as to determine whether an imported good is like a competing domestic one that may be receiving better treatment in the domestic market. However, if a Member can extend its consideration of the character of an imported good to some indefinite point after physical importation, in order to evaluate how or by whom the good is used, any Article III test becomes an exercise in relativity.

4.598 Under China's approach, one imported good may be identical to both another imported good and a domestic equivalent. Yet, a Member may grant different treatment to the first imported good because it was bought by company X and not company Y, or was used in a process that included over 60 per cent imported parts, whereas the other imported good was used mostly with domestic parts. If we are examining the imported and domestic goods under, say, Article III:4, tariff classification and the physical characteristics of the good are now unrelated. Under the measures, two otherwise-identical imported goods are given two different tariffs solely on the basis of their end-use.

4.599 China tries to confuse this fact by arguing that, if the classification of a particular motor vehicle at the border is not obvious, the complainants would limit China to considering that motor vehicle as a collection of parts. In fact, China goes further than that, to suggest that the complainants contend that removing something as simple as a wiper blade requires the classification of the vehicle as a collection of parts. China is entitled to classify parts that have the essential character of a finished vehicle, as they are presented in a single shipment at the border, as a finished vehicle; however, it is *not* China's right to withhold a decision on essential character until it sees fit.

4.600 China's argument is that the scope of Article II should be expanded, and the scope of Article III narrowed. China attempts to justify this by wrapping its Article II defence in an erroneous interpretation of WCO, not WTO, obligations. And that defence can be reduced to two flawed notions: first, that a Member may unilaterally characterize and artificially extend the "importation" stage to have a Measure covered under Article II; and, second, that a duty liability can relate to any point in time during this artificial "importation" stage.

4.601 Canada has shown in its written submissions that both notions are wrong in law. To accept otherwise would allow a Member to undermine its tariff commitments by affording protection to domestic production through an extension of the coverage of Article II to whatever point after physical importation suits the interests of the importing Member. China's defence does not address the central arguments presented by the complainants, and fails to explain why this logic applied to China's automobile industry should not also be true for other types of commercial operations that use parts charged at a lower rate than finished goods.

4.602 China maintains that its Schedule serves to protect it from a clear violation of Article III of the GATT 1994, and by extension Article 2 of the TRIMs Agreement, through the presentation of an anti-circumvention argument that is found nowhere in the WTO Agreement. The Appellate Body in *EC – Export Subsidies on Sugar* reaffirmed that a Member cannot rely on its Schedule to cure a violation of another provision of a covered agreement.

4.603 The measures effectively nullify WTO disciplines on domestic-content requirements. Consider the discipline set out in Article III:5 of the GATT 1994 concerning the application of

internal quantitative regulations, something that China simply ignores. If a Member applies a threshold for domestic content, it would still be subject to the discipline imposed by Article III:5. Since China cannot marry the restriction on imposing such measures in the internal market with an argument that the threshold is necessary to permit the application of tariff lines, it avoids the issue entirely.

4.604 Further, the broad scope for Article II:1(b) of the GATT 1994 that China has invented cannot exist in the same legal universe as, for example, the clear restriction in Article III:4 against discrimination in the internal sale, offering for sale, purchase or distribution of an imported good. Canada has established, and China has not denied, that the measures discriminate in each of these ways against the sale, purchase and distribution of foreign auto parts. China has maintained that Articles II and III are binary. This ignores the fact that Article III can, in certain instances, apply at the border, such as with Article III:4. Nothing in the text of Article II authorizes the operation of the measures in the face of the prohibition in Article III:4, and China does not address this.

4.605 China argues that the measures are justified as they are consistent with widespread Member practice, that it can classify goods on the basis of their end-use, and that it can establish different points in time at which importation may occur. It suggests that documentation it requires can justify this. And it argues, in the context of the term "as presented", that it can link the distinct legal concepts in Article II into one indistinguishable whole. There is no practice, and no legal justification in either the text of Article II or the statements of the complainants to support these claims.

4.606 All parties, as well as the WCO, agree that proper classification is made on the basis of the state of a good when it is presented at the border. Yet China "classifies" parts based on their status once they are assembled in a final vehicle by a vehicle manufacturer. There is nothing in the text of Article II to justify this reading of the WTO Agreement.

4.607 Canada has argued that the general process of importation under Article II is distinct from the single point of assessment for ordinary customs duties. This is evident from the distinction between the term "impose as a condition of" that China suggests can be read into Article II:1(b) of the GATT 1994, first sentence, and the term "on their importation" that is actually there. China argues, incorrectly, that the fact that a good may be released into an importer's custody prior to payment of duties justifies the conclusion that any duty subsequently assessed can relate to the use of the good after release. In China's words, "the characterization of a particular charge … will depend upon the *reason or event* that triggered the imposition of the charge".

4.608 The reason for imposing a charge is legally irrelevant, as *EEC – Parts and Components* makes clear. And there can only be one "event" under Article II:1(b), first sentence, namely the assessment of the product in a given shipment based on its objective characteristics at the border. That reason or event does not change for ordinary customs duties, despite China's attempt to conflate the first and second sentences of Article II:1(b).

4.609 China argues that the flexibility to impose other charges under Article II applies to ordinary customs duties, and tries to link its measures to other charges levied at importation, including anti-dumping duties, countervailing duties and other duties or charges. But this case is about the 10 per cent rate of ordinary customs duty that China is permitted to levy against imported auto parts, and no more.

4.610 Canada has demonstrated that documentary evidence in context is only one aspect of this assessment. Yet China continues to argue that the documentation required under the measures is a justification for its classification practices, claiming that "a customs declaration or other documentary

evidence" is sufficient, in order to classify imported auto parts as automobile parts characterized as complete vehicles. This ignores the fact that importers are required to submit this documentation as a means to obtain an import licence. And he measures deem parts to be whole vehicles even in the great majority of instances under the HS Classification where they should be considered as parts.

4.611 Given that the proper classification is based on the state of the goods in a single shipment at the border, China's recourse is to stretch a single WCO decision to stand for a general proposition that Members may classify split shipments as if they arrived together.

4.612 Considering both the reality of the automobile market and the nature of China's defence under GATT Article XX as applied to the whole of the measures, the only reasonable conclusion is that Article XX does not offer a defence to China. The measures are designed to support and develop China's domestic industry in a manner inconsistent with the requirements of Article XX(d). They are arbitrary in application and expressly designed to restrict trade.

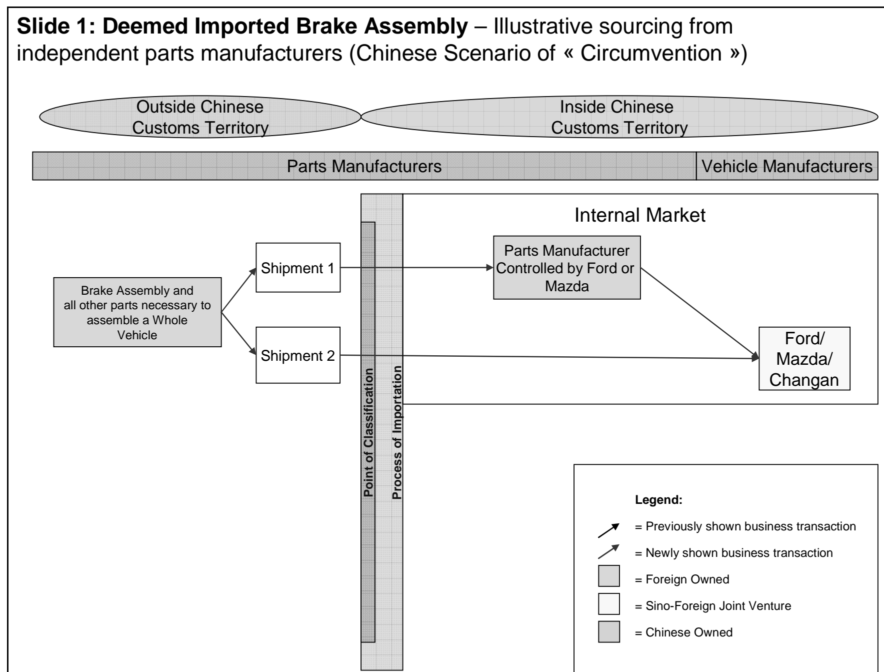
4.613 Canada has shown that China's Article II argument is an Article XX(d) of the GATT 1994 defence by another name. Even if one accepts that the measures may be considered in respect of Article II, the measures are applied such that some identical products receive different tariff treatment in a manner that is inconsistent with China's Schedule. In respect of goods presented at the border, this would result in a breach of Article II; since the Schedule itself (or its incorporation into Chinese law) seems to be the grounds for China's invocation of Article XX(d), its misapplication can hardly then be the reason for turning to Article XX(d) in the first place.

4.614 By arguing that there is an effort by vehicle manufacturers to get around the tariff rates that it negotiated, China *creates* a legal problem that does not exist, namely tariff "circumvention". It establishes arbitrary thresholds to define a motor vehicle, which allows it to presume "circumvention" if the artificial thresholds are reached.

4.615 According to China, there should be special rules applied to auto manufacturers in respect of otherwise-clear tariff headings, simply because a company may have sourced a large quantity of parts outside China. The reason for this, says China, is that manufacturers could evade duty liability for complete motor vehicles by arranging to import parts and components through suppliers.

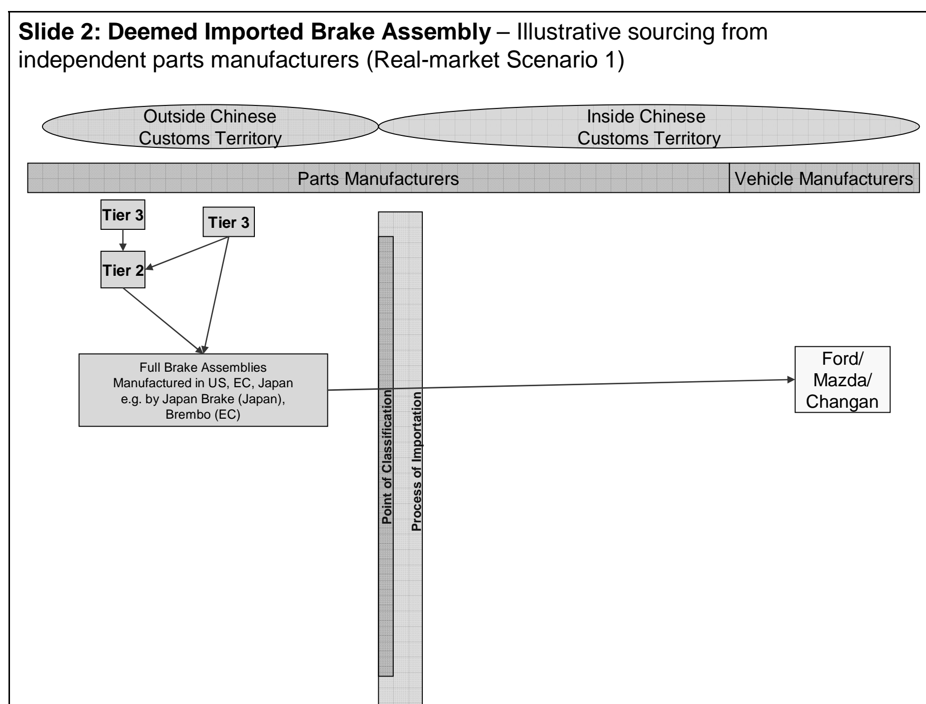
4.616 This position is untenable. Canada demonstrates this with a series of slides focussing on sourcing of the key parts for a brake system which, under the measures, constitute a Deemed Imported Brake Assembly. The normal chain of supply is a complex web of parts manufacturers, joint ventures, commercial linkages and temporary or permanent integration of operations within and across borders, often with a single company playing multiple roles.

