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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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TABLE OF CASES CITED IN THIS REPORT

Short Title	Full Case Title and Citation
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

[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

[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]

[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

[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:

[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.

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[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, 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. [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 absolute level 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 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, 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 all 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 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."

4.290 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".

[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.

[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

[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.

[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

[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]

[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.

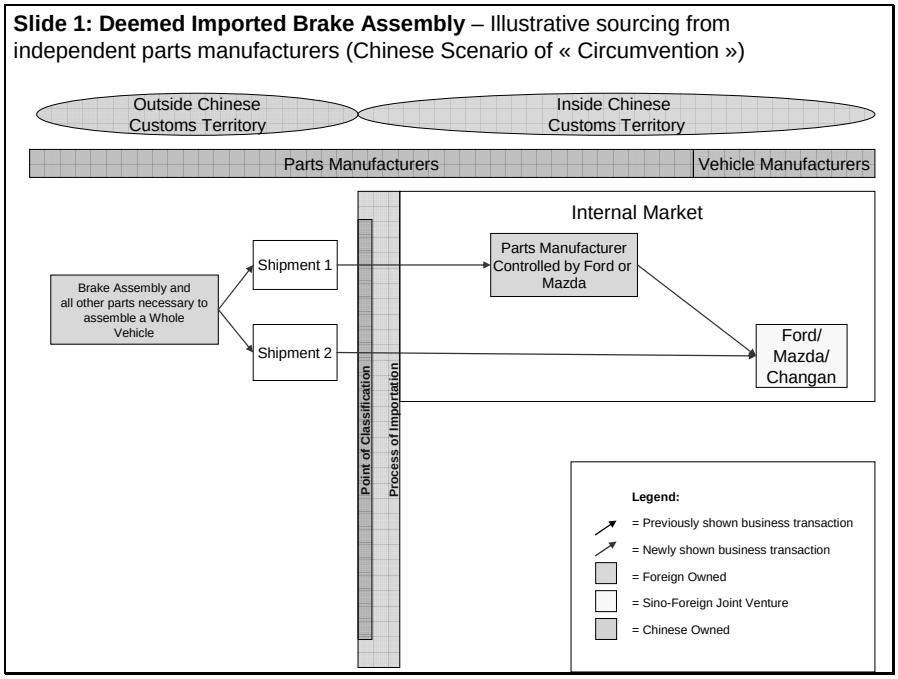
4.613 Canada has shown that China's Article II argument is an Article XX(d) of the GATT 1994 defence by another name. Even if one accepts that the measures may be considered in respect of Article II, the measures are applied such that some identical products receive different tariff treatment in a manner 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.

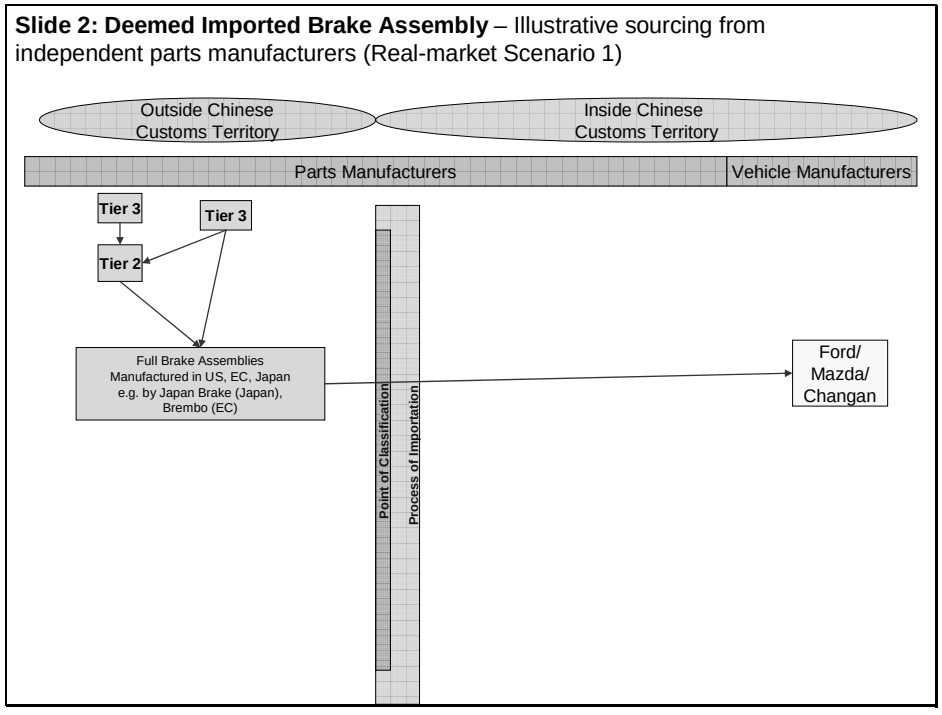
4.616 This position is untenable. Canada demonstrates this with a series of slides focussing on sourcing of the key parts for a brake system which, under the measures, constitute a Deemed Imported Brake Assembly. The normal chain of supply is a complex web of parts manufacturers, joint ventures, commercial 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.