4.617 Slide 1 describes what China says is happening: all the parts necessary to assemble a vehicle are together at one location abroad. Instead of being shipped together, the shipment is separated into two shipments. Those parts are then received by one joint-venture vehicle manufacturer, which uses the parts to assemble a complete vehicle. China has presented no evidence that this ever happens.

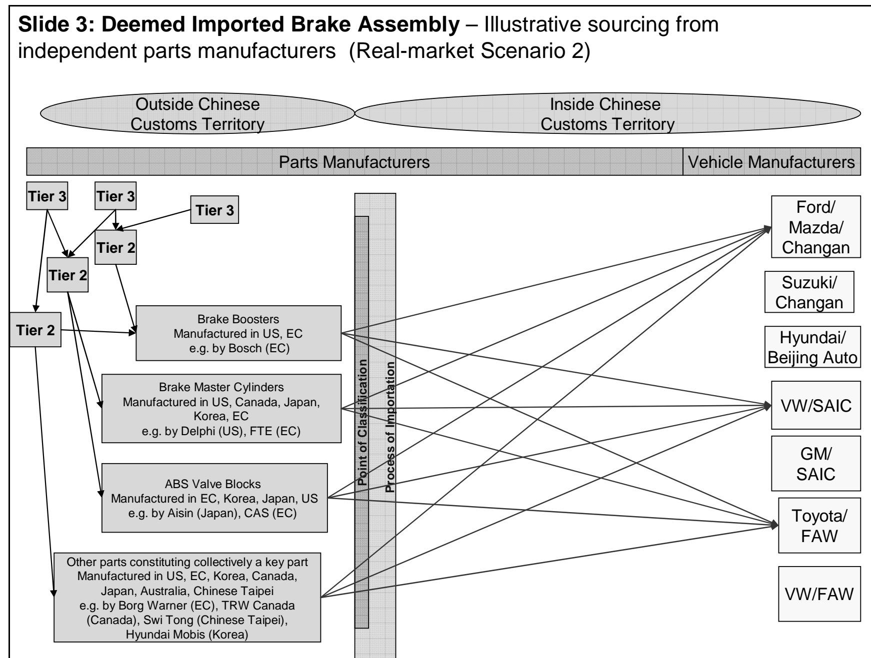


4.618 Now let us look at the real commercial world, at how parts sourcing *actually* operates in the auto industry. In every scenario, the measures deem the resulting brake assembly manufactured by a vehicle manufacturer to be imported, with the consequence of the application of the motor vehicle tariff.

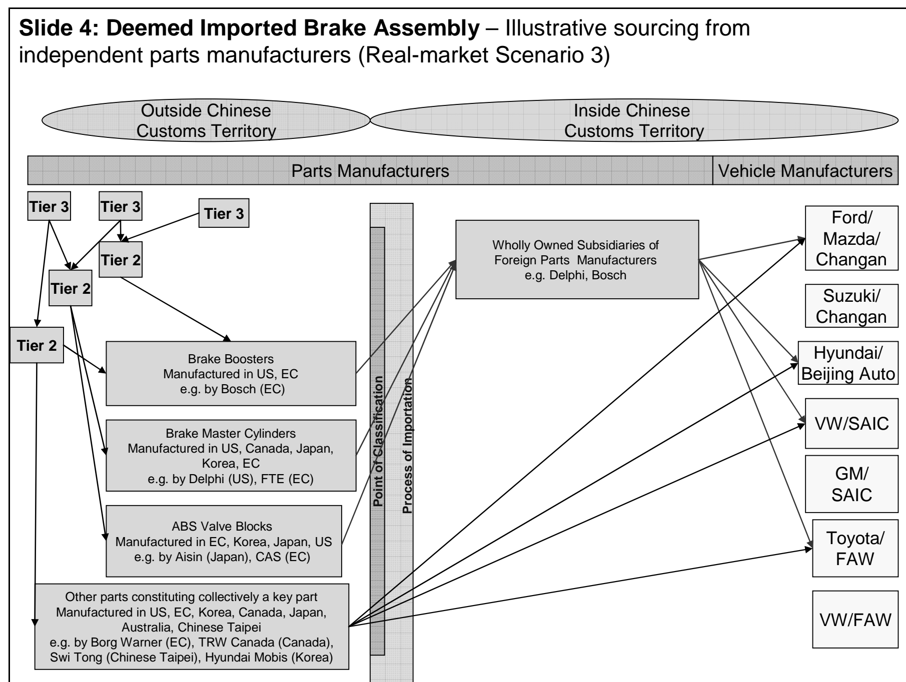
4.619 Slide 2 shows a specialized parts manufacturer abroad that ships a full brake assembly directly to a vehicle manufacturer in China. The vehicle manufacturer needs to source separately all other parts for the vehicle.



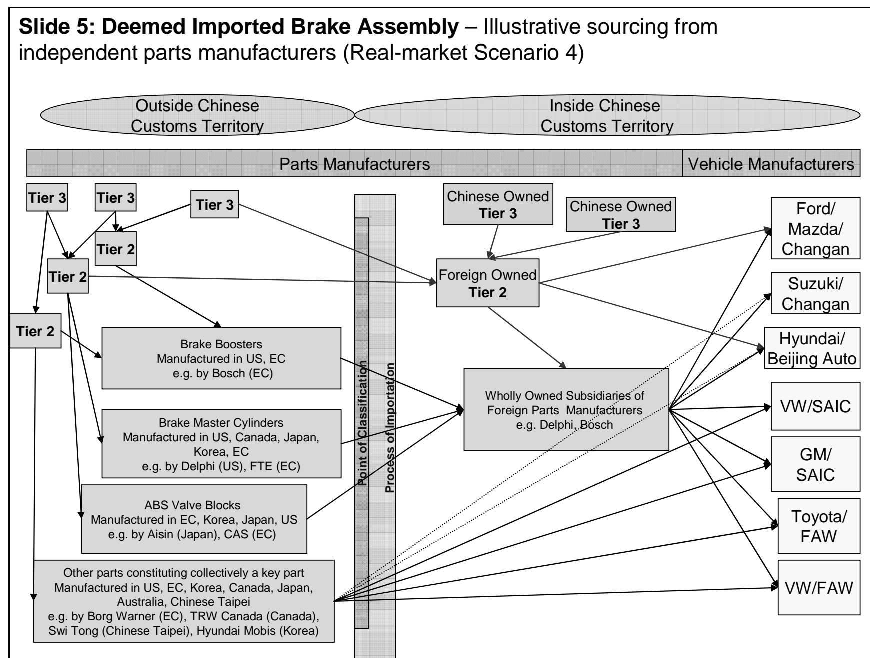
4.620 Slide 3 depicts separate shipments from different specialized parts manufacturers often in different countries, all of which are shipped directly from abroad to joint venture vehicle manufacturers in China.



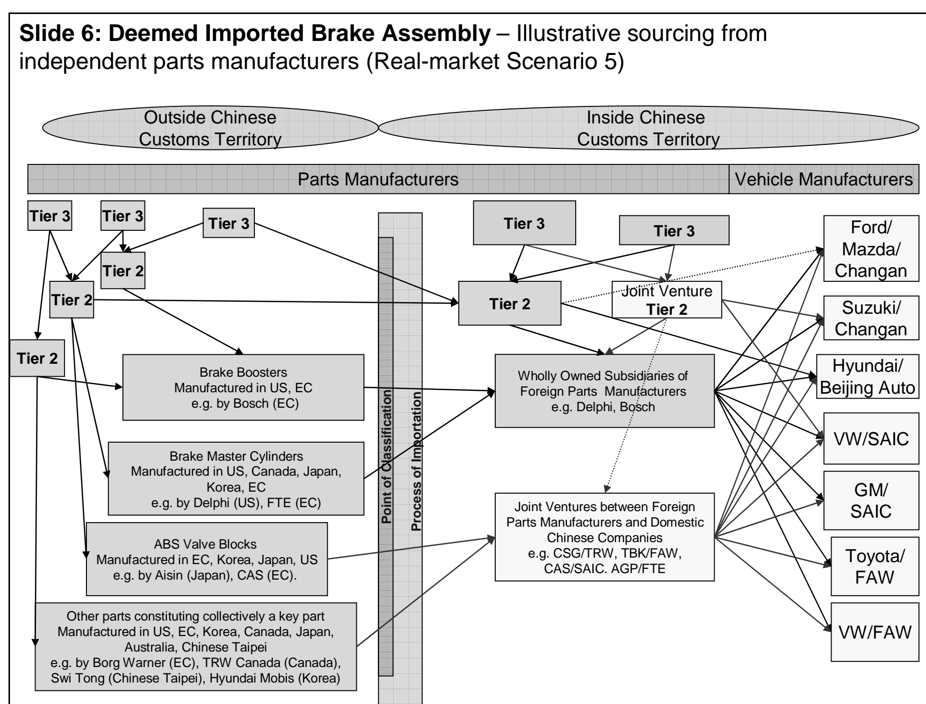
4.621 Slide 4 depicts a scenario in which three key parts are shipped to foreign-owned parts manufacturers in China, to be incorporated with parts produced in China by those companies and then shipped to vehicle manufacturers, which combines those parts with other brake parts shipped directly to them from abroad.



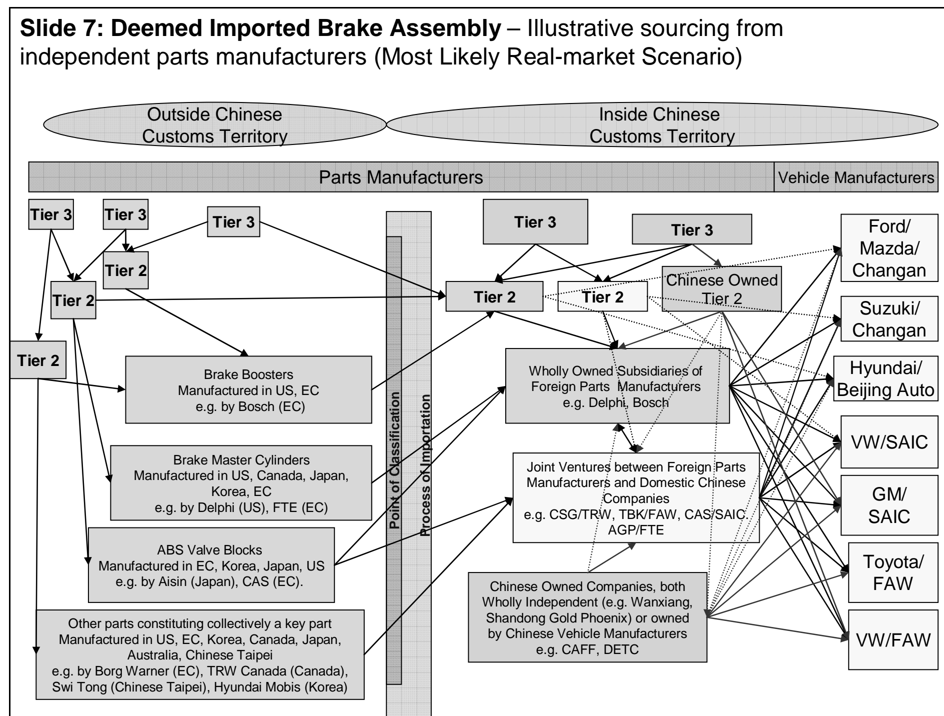
4.622 Slide 5 adds the involvement of foreign-owned suppliers in China that also produce parts for the brake system, with material and parts sourced both in China and abroad. The part for the brake system is then shipped either to a foreign-owned parts manufacturer or directly to a vehicle manufacturer, and is incorporated into the brake assembly of a vehicle.



4.623 Slide 6 adds the involvement of joint ventures in the parts industry, which import some key parts, source others parts within China, and ship either to foreign parts manufacturers or directly to vehicle manufacturers.



4.624 Slide 7 adds the involvement of wholly owned Chinese parts manufacturers. The assembly still has enough imported key parts to be Deemed Imported.



4.625 The last diagram emphasizes just how artificial the entire Chinese circumvention argument really is. China argues that it can aggregate the imported content of all brake parts in China, even though those parts pass through multiple independent parties in the internal market and are combined with domestic parts. China insists that every imported part must be linked by a vehicle manufacturer to a specific production model, at the same time as it is aggregated in what China characterizes as a broad effort to circumvent the motor vehicle rate. It is impossible to reconcile this with China's Article XX(d) argument. Commercial reality is far removed from the environment in which China suggests circumvention is a serious, if unfounded possibility. Simply, there is no necessity to justify the measures, and China's defence fails entirely.

P. ORAL STATEMENT BY CHINA AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

4.626 The central issue in this dispute is whether China's tariff provisions for motor vehicles have any meaningful effect. The complainants' argument leads to the conclusion that China cannot, in practice, apply its tariff for motor vehicles because importers can manipulate at will the boundary between a motor vehicle and parts of a motor vehicle to obtain the lowest rate of duty. The Panel must reject this argument and its conclusion.

4.627 China's tariff provisions for motor vehicles must be interpreted to have meaningful effect under the terms of Article II of the GATT 1994. This necessarily entails drawing a line between motor vehicles and the parts of motor vehicles, and between the form and the substance of what is imported in order to reflect commercial reality of the transaction.

4.628 The question before the Panel is whether the complainants have demonstrated that the manner in which China has drawn these two lines is inconsistent with China's WTO obligations. The

complainants have failed to meet this burden, especially in light of their own practices and in light of the WCO's responses to the Panel's questions.

1. The line between complete motor vehicles and parts of motor vehicles

4.629 Within the HS, the line between parts and wholes is expressed in terms of the "essential character" test under GIR 2(a). The complainants have failed to demonstrate that the measures at issue are inconsistent with application of the "essential character" test.

4.630 The WCO's responses to the Panel's questions strongly confirm this conclusion. The WCO has explained that Chapter 87 of the HS "presents unique classification challenges" in light of its simultaneous provision for motor vehicles and for various parts and assemblies of motor vehicles. The WCO has explained that "the borderlines among these headings" have not been examined by the HS Committee.

4.631 The WCO response has made clear that there is a difficult issue of classification involved in distinguishing between motor vehicles and parts of motor vehicles, and that the application of GIR 1 does not, by itself, resolve this classification issue. The WCO has also confirmed that the application of the essential character test reflected in GIR 2(a) to a specific set of facts is "within the purview of national customs administrations."

4.632 The complainants opted not to raise a dispute concerning the application of Decree 125 to specific combinations of motor vehicle parts and components. They have also failed to offer a clear position on the factors that are relevant in applying the essential character test. The complainants have, therefore, failed to demonstrate that the challenged measures necessarily result in an improper application of the essential character test to motor vehicle parts and components.

2. The line between form and substance

4.633 Under GIR 2(a), the condition of goods "as presented" at the border defines the parameters in which customs authorities may evaluate the goods concerned. The interpretation of "as presented" defines the extent to which China can classify a shipment of auto parts and components on the basis of evidence that it is one of a series of shipments that, taken together, have the essential character of a motor vehicle and can be assembled into a motor vehicle within the parameters of the assembly operations described by GIR 2(a).

4.634 According to the WCO, the HS "is silent" on the meaning of the term "as presented". China considers that the central issue before the Panel, at this juncture, is how it should proceed to resolve the present dispute in light of the absence of an agreed interpretation of this term by the WCO, and in the absence of the complainants' failure to establish an interpretation of this term that plainly results from the application of customary principles of international law.

4.635 The question of whether the challenged measures result in proper classification of motor vehicles under GIR 2(a) is central to the resolution of the present dispute. Both sides of this dispute have placed significant weight on their respective understandings of the term "as presented." The complainants' basic thesis is that the challenged measures do not result in the collection of a valid customs duty because the charges are not based on the condition of auto parts and components "as presented" at the border. Therefore, in their view, the challenged measures impose "internal" charges subject to the disciplines of Article III and the TRIMs Agreement. China, on the other hand, considers that the measures are based on a proper understanding of the term "as presented," because the classification is based on the declaration of the importer that an entry of parts and components is

related to other entries of parts and components through their common assembly into a complete article. China therefore considers that the challenged measures collect ordinary customs duties on motor vehicle parts and components on their importation into its customs territory, and that the collection of these duties is consistent with its rights and obligations under Article II.

(a) The complainants have not articulated an interpretation of the term "as presented"

4.636 The complainants have offered only circular definitions of the term "as presented". Their definitions refer to goods "as presented" to customs or to the "state of a product upon arrival at the border". These definitions beg the question of what the term "as presented" means. They do not clarify whether the term refers solely to the physical characteristics of a single container, to the contents of multiple containers, or whether it can encompass a consideration of the documentary evidence accompanying the shipment.

4.637 As the complaining parties in this dispute, the burden is on the complainants to establish that the challenged measures are inconsistent with China's obligations under the relevant provisions of the covered agreements. In the absence of any articulation of the term "as presented," and in the absence of any substantiation of this term in accordance with customary principles of international law, the complainants have no basis to assert that Decree 125 is inconsistent with the HS or with international customs practice.

(b) The complainants' implicit interpretation of GIR 2(a) lacks foundation

4.638 The complainants implicitly propose an interpretation of GIR 2(a) requiring customs classification according to the form in which the importer "presents" a collection of parts and components. On this interpretation, importers can "present" parts and components of an article in whatever form they wish, and customs authorities must accept the proposed classification without regard to other evidence which shows that the importer is importing parts and components that have the essential character of the complete article.

4.639 The complainants have failed to provide any support for the proposition that GIR2(a) precludes the consideration by customs authorities of whether multiple shipments of parts and components are related to each other through their common assembly into a complete article. The complainants have merely asserted this interpretation of GIR 2(a). It is an interpretation that fails to give effect to the role that GIR 2(a) plays within the HS, as it leaves the relationship between complete articles and parts of those articles entirely at the discretion of the importer. It is, moreover, an interpretation that is contradicted by the complainants' own arguments and customs practices.

3. Three paths toward the resolution of this dispute

4.640 The complainants have advanced claims that the challenged measures violate Article III and the TRIMs Agreement, as well as Article II. In order to establish any of these claims, the complainants must demonstrate that the challenged measures do not collect ordinary customs duties that China is allowed to collect under its Schedule of Concessions. The complainants have failed to meet this burden. China, by contrast, has demonstrated that it is consistent with the context of GIR 2(a) to interpret the term "as presented" in a manner that allows customs authorities to draw a line between the substance of what an importer brings into the customs territory and the form in which it does so.

4.641 The WCO has advised the Panel that there is no agreed interpretation of the term "as presented" in GIR 2(a). This suggests that there is a known and unresolved ambiguity within

GIR 2(a) concerning the line between form and substance in the classification of parts and components. The ambiguity in GIR 2(a) is suggested not only by the absence of an authoritative interpretation of the term "as presented" within the WCO, but also by the complainants' inability to articulate and substantiate what this term means under established international norms, or by reference to other interpretive principles under the *Vienna Convention*. China does not consider that it is consistent with Article 3.2 of the DSU to resolve these types of policy questions within the context of dispute settlement.

4.642 There are three possible ways forward for the Panel to resolve this case. First, the Panel could find that the complainants have failed to meet their burden of demonstrating the inconsistency of the measures at issue with China's WTO obligations.

4.643 Second, the Panel could recognize that China, unlike the complainants, has articulated an understanding of the term "as presented" in GIR 2(a), and has demonstrated that this interpretation is supported by the interpretive principles of the *Vienna Convention.* This interpretation supports China's position that the challenged measures are consistent with its rights and obligations under Article II.

4.644 Third, the Panel could that find that the resolution of this dispute is contingent upon the interpretation of a term that, at present, remains ambiguous. This is precisely the circumstance in which the doctrine of *in dubio mitius* is applicable. In the present context, the application of this doctrine supports an interpretation of the term "motor vehicles" in China's Schedule of Concessions, and an interpretation of the term "as presented" in GIR 2(a), that preserves China's sovereign authority to define and enforce the boundaries between motor vehicles and parts of motor vehicles, and to ensure that all of its tariff provisions have effect. By the same principle, the complainants' implicit interpretation of these terms, which would deprive China's tariff provisions for motor vehicles of any meaningful effect, must be rejected as inconsistent with the doctrine of *in dubio mitius*. This ambiguity can be resolved, either by the WCO (as the WCO has suggested) or by the General Council in accordance with Article IX:2 of the WTO Agreement. Once there is a clear resolution of this issue, it would be possible for a WTO dispute settlement panel to evaluate Decree 125 in relation to the standards that are adopted.

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments presented by Argentina, Australia, Brazil, Japan and Mexico in their written submissions and oral statements are reflected in the summaries below.[63]

A. THIRD PARTY SUBMISSION BY ARGENTINA

1. The challenged measures are not border measures under Article II of the GATT 1994

5.2 One of the main points in dispute is whether the measures[64] at issue constitute either border measures governed by Article II of the GATT 1994 or rather internal taxes ruled by Article III:2 of the GATT 1994 or internal regulations referred to in Article III:4 of the GATT 1994.

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[63] The summaries of the third parties' arguments are based on the executive summaries submitted by the third parties to the Panel, in the case of Argentina and Japan; and on the oral statements submitted by Australia, Brazil and Mexico. Footnotes in this section are those of the third parties.

[64] The Measures challenged are: "Automotive Policy Order 2004"(Exhibit JE-18); "Decree 125"(Exhibit JE-27); "Announcement 4" (Exhibit JE-28).

5.3 In order to be considered a border measure under Article II:l(b) such measure should be a duty or duties charged upon "importation into the territory" or in "connection with the importation".[65] Under the measures in dispute, a duty for whole vehicles is charged upon assembly of the imported parts. The fact that the duty is charged after the verification by the authorities and once the vehicle was manufactured is a feature that tells that the condition for the application of the duty is the assembly and manufacture of the vehicle and not the importation of the parts.