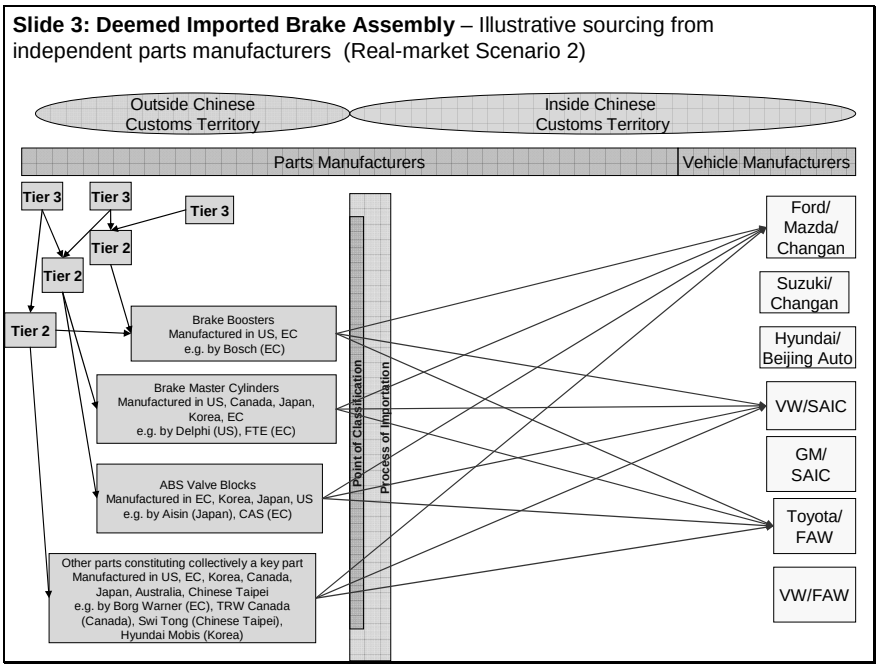


4.618 Now let us look at the real commercial world, at how parts sourcing *actually* operates in the auto industry. In every scenario, the measures deem the resulting brake assembly manufactured by a vehicle manufacturer to be imported, with the consequence of the application of the motor vehicle tariff.

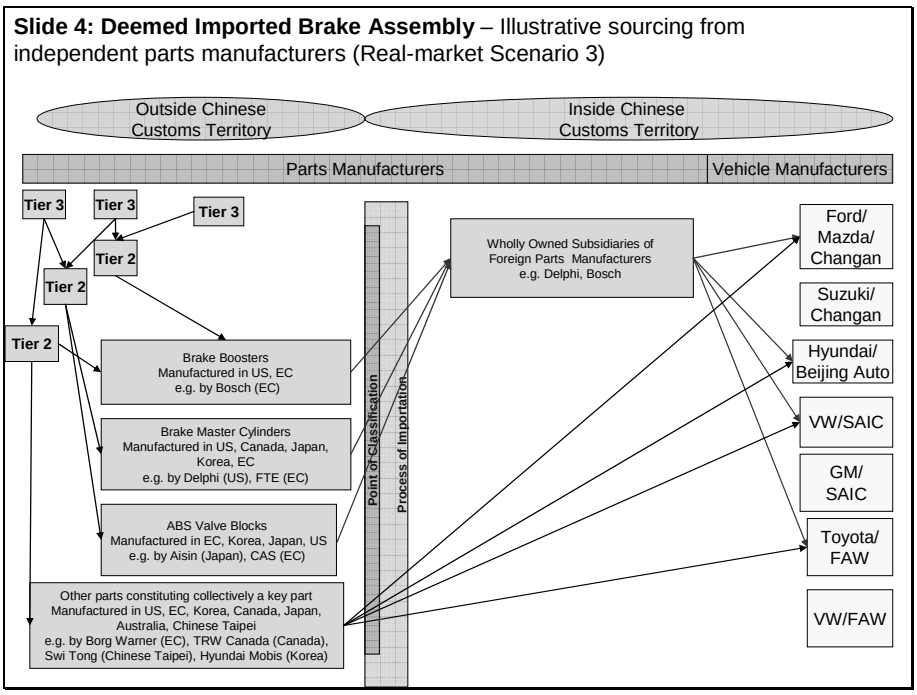
4.619 Slide 2 shows a specialized parts manufacturer abroad that ships a full brake assembly directly to a vehicle manufacturer in China. The vehicle manufacturer needs to source separately all other parts for the vehicle.