5.4 China suggests that its measures are conditioned upon importation because the auto parts are not in free circulation up until the point where the parts and components are assessed at the tariff rate for motor vehicles if the manufacturer uses the imported parts and components as part of a larger collection of imported parts having the essential character of a motor vehicle.[66] The panel in *EEC - Parts and Components* understood that the treatment of imported goods as not being "in free circulation" cannot support the conclusion that the duties are being levied "in connection with importation" within the meaning of Article II:l(b).[67]

5.5 Furthermore, China seeks to demonstrate that the charges collected after the importation are border measures because the collection is administrated by Customs. Argentina considers this should be carefully assessed since a Member could circumvent its Article III of the GATT 1994 obligations simply by appointing the Customs Office as the collector agency of an internal charge.

5.6 The manner in which the measures at issue in this dispute work suggests that they are internal taxes and internal regulations applicable only to imported parts. Therefore such measures fall under the provisions of Article III:2 and Article III:4 of the GATT 1994. If the Panel were to find any inconsistency of the measures with the above mentioned provisions regarding national treatment, a finding on the consistency of China's measures with Part 1, paragraph 7.2 of the Accession Protocol of China would also be relevant.

2. China's measures are not similar to anti-dumping or countervailing anti-circumvention measures

5.7 Argentina considers it is not appropriate to make a parallelism between ordinary customs duties and antidumping or countervailing anti-circumvention measures. China makes such parallelism in order to justify its measures as being anti-circumvention measures.

5.8 Under an antidumping or countervailing anti-circumvention measures the duties are charged at the border at the time of importation and not subsequently or dependent upon their incorporation to whole parts. The difference between China's measures and AD/CVD anti-circumvention measures suggests that China's measures are not anti-circumvention ones, and that therefore there is not a common, consistent or discernible practice.[68]

5.9 Admitting that China's measures are imposed to prevent circumvention of ordinary customs duties[69] would lead to include within Article II of the GATT 1994, measures that involve burdensome administrative procedures prior and after importation only applicable to manufacturers of imported parts, as well as duties charged conditioned upon how and which imported parts the manufacturer decides to fit in the final product. This would allow restrictions to imports of other Members' goods

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[65] See GATT Panel Report on *EEC - Parts and Components*, para 5.8.
[66] China's first written submission, para 46.
[67] GATT Panel Report on *EEC - Parts and Components*, para 5.7.
[68] Appellate Body Report on *US - Gambling,* para 192.
[69] China's first written submission, para. 112.

not committed in their Schedules of Concessions under-covered by the protection of an alleged anti-circumvention measure.[70]

3. The measures are not justified under Article XX(d).

5.10 China states that the challenged measures are justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with China's customs law.[71] In order for a measure to be considered "necessary" under Article XX(d) one of the features involved in the "weighing and balancing" is the respective impact of the measure on international commerce.[72]

5.11 The differential treatment granted to imported parts results in a restriction on the entry of imported parts in the Chinese automobile market. The Appellate Body in *Korea -Various Measures on Beef* found that: *"A measure with a relatively slight impact upon imported products might more easily be considered as 'necessary' than a measure with intense or broader restrictive effects.*"[73] The effects the challenged measures have on imported parts result in a restriction to commerce. Therefore the "necessity" test is not satisfied, preventing China to justify the measures under Article XX (d).

5.12 Finally, if the Panel where to analyse the justification of the measures under the chapeau of Article XX, Argentina considers pertinent the rulings of the Appellate Body in *US - Shrimp* and *US - Gasoline* regarding the prevention of "abuse of the exceptions of Article XX."[74]

B. THIRD PARTY SUBMISSION BY JAPAN

1. Article III of the GATT 1994 applies to the measures

5.13 The duties imposed under China's measures are appropriately classified as internal charges under Article III:2 of the GATT 1994 and the measures as internal regulations under Article III:4. Under GATT and WTO jurisprudence, it is not the label that Members attach to trade measures that is determinative of whether they constitute internal measures or border measures, but their actual operation.

(a) Relevant WTO and GATT case law

5.14 In *EC – Bananas III*, the EC argued that its import licensing system was a border measure not subject to Article III. The Appellate Body, however, confirmed the Panel's conclusion that the procedures went "far beyond" the "mere requirements" needed to administer a tariff-rate quota system and thus fell within the scope of Article III of the GATT 1994.[75]

5.15 Several GATT Panels also confirm this approach. At issue in *EEC – Parts and Components,* was an EC regulation intended to prevent circumvention of anti-dumping duties. Pursuant to the EC regulation, duties were payable on assemblies produced in the EC that contained a significant proportion of imported parts, when the finished product imported from the country would have been

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[70] See also Japan's third party submission, para.35.
[71] China's first written submission, para. 201.
[72] China's first written submission, para. 208.
[73] Appellate Body Report on *Korea -Various Measures on Beef*, para. 163.
[74] Appellate Body Report on *US - Shrimp*, para. 116, quoting Appellate Body Report on *US - Gasoline*, page 22.
[75] Appellate Body Report on *EC - Bananas III*, para. 211.

subject to anti-dumping duties. According to the GATT Panel these "anti-circumvention duties" were not imposed conditional on importation or at the time of importation of the product.[76]

5.16 Similarly, in *EEC – Animal Feed Proteins*, the Panel decided that a security deposit for the importation of vegetable proteins should be examined under Article III, not Article II.[77] The Panel's conclusion was in significant part based on its evaluation of whether the charges at issue were "collected at the time of, and as a condition to, the entry of the goods into the importing country."[78]

5.17 Finally, in *Belgian Family Allowances*, the Panel found that the disputed levy was an internal charge subject to Article III, not a tariff subject to Article II. The Panel noted that the levy was "charged, not at the time of importation, but when the purchase price was paid", and that the levy was assessed "only on products purchased by public bodies for their own use and not on imports as such."[79]

(b) The Chinese measures result in violations of Article III of the GATT 1994

5.18 The duties imposed under the measures are internal charges and not customs duties as they are not imposed conditional merely on importation of the parts, but rather on the way the finished car is assembled or produced in China and thus the way in which the imported parts are used. Several features of the measures demonstrate this.

5.19 First, the measures require the collection of charges only after auto parts have been imported and assembled into a complete vehicle, not upon their presentation at the border. Under Decree 125, the duty on a part is assessed following assembly and production, rather than directly upon importation (cf. Arts. 7, 11, 27-35). The level of the duty on imported parts thus depends on their final assembly into a completed vehicle in China. If the imported parts will be incorporated in a car, which, pursuant to Decree 125, does not have sufficient local content, the imported parts will be subject to customs duties that are normally payable on a completely built up imported car (cf. Decree 125, Arts. 21 and 22); the final duty on the parts is only assessed after their assembly into entire automobiles (cf. Art 28); whether a part bears the features of a complete vehicle is determined after the parts have been assembled (cf. Art 5).

5.20 Second, the charges are applicable primarily to automobile manufacturers, rather than the importers of specific auto parts. Manufacturers are responsible for the payment of duties even if the parts were purchased in the domestic market from the suppliers that previously imported them (cf. Decree 125, Arts. 27-35).

5.21 Third, verification by customs authorities at the site of the manufacturer (cf. Decree 125, Arts. 17-20) occurs following assembly and production. When viewed in combination with the other elements listed here it certainly confirms the internal character of the measures.

5.22 Finally, duties are levied according to how imported auto parts are incorporated in domestic production (cf. Decree 125, Arts. 21-24). Indeed, the "tariff" rate of the part can change during the production of the vehicle, if the mix of imported parts used in assembly changes (cf. Decree 125, Art. 20). Accordingly, duties payable under Decree 125, while in name "customs duties", are in fact

[76] GATT Panel Report on *EEC – Parts and Components*, para. 5.5.
[77] GATT Panel Report on *EEC – Animal Feed Proteins*.
[78] *Id.*, para. 4.16 (b) (citing Reports of the Sub-Committee at the Havana Conference at pages 62-63).
[79] GATT Panel Report on *Belgium Family Allowances*, para. 2.

internal charges subject to Article III:2 of the GATT 1994, rather than customs duties subject to Article II.

(c) China's first written submission does not refute the evidence that the challenged measures are internal charges subject to Article III of the GATT 1994

5.23 In China's First Written Submission (hereinafter referred to as FWS China), China argues that three factors suggest that the measures in dispute impose customs duties, not internal charges. (cf. FWS China, para. 44) Japan submits some observations as to why China's assertions are not convincing.

5.24 First, China asserts that the importer "will ordinarily declare at the time of importation whether an entry of auto parts and components will be used to assemble a complete imported vehicle."[80] The fact that a measure requires some action at the time of importation does not mean that the measure is therefore a border measure. Indeed, in *EEC – Animal Feed Proteins*, a GATT Panel found that a *security deposit for the importation of a good* should be examined under Article III. Furthermore, it is important to note that the challenged measures require a declaration on the content of the completed auto vehicle after it is manufactured in China, not on the contents of a particular consignment upon importation. Thus, even if a consignment contains only engines, the importer must declare it to be a "deemed complete vehicle" depending on what other parts the engine will be paired with as part of the manufacturing process.

5.25 Second, China argues that under the measures, auto parts entering China remain in bonded status and are not in free circulation in its customs territory. (cf. FWS China, para. 46) However, this assertion is irrelevant to the Panel's consideration. The GATT Panel in *EEC – Parts and Components* concluded that "[t]he fact that the EEC treats imported parts and materials subject to anti-circumvention duties as not being 'in free circulation' … cannot … support the conclusion that the anti-circumvention duties are being levied 'in connection with importation' within the meaning of [GATT] Article II:1(b)".[81] To find otherwise, said the panel, would mean that the basic objectives underlying Article II and III could no longer be achieved.

5.26 Finally, China asserts that the "challenged measures are administered by the Customs General Administration of China" and that "duties collected pursuant to Decree 125 are classified as ordinary customs duties. (cf. FWS China, para. 47) This assertion is not relevant either. The GATT Panel in *EEC – Parts and Components* specifically expressed concern that if the description or categorization of a charge under domestic law were relevant to whether the charge is covered by Article III of the GATT 1994, a Member "could in particular impose charges on products after importation simply by assigning the collection of these charges to the customs administration and allocating the revenue generated to their customs revenue."[82] The Panel thus rejected that the disputed charge was covered by Article II.

2. Alternatively, Article II of the GATT 1994 applies to the measures

5.27 If the Panel were to characterize the charges at issue as customs duties, Japan supports the view of the complainants that the Chinese measures are inconsistent with Article II of the GATT 1994.

[80] See *id.* para. 45.
[81] GATT Panel Report on *EEC – Parts and Components*, para. 5.7 (original emphasis).
[82] GATT Panel Report on *EEC – Parts and Components*, para. 5.7.

(a) China's measures result in a prima facie violation of its tariff commitments

5.28 China's Schedule of Concession on autos and auto parts is based on the nomenclature prescribed in Chapter 87 of the HS Code titled "vehicles other than railway or tramway rolling-stock, and parts and accessories thereof". The ordinary meaning of these headings within their context is clear: when a good constitutes one of the parts described in headings 8706 – 8708 it is to be classified under those headings. As a car body without engine and certain other components cannot be considered a "motor car or other motor vehicle" within the ordinary meaning of these terms, but only as a part or parts of it, it cannot be classified as a whole vehicle but only as its individual component part.

5.29 As China acknowledges, the "essential character" rule as formulated in the HS and its Explanatory Notes constitute relevant context in interpreting its tariff schedule. (cf. FWS China, para. 84). Under this rule, only if imported parts possess the "essential character" of the complete or finished article, will they be considered the complete or finished article. Any application of the measures imposing whole vehicle duties on parts that do not have the essential character of the whole vehicle violates Article II.

(b) China inappropriately combines goods imported separately

5.30 In keeping with its 'anti-circumvention' theory, China asserts that the key interpretive issue before the Panel is whether its challenged measures are based on a valid interpretation of the term "motor vehicles". China's defense is based on the notion that all it is doing is to assess the nature of imported products based not on the form in which they are imported but on the extent to which they are combined with other imports in the end product. China suggests that this would be consistent with Article II of the GATT 1994 and with the customs practices of other Members.

5.31 In reality, there is nothing in the ordinary meaning of China's classification headings for vehicles or auto parts to support any distinction in tariff rates depending on the ultimate use of imported car parts. Indeed, in interpreting China's tariff schedule, the Panel has to give meaning not only to China's commitment on "motor vehicles" but equally to its commitments on motor vehicle "parts".

5.32 As to context, the "essential character" rule under the HS which is incorporated in China's Schedule, stipulates that, if imported parts "as presented" possess the "essential character" of the complete or finished article, they will be considered the complete or finished article. Thus, where a consignment of imported car parts possesses the essential character of a motor car or other motor vehicle as they are presented to customs, they can be considered covered by heading 8702-8704. However, if they constitute "as presented" a "vehicle chassis fitted with engines and bodies" covered by headings 8706–8708 or "auto part[s]" covered by headings 8407-8408, then such imported parts cannot be considered as covered by headings 8702-8704.

5.33 Subsequent practice of Members also shows that goods presented in multiple consignments cannot be considered together as one article. As a rule, Japan's customs authorities, for example, base their classification decisions on the imported products at the time of customs clearing; and goods imported in different consignments are classified jointly only in exceptional cases. Japan understands that the same is true in the EC[83].

[83] European Court of Justice, Case C-35/93, *Develop Dr. Eisbein GmbH & Co*, 16 June 1994, ECR [1994] I-2655, para. 19, held that "(a)n article is to be considered to be imported unassembled or

5.34 Where China refers to the US and EC rules on split consignments, it fails to clarify that these are exceptional provisions. These are applied at the request and to the benefit of an importer, who wants to avoid for instance the administrative burden of having to file separate customs declarations for one consignment that has been divided up in different shipments. (cf. FWS China, para.157-159) Such rules apply in limited cases, and are designed not to counter circumvention but are applied at the importer's choice to ensure that the importer of record is not penalized for a carrier's decision to split shipments.

5.35 Accordingly, even if the duties imposed under the measures are considered customs duties, any application of the measures where part(s) imported into China (in one consignment) do not possess the essential character of the whole vehicle results in a violation of China's Schedule and Article II of the GATT 1994.

3. Tariff classification of CKD and SKD Kits

5.36 In addition to the general violations mentioned above, the measures' blanket treatment of CKD/SKD kits as "whole vehicles" irrespective of the precise content and condition of such kits also leads to a specific violation of Article II and Paragraph 93 of the Working Party Report ("WPR").

(a) China's tariff treatment of CKD and SKD kits under the challenged measures violates Article II of the GATT 1994

5.37 CKD and SKD kits range from kits that include certain but not nearly all parts of a motor vehicle and that still need substantial assembly and production work, to kits that are essentially entire motor vehicles that have simply been disassembled to facilitate transport. Thus, CKDs/SKDs may in certain circumstances constitute the "whole vehicle" but in many others will not.

5.38 The measures, however, impose a blanket rule that CKD and SKD kits are among the combinations of parts and components that are deemed to constitute a whole vehicle. China's blanket treatment of CKD and SKD kits as "whole vehicles" therefore will necessarily lead to violations of Article II of the GATT 1994. China's defense is contradictory. On the one hand, it argues that the measures do not apply to CKD and SKD kits. (cf. FWS China, para.37) On the other hand, the plain text of Article 21 of Decree 125 very clearly includes such kits as combinations of parts that are automobile parts characterized as complete vehicles.

(b) China's treatment of CKD and SKD kits violates paragraph 93 of the Working Party Report

5.39 In addition, China's treatment of CKD and SKD kits also leads to a violation of its commitment under the Working Party Report. Japan supports the view expressed by certain of the complainants in this regard. The measures have effectively created a new tariff line for CKD and SKD kits with a 25 per cent tariff, as all kits are now subject to this tariff. (cf. FWS US, para.122) This constitutes a violation of China's commitments flowing from paragraph 93 of the Working Party Report. China was not obliged to establish a new tariff line for kits; but if it did formulate a generally applicable tariff, it was bound to impose a 10 per cent tariff.

5.40 It would be no defense for China to say that it did not formally open a new tariff line for CKD and SKD kits, as it did not amend its tariff schedule. Effectively, the measures have created a new

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disassembled where the component parts, that is the parts which may be identified as components intended to make up the finished product, are all presented for customs clearance at the same time (…)."

tariff for such kits. China is obliged to implement its WTO obligations, including the commitments flowing from the Working Party Report, in good faith.

4. Article XX of the GATT 1994 does not justify the measures

5.41 China argues that the measures were designed to secure compliance with its customs laws and regulations. (cf. FWS China, para. 203-204) The measures, however, nowhere refer to any such objective to counter circumvention of China's customs rules. Indeed, China merely refers to the generic language in its Policy Order 8that China will "strictly levy import duties at tariff rates applicable to complete vehicles and parts, so as to prevent tariff evasion." (cf. FWS China, para. 24) It is unclear how this would be relevant, let alone provide any kind of justification for the measures. Moreover, it specifically refers to both "whole vehicles and parts" and makes no reference whatsoever to CKD or SKD kits or any particular risk of circumvention relating to such kits.

5.42 China has provided no evidence that China-based car manufacturers, having legitimately benefited for many years from China's lower duties on auto parts through local assembly operations, recently shifted to customs fraud by importing complete vehicles as auto parts. If anything, China has shown that major car manufacturers have abided by China's customs rules, whether these are WTO-compatible or not. Thus, China has noted that major car manufacturers have imported CKD and SKD kits into China under tariff classifications consistent with China's customs rules. (cf. FWS China, para. 39)

5.43 In addition, the effect on trade from the measures is severe. They are framed very broadly, covering multiple shipments from various sources and to various parties within China. China's measures impose a blanket rule that if imports are used in certain proportions with other imports they will always be treated as "whole vehicles", and therefore subject to higher customs duties. Indeed, China will treat combinations of parts imported from different suppliers or even different national origin as one single "whole vehicle" for these purposes. The measures also do not distinguish between parts imported into China by the manufacturer of the vehicle and parts imported into China by third parties, such as parts suppliers. This particular element merits a closer look.

C. THIRD PARTY SUBMISSION BY MEXICO

1. Introduction

5.44 The Government of the United Mexican States (Mexico) is grateful for the opportunity to present its views in this dispute. Mexico is participating as a third party owing to its trade interest in this case. Mexico notes with concern the failure of China to comply with its obligations under the WTO, particularly in view of the fact that the Mexican auto parts industry accounts for an important part of its manufacturing sector's gross domestic product.

5.45 Mexico agrees with the arguments presented by the United States, the European Communities and Canada according to which the imposition of measures that favour domestic auto parts over imported parts amounts to a violation of the fundamental WTO principles of non-discrimination. Through three specific instruments that are challenged in this dispute today (the measures), China imposes additional charges and administrative burdens on imported auto parts that are not imposed on auto parts produced in Chinese territory. This inevitably alters the conditions of competition between domestic and imported products, which in its turn provides automobile producers with an incentive to use domestic auto parts rather than imported auto parts.

5.46 In particular, the measures imposed by China violate the GATT 1994, the TRIMs Agreement, SCM Agreement, and certain provisions of its Accession Protocol.

2. The GATT 1994

5.47 In Mexico's view, the measures adopted by China are "internal measures" that are inconsistent with Article III of the GATT 1994 in that they provide for less favourable treatment for imported auto parts than for domestic auto parts. Contrary to what China contends in its first submission[84], the measures at issue are not "border measures", but "internal measures". Considering that these measures are applied once the product has been imported and not upon its importation, this Panel should conclude that by their nature, the measures are internally applied measures.

5.48 More specifically, China's measures with respect to auto parts are inconsistent with the following paragraphs of Article III:

(a) Paragraph 2, in that they result in internal charges in excess of those applied to domestic products;

(b) paragraph 4, in that they are measures which affect the sale, purchase, transportation, distribution and use in the domestic market[85];

(c) paragraph 5, in that they are quantitative regulations that require that a specified amount or proportion of a product be supplied from domestic sources.

5.49 Paragraphs 2, 4 and 5 of Article III of the GATT 1994 set out the different ways in which to comply with the national treatment obligation. Accordingly, the measures imposed by China are inconsistent with these three scenarios of the principle of national treatment.

3. TRIMs Agreement

5.50 The measures adopted by China also violate WTO disciplines from the point of view of trade-related investment measures (TRIMs).

5.51 In Mexico's view, the challenged measures are inconsistent with the TRIMs agreement, in the order of analysis applied by the Panel in *Indonesia – Autos.*[86] The Panel in that dispute considered that the inconsistency of the measures should be analysed in two stages: first, by determining if the measures at issue were TRIMs, which involved determining whether they were (i)"investment measures" and (ii) "trade-related" measures; and secondly, to examine whether the TRIMs violated Article III of the GATT 1994.

5.52 Regarding the first stage, Mexico considers that the measures adopted by China are indeed trade-related investment measures. As indicated in *Indonesia – Autos*, a measure that is "aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components" is an "investment measure".[87] This same Panel affirmed that measures that are local

[84] See China's first written submission, paras. 41-70.

[85] Regarding the term "affecting" in Article III:4 of the GATT 1994, Mexico considers that the view of the Panel in *India –Autos* (DS175) (paragraph 7.197) applies to this case. In that dispute, the Panel interpreted "affecting" as being able to occur when an incentive is provided to purchase local products or when the conditions of competition between the domestic and imported products are modified.

[86] Panel Report on *Indonesia – Autos* para. 14.72.

[87] *Ibid*., paragraph 14.80.

content requirements "would necessarily be 'trade-related'".[88] Consequently, in the case at issue, both of the requirements for a TRIM are met.

5.53 Regarding the second stage, in the light of the considerations set forth above, Mexico is of the opinion that the measures imposed by China violate Article III of the GATT, namely the requirements set forth in paragraphs 2, 4 and 5 thereof. Consequently, the measures at issue are inconsistent in terms of the analysis of the Panel in *Indonesia – Autos*.

5.54 Moreover, Article 2 of the TRIMs Agreement states that no Member shall apply any TRIM that is inconsistent with the provisions of Article III of the GATT 1994 (National Treatment). Article 2.2 clarifies the point by referring to the "Illustrative List" of TRIMs that are considered inconsistent with the national treatment obligation.

5.55 The measures at issue fall squarely into paragraph 1(a) of the Illustrative List, which concerns TRIMs that have local content requirements. Specifically, paragraph 1(a) refers, as an example of TRIMs that are inconsistent with Article III of the GATT 1994, to those compliance with which is necessary to obtain an advantage, and which require:

> the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. (Emphasis added).

5.56 In this context, it is clear that the challenged measures meet the description in paragraph 1(a) of the Illustrative List since (i) they are necessary to obtain an advantage, and (ii) they require as a condition the use of products of domestic origin.