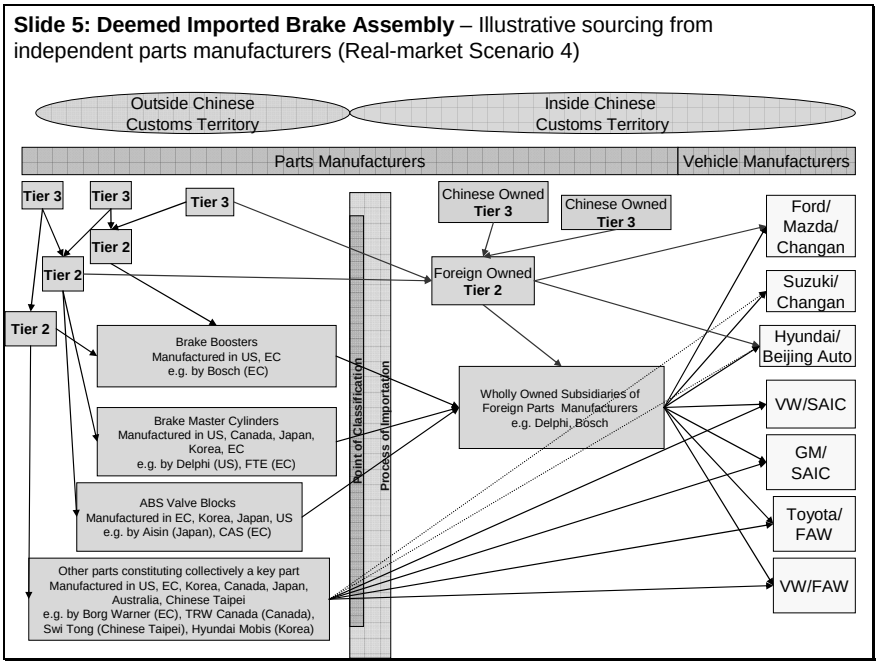
4.620 Slide 3 depicts separate shipments from different specialized parts manufacturers often in different countries, all of which are shipped directly from abroad to joint venture vehicle manufacturers in China.



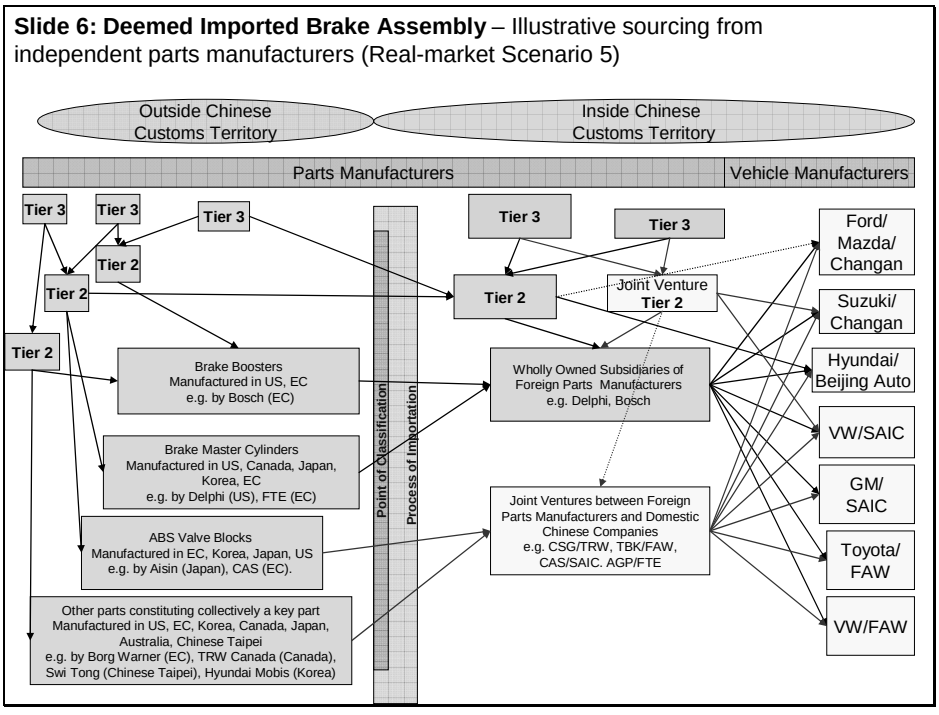
4.621 Slide 4 depicts a scenario in which three key parts are shipped to foreign-owned parts manufacturers in China, to be incorporated with parts produced in China by those companies and then shipped to vehicle manufacturers, which combines those parts with other brake parts shipped directly to them 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.

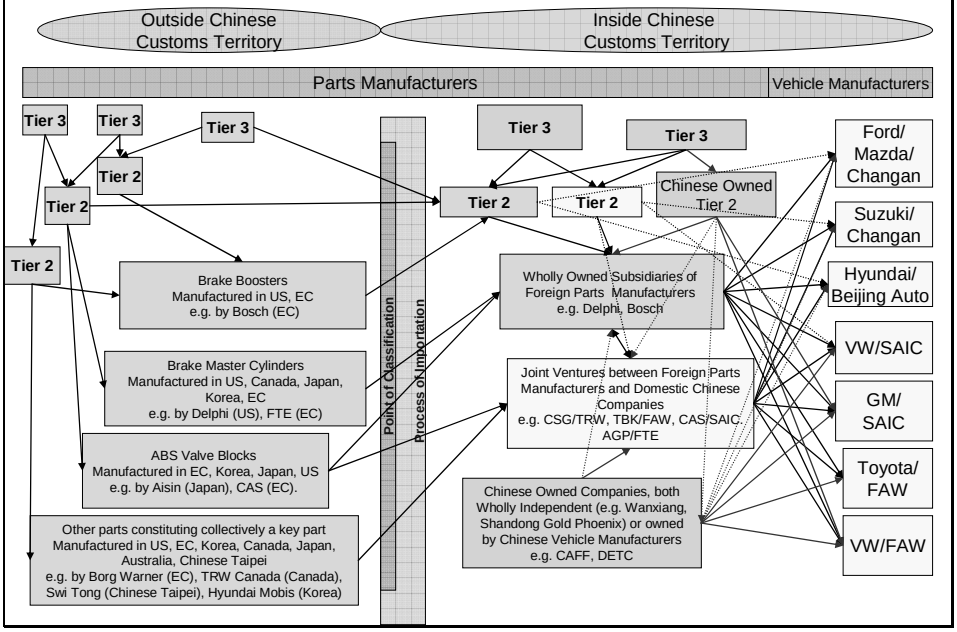


4.623 Slide 6 adds the involvement of joint ventures in the parts industry, which import some key parts, source others parts within China, and ship either to foreign parts manufacturers or directly to vehicle manufacturers.



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.

Slide 7: Deemed Imported Brake Assembly – Illustrative sourcing from independent parts manufacturers (Most Likely Real-market Scenario)



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.

[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

[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

[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.

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[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.

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[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

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[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

[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

[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

[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

[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

[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.

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[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.

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[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.

2. Conclusion

5.128 For the reasons set forth above and in our written submission, China's defense of its measures must fail. China's unprecedented and far-reaching "anti-circumvention" measures, if upheld, will have a chilling effect on international trade. Particularly, the trade in more sophisticated products with multiple parts risks being jeopardized. Accordingly, Japan respectfully requests the Panel to uphold the claims of the complainants.

VI. INTERIM REVIEW

6.1 On 13 February 2008, the Panel submitted its Interim Reports to the parties. On 27 February 2008, the European Communities, the United States, Canada and China submitted written requests for review of the Interim Reports.[153] None of the parties requested an interim review meeting. On 5 March 2008, the United States, Canada and China submitted written comments on each others' requests for interim review. On the same day, the European Communities informed the Panel that it fully supports the comments by the United States and Canada on China's interim review comments of 27 February 2008 concerning paragraph 7.753 of the Interim Reports.

6.2 In accordance with Article 15.3 of the DSU, this section of the Panel's reports sets out the Panel's response to the arguments made at the interim review stage, to the extent that an explanation is necessary. The Panel has modified aspects of its reports in light of the parties' comments where it considered these appropriate, as explained below. The Panel has also made certain technical and editorial corrections and revisions to the Interim Reports for the purposes of clarity and accuracy. References to sections, paragraph numbers and footnotes in this Section VI relate to the Interim Reports.

A. SECTION VII.F OF THE INTERIM REPORTS CONCERNING CKD AND SKD KITS

1. Article II:1(b) of the GATT 1994

(a) Paragraphs 7.708 and 7.734 – Canada's comments

6.3 **Canada** submitted that it did provide documentary evidence to support its view that China has been "treating CKD and SKD kits as parts" by applying lower tariff rates than for whole motor vehicles. Canada refers to paragraphs 67 and 68 of its second written submission, in particular to Exhibits JE-25, CDA-28, and CDA-32 and the documentary evidence provided in its response to Panel question No. 61(b). Canada requested that if this paragraph refers to the submission of the complainants regarding tariff *treatment* of CKD and SKD kits, then the reference to not providing documentary evidence be removed, and that a comment noting the existence of Canada's evidence be included either in paragraph 7.708 or in a footnote.