4. China's Accession Protocol

5.57 China's commitment to comply with Article III of the GATT 1994 and the TRIMs Agreement is clearly established in its Accession Protocol. Regarding the obligation to comply with Article III of the GATT 1994, paragraph 7.2 of the Accession Protocol states as follows:

> In implementing the provisions of Articles III and XI of the GATT 1994 and the Agreement on Agriculture, China shall eliminate and shall not introduce, re-introduce or apply non-tariff measures that cannot be justified under the provisions of the WTO Agreement. (...) (Emphasis added).

5.58 Regarding the TRIMs Agreement, paragraph 7.3 of the Accession Protocol states as follows:

> China shall, upon accession, comply with the TRIMs Agreement, without recourse to the provisions of Article 5 of the TRIMs Agreement. China shall eliminate and cease to enforce trade and foreign exchange balancing requirements, local content and export or performance requirements made effective through laws, regulations or other measures. (Emphasis added)

5.59 According to the cited provisions, upon accession to the WTO China assumed the obligation to bring its measures into conformity with WTO disciplines, including Article III of the GATT 1994 and the TRIMs Agreement.

[88] *Ibid*., paragraph 14.82.

5. Conclusion

5.60 For the above reasons, Mexico considers that China is acting in a manner inconsistent with its WTO obligations by maintaining measures that favour the use of domestic auto parts in preference to imported auto parts. These measures violate the commitments that China assumed upon acceding to the WTO, and hence undermine the legitimate expectations of the other Members.

D. ORAL STATEMENT BY ARGENTINA AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

1. The challenged measures are not border measures under Article II of the GATT 1994

5.61 One of the main points in dispute is whether the measures[89] at issue constitute either border measures governed by Article II of the GATT 1994, or rather internal taxes ruled by Article III:2 of the GATT 1994 or internal regulations referred to in Article III:4 of the GATT 1994.

5.62 In order to be considered a border measure under Article II:1(b) such measure should be a duty or duties charged upon "importation into the territory" or in "connection with the importation"[90]. Under the measures in dispute, a duty for whole vehicles is charged upon assembly of the imported parts. That is clear from the text of Decree 125 which provides in its Article 28: "After the imported automotive parts are assembled and manufactured into whole vehicles, automobile manufacturers shall declare such items to Customs, and Customs shall […] proceed with categorization and duty collection". The fact that the duty is charged after the verification by the authorities and once the vehicle was manufactured is a feature that tells that the condition for the application of the duty is the manufacture of the vehicle and not the importation of the parts. Moreover, the fact that the duty charged could be higher if the manufacturers decide to fit other imported parts into the model vehicle registered[91], or that a difference in duties is recognized if the parts were purchased from a local supplier and not imported by the manufacturer[92] confirm that the goods' taxable event takes place upon assembly and not upon the entry of the product into the territory.

5.63 China argues that as the EC revised anti-circumvention measure, the challenged measures impose duties that are conditional upon the entry of goods into China, and are therefore border measures subject to Article II of the GATT 1994.[93] As stated by China, the revised EC anti-circumvention measure "applies the anti-dumping duty to the imported parts and components as a condition of their importation". China suggests that its measures are also conditioned upon importation as the EC's one because the auto parts are not in free circulation until the tariff rate for motor vehicles is assessed upon them, if the manufacturer uses the imported parts and components as

[89] By "Measures" Argentina refers to: The Policy on Development of the Automotive Industry, issued on May 21, 2004, by China's National Development and Reform Commission (NDRC) as Order No.8. ("Automotive Policy Order 2004") (Exhibit JE-18); "Administrative Measures on Importation of the Automotive Parts Deemed Whole Vehicles", issued as Decree 125 on February 28, 2005 by China's General Administration of Customs ("Customs"), NDRC, Ministry of Finance, and Ministry of Commerce in accordance with the Automotive Policy Order ("Decree 125") (Exhibit JE-27); "Rules for Verifying whether imported Automotive Parts are deemed Whole Vehicles", issued as Public Announcement No.4 by Customs on March 28, 2005, in accordance with Decree 125 ("Announcement 4") (Exhibit JE-28).

[90] See GATT Panel Report on *EEC – Parts and Components*, where the Panel in paragraph 5.8 found: "In the light of the above, the Panel found that the anti-circumvention duties are not levied "**on or in connection with importation**" within the meaning of Article II:1(b), and consequently do not constitute customs duties within the meaning of that provision.

[91] Article 20 of Decree 125.

[92] Article 29 of Decree 125.

[93] China's first written submission, para.61.

part of a larger assembly of imported parts having the essential character of a motor vehicle.[94] The panel in *EEC – Parts and Components* understood that the treatment of imported goods as not being "in free circulation" cannot support the conclusion that the duties are being levied "in connection with importation" within the meaning of Article II:1(b).[95]

5.64 The wording of the norm such as "bonded goods"[96] or "at the import stage"[97] not necessarily imply that the measures at issue are in fact border measures. Again, as the Panel held in *EEC – Parts and Components*, "if the description or categorization of a charge under the domestic law of a contracting party were to provide the required 'connection with importation', contracting parties could determine themselves which of these provisions would apply to their charges."[98]

5.65 Furthermore, China seeks to demonstrate that the charges collected after importation are border measures because the collection is administrated by Customs. Argentina considers this should be carefully assessed, given the possibility that this could provide for any Member to circumvent its obligations under Article III of the GATT 1994, only by appointing the Customs Office as the one in charge of collecting a tax that is in fact an internal charge and not a border measure. This kind of reasoning was also supported by the Panel in *EEC – Parts and Components* when it held that Members "could in particular impose charges on products after their importation simply by assigning the collection of these charges to their customs administration and allocating the revenue generated to their customs revenue. With such an interpretation the basic objective underlying Articles II and III, namely that discrimination against products from other contracting parties should only take the form of ordinary customs duties imposed on or in connection with importation and not the form of internal taxes, could not be achieved."[99]

5.66 The manner in which the measures at issue in this dispute work suggests that the measures are internal taxes and internal regulations applicable only to imported parts rather than border measures ruled by Article II of the GATT 1994. Therefore such measures fall under the provisions of Article III:2 and Article III:4 of the GATT 1994. In Argentina's written submission we have already made an analysis of the measures under Articles III:2 and III:4 of the GATT 1994, therefore we do not wish to repeat it here. Nevertheless, if the Panel where to find any inconsistency of the measures with the above mentioned provisions regarding national treatment, a finding on the consistency of China's measures with Part 1, paragraph 7.2 of the Accession Protocol of China would also be relevant.

2. China's measures are not similar to anti-dumping or countervailing anti-circumvention measures

5.67 Argentina considers that it is not appropriate to make a parallelism between ordinary customs duties and antidumping or countervailing anti-circumvention measures. China makes such parallelism in order to justify its measures as being anti-circumvention measures.

5.68 Antidumping and countervailing anti-circumvention measures are applied to goods that are imported with the sole purpose of being assembled into final products which imports are subject to antidumping or countervailing duties, in order to prevent the material injury or threat of material injury or the retardation in the establishment of a domestic industry. Under an antidumping or

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[94] China's first written submission, para. 46.
[95] GATT Panel Report on *EEC – Parts and Components*, para. 5.7.
[96] Article 16 of Decree 125.
[97] Article 28 of Decree 125.
[98] GATT Panel Report on *EEC – Parts and Components*, para. 5.7.
[99] *Ibid,* 5.7.

countervailing anti-circumvention measures the duties are charged at the border at the time of importation and not subsequently or dependent upon their incorporation to whole parts.

5.69 Contrary to what China asserts, antidumping and countervailing duties and AD or CVD anti-circumvention duties are different to ordinary custom duties. AD/CVD duty and AD/CVD anti circumvention duties are aimed to resolve a situation of injury within the domestic market caused by products imported at discriminatory prices due to subsidization or due to a dumping practice.

5.70 Therefore, the difference between China's measures and AD/CVD anti-circumvention measures added to the fact that the later are duties charged at the border and not upon assembly of the goods, suggests that China's measures are not anti-circumvention ones, and that therefore there is not a common, consistent or discernible practice.[100]

5.71 Admitting that China's measures are imposed to prevent circumvention of ordinary customs duties[101] would lead to include within Article II of the GATT 1994, measures such as these ones, that involve burdensome administrative procedures - prior and after importation - only applicable to manufacturers of imported parts, as well as duties charged conditioned upon how and which imported parts the manufacturer decides to fit in the final product. This understanding would allow Members to apply restrictions to imports of other Members' goods not committed in their Schedules of Concessions under-covered by the protection of an alleged anti-circumvention measure.[102]

3. The measures are not justified under Article XX(d).

5.72 China states that the challenged measures are justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with China's customs law.[103] However, Article 1 of Decree 125 clearly states that the measures "are formulated […] with a view to formalizing and strengthening the administration of the importation of automobile parts, and promoting the healthy development of the automobile industry".[104] The text of the norm suggests that there is not a clear "compliance" univocal objective in the norms as suggested by China throughout its written presentation[105]. In order to a measure to be considered "necessary" under Article XX (d) one of the features involved in the "weighing and balancing" is the respective impact of the measure on international commerce.[106]

5.73 Argentina considers that the impact these measures could have are far beyond to what could be considered "slight". The fact that the measures result in higher tariff rates to those parts that are finally assembled into whole vehicles, no matter whether the importation was done by the manufacturer or by a local supplier whose only objective is to import parts, results in a disincentive for local purchasers and manufacturers to buy the imported parts. Furthermore, the administrative burden imposed to importers and manufactures of vehicles that use imported parts helps to skew the choice of manufacturers who are to decide between buying imported or domestic parts. The differential treatment between local parts and imported ones obviously affects the competitive conditions of the imported product on the Chinese market and more specifically, affects the conditions of internal offering for sale or purchase of these products. Altogether, this results in a restriction on

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[100] Appellate Body Report on *US – Gambling,* para. 192.
[101] China's first written submission, para. 112.
[102] See also Japan's third party submission, para.35.
[103] China's first written submission, para. 201.
[104] Article 1 of Decree 125, Exhibit CHI-2.
[105] China's first written submission, paras. 202, 204, 205, 207, 208 and *ff.*
[106] China's first written submission, para. 208.

the entry of imported parts in the Chinese automobile market. The Appellate Body in *Korea – Various Measures on Beef* found that*: "A measures with a relatively slight impact upon imported products might more easily be considered as "necessary" than a measure with intense or broader restrictive effects."*[107] The effects the challenged measures have on imported parts result in a restriction to commerce. Therefore the "necessity" test is not satisfied, preventing China to justify the measures under Article XX(d).

5.74 Finally, were the Panel to analyse the justification of the measures under the *chapeau* of Article XX, Argentina considers the rulings of the Appellate Body in *US – Shrimp* and *US – Gasoline* regarding the prevention of "abuse of the exceptions of Article XX", a guidance of relevance for that task.[108]

4. Conclusion

5.75 To conclude, Argentina wishes to make the following remarks:

- First of all, Argentina is not convinced by China's argument on the fact that the measures are border measures rather than internal taxes. Therefore, Argentina believes the measures fall under the provisions of Article III:2 and Article III:4 of the GATT 1994.

- Secondly, Argentina considers there is no similarity between AD/CVD anti-circumvention measures and China's measures because they deal with different subject matters, they have different purposes and most importantly, the former consists of duties charged upon importation while the later is a duty charged upon verification of the content of imported parts that had been put together into the locally manufactured vehicle. Considering China's measures as tariff anti-circumvention measures will allow members to call ordinary customs duties to taxes and charges that depend upon manufacture and verification of goods containing imported parts and calling ordinary custom duties to measures that entail burdensome administrative procedures only applicable to users of imported goods. Such measures might entail some sort of restriction to imports and would suppose broadening the scope of interpretation of Article II, while leaving Article III with little or no application.