6.4 In a similar context as its request in respect of paragraph 7.708 above, Canada submitted that it disagrees with the Panel's finding in paragraph 7.734 that it did not provide specific evidence that "China 'treated' CKD and SKD kits imports with substantially lower tariff rates than complete motor vehicles since 1996 and prior to China's accession". In addition to Exhibit JE-25, which is addressed in footnote 1077 of the Interim Reports, Canada pointed to the documentary evidence referred to in its response to Panel question No. 61(b) and statistical evidence supported with documentation in paragraph 68 of its second written submission and requested that the reference to not providing

[153] Letter of the parties of 27 February 2008.

specific evidence be removed, and that a comment noting the existence of that evidence be included either in the paragraph or in a footnote.

6.5 **China** objected to Canada's proposed revision to these paragraphs. According to China, the only documentary evidence provided by Canada is addressed in footnote 1077 of the Interim Reports. In addition, Canada's response to Panel question No. 61 contains no documentary evidence.

6.6 First, regarding the evidence provided in paragraphs 67 and 68 of Canada's second written submission, the **Panel** notes that Exhibit CDA-28 provides information on the basis of which Canada argues that CKD and SKD kits are not subject to the same tariff rate as motor vehicles, but will be subject to a tariff rate depending on the local content rate of the CKD or SKD kit, which is lower than the rate for motor vehicles. As we noted in footnote 1077 of the Interim Reports, however, this piece of evidence uses the term CKD or SKD kits more in a general sense without confining its scope to a particular collection of auto parts that could be considered as falling within the scope of a CKD or SKD kit as defined by the Panel in the Interim Reports. Specifically, we recall our finding in paragraph 7.644 of the Interim Reports that, with respect to the extent of auto parts and components that need to be contained in a kit so as to constitute a CKD or SKD kit, the parties generally agree that in the automobile industry, the term is understood as referring to "all, or nearly all, of the auto parts and components necessary to assemble a complete vehicle". Given the ambiguous scope of the term "CKD and SKD kits" used in Exhibits CDA-28 and JE-25, we do not consider that these exhibits prove that China "treated" CKD and SKD kits as parts by applying lower tariff rates than for motor vehicles since 1996 and prior to China's accession to the WTO.

6.7 Second, based on Exhibit CDA-32, Canada argues that the value of imports of motor vehicles (HS headings 87.02 to 87.05) from Canada in 1999 was only US$279,000, while imports of auto parts from Canada were US$75 million. Given the amount of 23,000 CKD kits imported to China in 1999, Canada argues that these CKD kits cannot have been classified as motor vehicles, unless they were valued at US$12 each. In contrast to Canada's observation, however, Exhibit CDA-32 shows that the sum of imported motor vehicles falling under HS heading 87.02 to 87.05 amounts to more than US$5 million. Because of the inaccuracy of the data referred to by Canada, we cannot draw any conclusion from this specific evidence on how China classified CKD kits in 1999.

6.8 Finally, as argued by China, Canada has not provided any documentary evidence in Canada's response to Panel question No. 61(b). In its response, Canada addresses the creation of a tariff commitment but does not provide documentary evidence regarding China's treatment of CDK and SKD kits after its accession.

6.9 The **Panel** has revised footnote 1077 to clarify the Panel's reasoning in response to Canada's comments. A cross-reference to footnote 1077 has also been made in footnote 1049.

(b) Paragraph 7.731, 7.733, 7.734, and 7.735 – United States' comments

6.10 The **United States** submitted that paragraphs 7.731, 7.733, 7.734, and 7.735, which were based on China's response to Panel question No. 254, did not reflect the additional information that China subsequently provided in its comments on the complainants' responses to the same question. Therefore, the United States suggested that it would be more accurate if the reports reflected China's acknowledgement that China did provide reduced tariff rates on the importation of certain CKD and SKD kits. The United States also suggested that the United States' position would be more accurately

reflected if the reports clarified the United States' position by stating that "normally" (as opposed to always) a lower tariff rate was applied to CKD and SKD kits.[154]

6.11 **Canada** submitted that it fully supports the comments of the United States.

6.12 **China** submitted that it considered that the Panel accurately characterized the relevant evidence concerning China's pre-accession practices in respect of the classification and tariff assessment of CKD and SKD kits and thus objected to the United States' suggestion to reflect the relevant evidence concerning China's pre-accession practices in the reports. China suggested that to the extent that the Panel considered that a response to the United States' comment on paragraph 7.731 was warranted, an appropriate response would be to expand upon the footnote that is currently at the end of this paragraph (footnote 1075). China did not make any comment on the second point raised by the United States.

6.13 The **Panel** has added, for clarification, the additional information that China subsequently provided in its comments on the complainants' responses to Panel question No. 254 in the accompanying footnotes to paragraphs 7.731, 7.733, and 7.734 and also made a modification to paragraph 7.735 by deleting the last sentence. The Panel has also clarified the United States' position by inserting the word "normally" in paragraphs 7.733 and 7.734.

2. Paragraph 93 of China's Working Party Report

(a) Admission of Exhibit CDA-48

6.14 **China** objected to Canada's submission of Exhibit CDA-48 on the grounds that the Panel accepted the evidence in violation of paragraph 13 of the Panel's Working Procedures and requested the Panel to strike Exhibit CDA-48 from the record and remove any reference to this document in the Panel's Final Reports. China provided three reasons for its position that the acceptance of Exhibit CDA-48 violates paragraph 13 of the Working Procedures: (i) according to China, Canada was required to present evidence that China had created separate tariff lines for CKD and SKD kits no later than during the first substantive meeting. Because Canada submitted Exhibit CDA-48 only in its comments on China's response to Panel question No. 254, Canada was required to explain why it was previously unable to identify and submit the evidence and to show good cause for submitting Exhibit CDA-48 later than the first substantive meeting; (ii) further, China submitted that Canada's submission of Exhibit CDA-48 is not "factual evidence necessary for purposes of comments on answers provided by others", as required under paragraph 13 of the Panel's Working Procedures, because the factual issue of whether China had created separate tariff lines for CKD and SKD kits was central to Canada's claim under paragraph 93 of the Working Party Report and Canada should have identified the issue as part of Canada's affirmative case and presented its argument why ten-digit statistical annotations were relevant to whether China had created separate tariff lines for CKD/SKD kits; and (iii) the Panel should have accorded a period of time for other parties to comment on this late-filed evidence. In particular, China should not have been required to make an unsolicited intervention, or to comment on this evidence in a later submission in which the topic would not have been pertinent.

6.15 **Canada** argued that Article 11 of the DSU obliges panels to make an objective assessment of the facts of the case. Citing the statement by the Panel in *EC – Selected Customs Matters* that a panel would not be abiding by its duty in Article 11 of the DSU if it were to ignore evidence that may have a bearing on its findings in a dispute, Canada pointed to the Panel's finding in that case that it was not

[154] United States' letter of 27 February 2008, para. 6 and footnote 2.

necessary for a panel to determine whether particular evidence is, as China alleges, "new factual evidence", or whether it is "rebuttal evidence".[155] Canada submitted that what is relevant is that Article 12.1 of the DSU and paragraph 13 of the Working Procedures give the Panel the authority to admit Exhibit CDA-48. Accordingly, Canada was of the view that the Panel properly considered the evidence, under its authority pursuant to Article 12.1 of the DSU and paragraph 13 of the Working Procedures. Canada explained that Exhibit CDA-48 was provided as a "comment" on China's response Panel to question No. 254, and was necessary in order to highlight the relevance of the evidence that China provided in its answer to that question. Canada argued that Exhibit CDA-48 therefore meets this requirement under paragraph 13 of the Panel's Working Procedures and Article 11 of the DSU does not permit the Panel to ignore the evidence that has a bearing on the facts in the present dispute, much less to strike it from the record as China requests. China had had the opportunity to object to this evidence on procedural grounds but failed to do so.

6.16 Canada further argued that given that Exhibit CDA-48 is China's own customs tariff and reflects the fact that China classifies CKD and SKD kits under a separate heading from assembled vehicles, which China has admitted for the first time in its comments on the Interim Reports, China has not explained why it did not admit to this fact earlier.[156] Canada contended that the failure of China to produce that evidence provides additional reason for the Panel to consider Exhibit CDA-48.

6.17 Finally, Canada submitted that even if it were appropriate to exclude Exhibit CDA-48 as evidence, based on Exhibits CHI-47 and CHI-48 and the admission of China, the Panel still had sufficient evidence to find that China created tariff lines within the meaning of paragraph 93 of China's Working Party Report.

6.18 The **United States** argued that China's comments on Exhibit CDA-48 omitted that it is China's own evidence through Exhibits CHI-47 and CHI-48 that shows China classified CKD shipments under a separate tariff line for CKD kits and that Canada's Exhibit CDA-48 simply confirmed the existence of such tariff lines in China's Customs Tariff for 2005. The United States submitted that contrary to China's assertions, the evidence contained in Exhibits CHI-47 and CHI-48 and confirmed by Canada's Exhibit CDA-48, is relevant to an assessment of China's compliance with its obligations under paragraph 93 of China's Working Party Report.