- Finally, Argentina is not convinced by China's argument that the measures fall under the exception of Article XX(d), because the restrictive effects of the measures on international commerce make China unable to fulfil the "necessity" test to justify the application of the measures under Article XX(d).

E. ORAL STATEMENT BY AUSTRALIA AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

1. Introduction

5.76 The essence of the complainants' claims in this dispute is that China has re-introduced discriminatory internal charges and administrative requirements on imported auto parts. Australia's oral statement focuses on three key issues. Firstly, the proper characterisation of the challenged

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[107] Appellate Body Report on *Korea – Various Measures on Beef,* para. 163.

[108] Appellate Body Report on *US – Shrimp*, para. 116, quoting Appellate Body Report on *US – Gasoline*, page 22.

measures. Secondly, the interpretation of China's tariff schedule. Thirdly, the general exception in Article XX(d) of the GATT 1994.

2. Are the challenged measures border measures or internal measures?

5.77 The main contested issue before this Panel is whether the challenged measures are border measures subject to Article II or internal measures subject to Article III of the GATT 1994. It appears from China's first written submission[109] that its only defence to the complainants' claims under Article III of the GATT 1994, Article 2 of the TRIMs Agreement, and Part I of China's Accession Protocol is that the challenged measures are border measures.

5.78 The three complainants in this dispute have submitted a common factual background section. According to these facts, the challenged measures impose charges and administrative requirements on imported auto parts based on the use of those imported parts in vehicle manufacturing that takes place after importation, rather than on the state of the product upon presentation at the border. Australia understands that these imported parts have entered into commerce and are in free circulation within China once they have passed the border.

5.79 The commitment to binding tariff schedules provided for in Article II, and the national treatment obligation contained in Article III, are two of the core provisions in GATT 1994. The demarcation between these two provisions has been examined in a number of previous GATT and WTO cases. In Australia's view, the guidance contained in previous cases, when applied to the present facts, leads to the conclusion that China's measures are internal measures and not border measures. These prior cases also suggest that considerations of substance over form should also factor highly in the Panel's analysis in the present dispute.

5.80 The purpose of Article III is to ensure that internal measures are not "applied to imported or domestic products so as to afford protection to domestic production". According to the Appellate Body in *Japan – Alcoholic Beverages II*, the intention of Article III is "to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given".[110]

5.81 In *EEC – Parts and Components*, a case with many similarities of fact to the present dispute, a GATT Panel had to grapple with the question of whether a particular charge was a border measure or an internal measure.[111] The impugned measure in that case imposed duties on finished products assembled or produced in the EEC rather than on imported parts or materials. In concluding that it was an internal measure the GATT Panel made two key points.

5.82 Firstly, the GATT Panel held that the policy reason for the measure, namely to eliminate circumvention of duties, was irrelevant in determining whether it was a border measure or an internal measure. However, it was relevant whether the charge was due at the time or point of importation or whether it was collected internally.

5.83 Secondly, the GATT Panel held that the designation of the measure under domestic law as a customs duty, along with treatment analogous to a customs duty, was not dispositive of its characterisation as a border measure. Otherwise contracting parties would be able to readily defeat

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[109] China's first written submission, paras. 169-174.

[110] GATT Panel Report on *Italy – Agricultural Machinery*, para. 11; cited with approval in the Appellate Body Report on *Japan – Alcoholic Beverages II*, page 16.

[111] GATT Panel Report on *EEC – Parts and Components*, paras. 5.4-5.8.

the objective of Articles II and III, namely that discrimination against products from other contracting parties is only permissible by way of ordinary customs duties imposed on importation and not by way of internal taxes.

5.84 *Belgian Family Allowances* is another case in which a GATT Panel found that the levy in question was an internal measure. The fact that the levy depended on the internal use of the product, and was not charged at the time of importation, were influential in arriving at this result.[112] In *EEC – Animal Feed Proteins* a GATT Panel again lent support to the notion that in order to constitute a border measure a charge had to be collected at the time of, and as a condition to, the entry of the goods into the importing country.[113]

5.85 In light of these previous cases, Australia supports the thrust of Canada's arguments regarding the distinction between border measures and internal measures.[114] Broadly speaking, internal measures regulate internal trade, while border measures regulate the process of importation. Internal charges are imposed on activities occurring within the territory of a Member in relation to the normal internal trade of a product, while border charges are imposed at the time or point of importation. A Member may not, at its discretion, "deem" imported products not to have entered into their internal commerce and thereby avoid its national treatment obligations, as China appears to have done in this case with the use of a 'bond' on imports at the point of importation.

5.86 China has argued in this dispute that the challenged measures are designed to enforce its tariff schedule and prevent circumvention of its tariff bindings for motor vehicles.[115] However, China has not presented any evidence of a significant shift towards customs fraud in the automobile industry.[116] Furthermore, in Australia's view China has not effectively distinguished its challenged measures from the anti-circumvention duties at issue in *EEC – Parts and Components*.[117] In particular, China asserts that imposing border charges after the time or point of importation is permissible, so long as the charge fulfils a liability that arose as a condition of importation.[118] Presumably, in an attempt to establish a nexus with importation, the measures at issue include a declaration made at the time of importation. However, this declaration appears to be entirely focused on the way in which the imported parts will be used internally within China, rather than on the contents of a consignment upon importation. In addition, the charge is actually enforced after the point of manufacture once it can be established that a manufactured vehicle contains a certain percentage of imported parts. Therefore, in Australia's view, the liability attaches internally, after the vehicle has been manufactured.

5.87 Australia fully endorses the European Communities' systemic concern that, if the processing and manufacturing of products after importation into the territory of a Member were generally accepted as an intermediate step before tariff classification, the whole system of tariff classification would be rendered meaningless.[119] In addition, Australia shares Japan's systemic concern that acceptance of China's position would reduce the scope of the national treatment obligations in Article III.[120] In Australia's opinion such an interpretation would be incompatible with the object and purpose of both the WTO Agreement and the GATT 1994.

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[112] GATT Panel Report on *Belgium Family Allowances*, para. 2.
[113] GATT Panel Report on *EEC – Animal Feed Proteins*, paras. 4.13-4.18.
[114] Canada's first written submission, paras. 78-86.
[115] China's first written submission, paras. 3 and 43.
[116] See also Japan's third party submission, para. 2.
[117] See also Japan's third party submission, para. 19.
[118] China's first written submission, paras. 49-70.
[119] European Communities' first written submission, para. 140.
[120] Japan's third party submission, para. 22.

5.88 In summary, Australia submits that China's measures at issue are properly characterised as internal measures and are inconsistent with Article III of the GATT 1994.

3. What is the proper interpretation of China's tariff schedule?

5.89 However, should the Panel determine that the challenged measures constitute border measures, Australia supports the complainants' alternative argument that China's measures violate Article II of the GATT 1994.[121]

5.90 The complainants in this dispute claim that China's measures at issue classify imported auto parts as automobile parts characterized as complete vehicles after importation, resulting in a tariff of 25 per cent. They argue that this violates China's commitment to apply a tariff of 10 per cent on imported auto parts under Article II.[122] In its defence against this claim, China argues that it has been forced to impose the 25 per cent tariff on the automobile parts characterized as complete vehicles to prevent countries attempting to circumvent the higher tariff by importing disassembled cars in multiple shipments.

5.91 The essence of China's argument is that customs authorities should classify as a complete article any group of parts that has the essential character of that article, regardless of their state of assembly or disassembly. China argues that this is the case whether a group of parts enters the customs territory in one shipment or in multiple shipments.[123] China asserts that this position is supported by the "essential character" rule contained in GIR 2(a).[124]

5.92 Australia does not share China's interpretation of the "essential character" rule for the following reasons.

5.93 Firstly, China's view disregards the fundamental principle that when goods are classified in the HS it is always done on the basis of the objective characteristics of the product at the time of importation, that is, as imported and presented to Customs on a shipment-by-shipment basis. The intentions of the importer and differing duty rates are irrelevant.

5.94 Secondly, China's view disregards the significance of the crucial phrase "as presented" contained in the "essential character" rule. In fact, this phrase only appears once in China's eighty-three page submission[125] when China quotes the 'essential character' rule in full.

5.95 Thirdly, Australia notes that China refers to Australian practice in its submission.[126] For the information of the Panel, Australian customs practice in relation to the "essential character" rule underscores that the value of the parts in relation to the value of the completed good is irrelevant. Rather, what is required is an examination of the function, purpose and construction of the completed good to determine its essential character, and then an assessment whether the parts when assembled also exhibit that essential character. For example, the essential character of a motor vehicle might well be described as transporting people and goods using a motor. To be classified as a motor

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[121] European Communities' first written submission, paras. 207-281; United States' first written submission, paras. 116-122; Canada's first written submission, paras. 131-150.

[122] European Communities' first written submission, para. 280; United States' first written submission, para. 119; First Canada's first written submission, para. 44.

[123] China's first written submission, para. 2

[124] Annexed to the International Convention on the Harmonized Commodity Description and Coding System 1983.

[125] China's first written submission, para. 84.

[126] China's first written submission, para. 65.

vehicle, a collection of parts in a shipment, when assembled, must also exhibit that essential character. If a shipment includes all the parts necessary to form a motor vehicle, other than the motor itself, the parts would not have the essential character of a motor vehicle, and could not be classified as such.[127]

5.96 Fourthly, China's view undermines the ordinary meaning of the terms in its tariff schedule which provide for a clear separation between complete motor vehicles and parts thereof. In Australia's view this is contrary to the principle of effectiveness in treaty interpretation.[128]

5.97 Therefore, in Australia's opinion, on a proper interpretation of China's tariff schedule, the challenged measures are inconsistent with Article II of the GATT 1994.

4. Scope of the general exception under Article XX(d) of the GATT 1994?

5.98 China also asserts that the challenged measures are justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with China's customs laws.[129]

5.99 Australia, like Japan[130] and Argentina[131], finds China's Article XX(d) arguments unconvincing. China's assertion that the 'challenged measures have little or no restrictive impact on international trade'[132] does not sit comfortably with the material contained in the complainants' common factual background section. According to this material the challenged measures are impacting on the complainants' trade. Moreover, the challenged measures are adversely affecting the business of the Australian automotive components and parts industry.

5.100 Australia notes that China has not addressed the requirements of the chapeau of Article XX. This is significant as according to the Appellate Body the purpose of the chapeau is to prevent "abuse of the exceptions of Article XX".[133] Further, as a respondent seeking to invoke an exception, China bears the burden of proof under Article XX.[134]

5.101 Therefore, Australia submits that China's measures should not be afforded protection under Article XX(d) of the GATT 1994.

F. ORAL STATEMENT BY BRAZIL AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

5.102 The present dispute raises several questions of systemic interest to all WTO Members. In this oral statement, Brazil offers some thoughts on what it considers a key interpretative question before the Panel, namely: how should the Panel characterize China's Policy Order 8, Decree 125, and Announcement 4, as a matter of WTO law? In other words, are the measures at issue "border measures", to be examined under Article II of the GATT 1994, or "internal measures", to be examined under Article III of the GATT 1994?