6.19 First, as regards China's first point that Canada was required to present evidence that China had created separate tariff lines for CKD and SKD kits no later than during the first substantive meeting, the **Panel** notes that paragraph 13 of the Panel's Working Procedures allows the submission of factual evidence after the first substantive meeting if this is necessary for the purpose of, *inter alia*, comments to responses to panel questions provided by others. As an exception to this procedure, the submission of factual evidence in other instances than those listed in paragraph 13 will be granted upon a showing of good cause. As stated by China, Canada submitted Exhibit CDA-48 for the first time as part of its comments on China's response to Panel question No. 254. Because the submission of factual evidence in a party's comments on other parties' responses to a Panel question does not constitute an exception according to paragraph 13 of the Working Procedures, we do not consider that

[155] Canada's letter of 5 March 2008, para. 4, citing *EC – Selected Customs Matters*, paras. 7.69-7.70.

[156] Canada's letter of 5 March 2008, para. 8, footnote 8, citing to China's comments on the Interim Reports, para. 14. The Panel notes China's statement in its letter of 27 February 2008: "In its comments on China's response to [Panel] question No. 254, and in submitting CDA-48, Canada did not explain why it was previously unable to identify and submit as evidence the *Customs Import and Export Tariff of the People's Republic of China* - a fairly obvious source of evidence, if one has the burden of establishing the creation of separate tariff lines for CKD and SKD kits" (page 10, paragraph 18).

Canada was required to explain why it was previously unable to identify and submit Exhibit CDA-48 and to show good cause in introducing this evidence as China argues.

6.20 Regarding China's second point that Canada's submission of Exhibit CDA-48 was not "factual evidence necessary for purposes of comments on responses provided by others", as required under paragraph 13 of the Panel's Working Procedures, we do note that the factual issue of whether China had created separate tariff lines was central to Canada's claim and thus an earlier submission of evidence might have been preferable to a submission at a later stage of the panel proceeding. However, there are no provisions in the DSU or the Panel's Working Procedures that unconditionally preclude the Panel from accepting evidence submitted by a party later than during the first substantive meeting. Article 11 of the DSU requires the Panel to make an objective assessment of the matter before it, including an objective assessment of the facts of the case. In this context, in *Argentina – Textiles and Apparel*, Argentina argued that the Panel had acted inconsistently with Article 11 of the DSU by allowing certain evidence offered by the United States two days before the second substantive meeting of the Panel with the parties. However, the Appellate Body stated that "Article 11 of the DSU does not establish time limits for the submission of evidence to a panel."[157] Further, the Appellate Body noted that "the Working Procedures in their present form do not constrain panels with hard and fast rules on deadlines for submitting evidence."[158] In addition, the Appellate Body stressed the Panel's wide discretion concerning the acceptance of new evidence by stating that "while another panel could well have exercised its discretion differently, we do not believe that the Panel here committed an abuse of discretion amounting to a failure to render an objective assessment of the matter as mandated by Article 11 of the DSU."[159] In light of this, notwithstanding a general preference to receive evidence at an early stage of the panel proceeding, we confirm our view that accepting Canada's evidence that was provided as part of its comments on China's response to Panel question No. 254 was in accordance with paragraph 13 of the Working Procedures and doing otherwise would be in violation of our duty under Article 11 of the DSU.

6.21 Furthermore, contrary to China's argument, the evidence submitted by Canada through Exhibit CDA-48 should be considered "necessary for the purpose of comments on answers" according to paragraph 13 of the Working Procedures. In this context, we recall the Panel's reasoning in *US – Offset Act (Byrd Amendment)*, where Canada asked the Panel to accept as evidence a letter which it submitted after the first substantive meeting. The Panel accepted the evidence noting that the information contained in the letter was pertinent to the proceedings since it related to an issue which it had been asked to consider.[160] In this dispute, China had offered the documentation of two specific CKD import entries (Exhibits CHI-47 and CHI-48) in its response to Panel question No. 254 in order to illustrate its classification practice respectively prior and subsequent to its accession to the WTO. Specifically, Canada responded to China's arguments on classification practice of CKD and SKD kits subsequent to China's accession, which were supported by Exhibit CHI-48, by submitting its own piece of evidence (Exhibit CDA-48). Therefore, it is our view that Canada's submission of additional factual evidence should be considered necessary for the purpose of its comment on China's response as it relates and is pertinent to the arguments made by China. As we noted above, although an earlier submission of the evidence would have been preferred, we understand that under Article 3.10 of the DSU all Members are expected to engage in the panel procedures in good faith in an effort to resolve the dispute. Accordingly, in the absence of any contrary proof, the Panel exercised its discretion, as noted by the Appellate Body in *Argentina – Textiles and Apparel*[161], in accepting evidence provided

[157] Appellate Body Report on *Argentina – Textiles and Apparel*, para. 79.
[158] Appellate Body Report on *Argentina – Textiles and Apparel*, para. 80.
[159] Appellate Body Report on *Argentina – Textiles and Apparel*, para. 81.
[160] Panel Report on *US – Offset Act (Byrd Amendment)*, para. 7.2.
[161] See paragraph 6.20 and footnote 159.

by Canada on the assumption that Canada acted in good faith without the intention to deliberately withhold the evidence until the later stage of the proceeding.