5.103 Brazil notes that the parties to this dispute provide different answers to this question. At this stage, Brazil does not express any views on the proper characterization of the measures at issue.

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[127] *Minister for Industry and Commerce v Zyfert* and *Collector of Customs for NSW v Putale Pty Ltd* in Full Federal Court of Australia.
[128] Appellate Body Report on *US – Gasoline*, page 23.
[129] China's first written submission, paras. 201-214.
[130] Japan's third party submission of Japan, paras. 49-56.
[131] Argentina's third party submission, paras. 28-36.
[132] China's first written submission, paras. 213.
[133] Appellate Body Report on *US – Shrimp*, para. 116.
[134] Appellate Body Report on *US – Wool Shirts and Blouses*, page 14.

However, and bearing in mind the important distinction between the disciplines of Article II and Article III of the GATT 1994, Brazil highlights key considerations regarding the differences between those articles.

5.104 Article II prevents Members from affording imported goods treatment that is less favorable than the treatment set forth in the Member's Schedule of Concessions. As the Appellate Body has confirmed, "a Schedule is made an integral part of the GATT 1994 by Article II:7 of the GATT 1994. Therefore, concessions provided for in that Schedule are part of the terms of the treaty."[135] Moreover, those Schedules "represent a common agreement among all Members."[136] Since Schedules reflect the balance of concessions negotiated by the Members, as the Panel in *EC - Chicken Cuts*[137] stated, they should not be subject to unilateral modification without appropriate compensation. Thus, Members cannot accord to the commerce of other Members treatment less favorable than the treatment provided for in the relevant schedule. By contrast, Article III of the GATT 1994 gives expression to the obligation not to discriminate between domestic and imported goods once the latter have been "cleared through customs."[138] Under Article III, Members enjoy discretion to alter domestic regulations provided that they respect their obligations related to non-discrimination.

5.105 In assessing whether measures fall under Article II or Article III of the GATT 1994, a panel must give meaning to the different scope of those Articles. In order to do so, Brazil submits that the Panel should take into account the condition for the imposition of the measures. In this sense, the characterization of a measure as a "border" or an "internal" measure will most likely depend on the event that triggers its operation. For the sake of abbreviation, Brazil will generally refer to this event as the "taxable event".

5.106 The first sentence of Article II:1(b), which applies to "ordinary customs duties," refers to "the products... *on their importation"*[139] The second sentence of Article II:1(b) applies to "all other duties or charges of any kind *imposed on or in connection with the importation."*[140] This language reflects the notion that the taxable event giving rise to the imposition of an "ordinary customs duty" is the *importation* of a product. Similarly, the reference to "other duties or charges of any kind", in the second sentence of Article II:1(b), establishes a connection between the taxable event and the act of importation.

5.107 In contrast to a custom duty or other charge under Article II of the GATT 1994, an internal tax or other internal charge in the sense of Article III:2 applies to products which have been *"imported* into the territory of any contracting party."[141] Thus, the taxable event in Article III:2 is not the act of importation. The same is also true of the triggering event in the case of measures affecting internal trade that are subject to Article III:4.

5.108 Hence, given that the taxable event is the key criterion in determining whether the measures at issue fall under Article II or Article III of the GATT 1994, the Panel must determine whether the condition for the application of the measures is the importation of products or rather the use of those products within China. In Brazil's view, the characterization of the taxable event in domestic law is relevant, but not decisive of its character in WTO law.

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[135] Appellate Body Report on *EC – Computer Equipment,* para. 84.

[136] Appellate Body Report on *EC – Computer Equipment,* para. 109.

[137] Panel Report on *EC - Chicken Cuts,* para. 7.320.

[138] GATT Panel Report on *Italy – Agricultural Machinery*, para. 11; cited with approval by the Appellate Body in *Japan - Alcoholic Beverages II*, at page 16.

[139] Article II:1(b) of the GATT 1994.

[140] *Id.*

[141] Article III:2 of the GATT 1994.

5.109 In assessing the taxable event for purposes of WTO law, some of the elements of the measures highlighted by the parties and the third parties might help the Panel. In Brazil's view, those elements include, among others: (i) the identity of the person liable to pay the charge imposed by the measures (i.e., the importer or the manufacturer); (ii) the "in bond" versus "in free circulation" status of the products within China; (iii) the time of collection of the duties; (iv) the agency or authorities responsible for the administration of the measures; and (v) the title or legal definition of the measures as characterized by China's legislation. In examining these, and other relevant elements, the Panel should consider them in their appropriate context and having regard to relevant Chinese legislation and GATT provisions.

5.110 In sum, Brazil considers that, as a preliminary matter, the Panel must decide whether the contested measures are to be considered under Article II or Article III of the GATT 1994. After resolving this question, the Panel would examine the substantive arguments and evidence submitted by the parties and third parties regarding the WTO provisions that the Panel finds to be relevant.

G. ORAL STATEMENT BY JAPAN AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

1. Argument

(a) Arguments relating to the GATT Panel Report in *EEC – Parts and Components*

5.111 First, we would like to address some points on the China's argument on *EEC – Parts and Components*, by expanding on the arguments in our written submission.

5.112 As discussed in our written submission, at issue in *EEC – Parts and Components* was an EC regulation to prevent circumvention of anti-dumping duties. China states there are two reasons why the reliance upon *EEC – Parts and Components* is misplaced[142]. First the measure at issue in *EEC – Parts and Components* differed from the Chinese measures concerned.[143] Second, *EEC – Parts and Components* interpreted Article II of the GATT 1994 to include charges imposed "conditional upon" the importation, but did not find that charges collected after importation were necessarily excluded. China further states that charges are considered to be imposed "conditional upon" importation as long as they "bear[] an objective relationship to the administration and enforcement of a valid customs liability"[144]. Japan would like to comment on these statements of China.

5.113 First, China argues that the administration of the measures concerned is different from the procedure identified by the panel in *EEC – Parts and Components*. Under the measures, China argues, it first conducts a pre-investigation, then, following the pre-investigation, an importer is required to declare whether imported parts will be used to assemble a vehicle model. Since the importer's declaration is made at the time of importation and such importation is secured by the provision of bond, China considers that the duties are imposed conditional upon the entry of goods into China[145].

5.114 As stated in our submission, the fact that a measure requires some action at the time of importation does not mean that the measure is therefore a border measure.[146] The declaration by importers made under the measures concerned focuses on what happens after the time of importation.

[142] China's first written submission, para. 51.
[143] *id.* para. 52.
[144] *id.* para. 67.
[145] *id.* para. 60.
[146] Japan's third party submission, para. 16.

To put it differently, the declaration is based on the content of the completed auto vehicle after it is manufactured and assembled in China, not the contents of a particular consignment upon importation.

5.115 Also the fact that auto parts concerned remain in bonded status does not support China's argument. The panel in *EEC – Parts and Components* clearly stated that "the fact that the EEC treats imported parts and materials subject to anti-circumvention duties as not being 'in free circulation' … cannot …. support the conclusion that the anti-circumvention duties are being levied 'in connection with importation' within the meaning of Article II:1(b)."[147] Therefore, China's explanation of the measures in dispute does not distinguish them in any relevant way from the measures at issue in *EEC – Parts and Components* and does not support China's claim that the measures are subject to Article II of the GATT 1994.

5.116 Second, China states that, since the charge imposed under the concerned measure bears "an objective relationship to the administration and enforcement of a valid customs liability," "the challenged measures are border measures within the scope of Article II".[148]

5.117 This seems to be just an attempt to argue that when something is domestically categorized as a customs rule, the imposition of charges under the rule should be considered to be covered by Article II. However, the fact that a WTO Member treats certain measures as "customs practices" for its domestic regulatory or administrative purposes does not have a bearing on the issue of whether the measures are within the scope of Article II or III of the GATT 1994. Indeed, *EEC - Parts and Components* demonstrates that all the measures conducted by "customs authorities" are not necessarily border measures for purposes of the GATT 1994 analysis.

5.118 The same is true with regard to China's assertion that there are widespread practices of WTO Members supporting its argument. Japan notes that the domestic practices of those Members are not determinative as to whether charges imposed under a measure are covered by Article II or Article III of the GATT 1994. Indeed, many of those practices may constitute internal regulations and not border measures, just like the measure at issue in *EEC – Parts and Components*. The test concerning Article II and III is an autonomous test the outcome of which is not determined by the choice of Members to treat the measures as "customs measures" or "internal regulations" for domestic administrative or regulatory purposes.

5.119 Moreover, China's measures are not comparable to the other measures to which China refers. China's measures reach very far indeed. For example, foreign manufacturers in China are responsible for "customs duty" payments even if they purchase parts in China's domestic market from suppliers who previously imported the parts.

5.120 For the reasons stated above and in our written submission, Japan respectfully requests that the Panel find that the measures in dispute operate as internal measures and impose charges subject to Article III:2 of the GATT 1994.

(b) The challenged measure violate the TRIMs Agreement

5.121 Japan agrees with the EC's argument that the concerned measures are inconsistent with the TRIMs Agreement.

[147] GATT Panel Report on *EEC – Parts and Components,* para. 5.7.
[148] China's first written submission, para. 67, 68.

5.122 China claims that the complainants fail to demonstrate that the measures are inconsistent with the TRIMs Agreement because the measures are not internal measures[149]. In this regard, Japan is of the opinion that the measures should be examined under the TRIMs Agreement.

5.123 In *Indonesia – Autos*, the Panel indicated that the TRIMs Agreement required two elements for showing a violation thereof; first, the existence of a Trade Related Investment Measure (TRIM) and second, the inconsistency of the TRIM with Article III or Article XI of the GATT 1994. In particular, as regards the second element, the chapeau of the Illustrative List of the TRIMs Agreement states as follows:

> "TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of the GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:
>
> (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production;"

5.124 It is important to note that, the Illustrative List provides that, if (i) the compliance with the TRIMs at issue is necessary to obtain an advantage and (ii) the TRIMs include local content requirements, the TRIMs "*are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of the GATT 1994*." Japan considers that the measures fit all these conditions and, therefore, violate the TRIMs Agreement.

5.125 First, as pointed out in our submission, several provisions of Policy Order 8 shows that the objective of the measures is to assist and protect the nascent domestic Chinese auto industry and to provide incentives for foreign manufactures to locate an increasing proportion of their manufacturing and supply base in China[150]. The Policy Order 8 and its implementing measures, therefore, constitute TRIMs under Article 1 of the TRIMs Agreement.

5.126 Second, with regard to an advantage, the panel in *Indonesia – Autos* found that "[t]he lower duty rates are clearly 'advantages' in the meaning of the chapeau of the Illustrative List to the TRIMs Agreement"; as such, the panel found that the Indonesian measures fell within the scope of the TRIMs[151]. China's measures also provide lower duty rates, 10 per cent, to auto parts meeting criteria, instead of 25 per cent for others without fulfilling the criteria. It is clear that the Chinese measures fall within the scope of the TRIMs.

5.127 Finally, the measures require that "the aggregate price of imported components attains 60 per cent or less" in order to obtain the advantage.[152] This requirement clearly falls under the local content requirements under paragraph 1(a) of the *Illustrative List*, which provides "the purchase or use by an enterprise of products of domestic origin, … in terms of a proportion of … value of its local production."

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[149] See *id.* para. 172.
[150] Japan's third party submission, para. 51.
[151] Panel Report on *Indonesia – Autos*, para. 14.89.
[152] Art. 21 of Decree 125.