6.22 Finally, the Panel does not find any basis in the DSU or the Panel's Working Procedures for China's argument that the Panel should, *sua sponte*, have accorded a period of time for other parties to comment on Exhibit CDA-48 filed by Canada. Rather, it is at the discretion of the Panel whether it will allow, upon request, parties time to respond to another party's submission. For example, in *Argentina – Textiles and Apparel*, the Panel accepted certain evidence offered by the United States two days before the second substantive meeting and at the same time allowed Argentina two weeks to respond to it after Argentina had drawn the Panel's attention to the difficulties in tracing and verifying the submitted documents. The Panel noted that "[t]he Panel could well have granted Argentina more than two weeks to respond to the additional evidence. However, there is no indication in the panel record that Argentina explicitly requested from the Panel, at that time or any later time, a longer period within which to respond to the additional documentary evidence of the United States."[162] In the present dispute, it is China, not the Panel, that should have initiated an opportunity to submit comments on Exhibit CDA-48. As noted in footnote 1094 of the Interim Reports, China could have invoked paragraph 13 of the Working Procedures to object to the submission of Exhibit CDA-48 and/or submitted its comments on the content of the exhibit. China, however, chose not to request the Panel for time to respond to the evidence submitted by Canada after receiving it on 9 August 2007.

6.23 For the foregoing reasons, the **Panel** concludes that the Panel's acceptance of Exhibit CDA-48 was proper in light of the Panel's obligation under Article 11 of the DSU and in accordance with paragraph 13 of the Panel's Working Procedures.

(b) Panel's analysis of Exhibit CDA-48 in paragraphs 7.749-7.753 of the Interim Reports

6.24 **China** requested that the Panel revise its analysis so as to remove any reliance on Exhibit CDA-48, or the existence of ten-digit codes for CKD and SKD kits in China's system of customs administration. China submitted two reasons for its request: (i) the exhibit relied on by the Panel (Exhibit CDA-48) is irrelevant to the question of whether China has created separate tariff lines for CKD and SKD kits because tariff headings at the ten-digit level (e.g. 8703.2334.90) as indicated in Exhibit CDA-48 are not "tariff lines". According to China, "ten-digit customs codes" are used solely for statistical or other customs administration purposes and have no bearing upon the tariff rate to which the goods are subject; and (ii) the practice of the complainants in this regard supports China's position. According to China, it is the unanimous practice of all parties to this dispute that ten-digit codes of this type are not "tariff lines". In this connection, China referred to the complainants' tariff schedules (Canada Customs Tariff, Harmonized Tariff Schedule of the United States, and the Integrated Tariff of the European Communities).

6.25 With respect to the argument that tariff headings at the ten-digit level are not "tariff lines", China also referred to Canada's statement in its response to Panel question No. 61(a) that it did not understand China, following its accession, to have created a separate tariff line at the seven- or eight-digit level for CKD or SKD kits. China argued that Canada thus understood that the relevant question was whether China had created separate tariff lines for CKD and SKD kits at the seven- or eight-digit level and that otherwise it is not clear why Canada would have referred to separate tariff lines at the seven- or eight-digit level. In China's view, the only purpose of this specific clarification in Canada's response to the Panel question would be to distinguish separate tariff lines at the seven- or eight-digit level from the existence of statistical annotations at the ninth- or tenth-digit levels.

[162] Appellate Body Report on *Argentina – Textiles and Apparel*, para. 80.

6.26 **Canada** argued that China's claim above was irrelevant to a determination of the proper interpretation of paragraph 93 of China's Working Party Report. First, referring to the *HS Classification Handbook*[163], Canada emphasized that there is no distinction in the HS between tariff classification at the eight- or ten-digit level. Furthermore, Canada contended that China's customs tariff on its face makes no distinction between items that are "statistical" and those that are used to determine a tariff rate: all items listed up to the ten-digit level are described together in the column "Tariff no.", and have a separate import duty rate listed in Exhibit CDA-48. Therefore, Canada submitted that the Panel was correct to conclude that China has created tariff lines for CKD and SKD kits within the meaning of paragraph 93 of China's Working Party Report.

6.27 Next, regarding China's reference to the complainants' practice, Canada submitted that China's evidence was not of assistance in interpreting paragraph 93 of the Working Party Report. Canada argued that with respect to the general proposition that classification at the ten-digit level was exclusively for statistical purposes, the practice of three Members did not meet the test for establishing common practice evidencing agreement of the WTO Members. This is particularly so when some Members, such as Indonesia as set forth in Canada's written submissions, do make distinctions on tariff treatment based on classification differences at the ten-digit level. Furthermore, Canada was of the view that the complainants did not classify CKD or SKD kits for tariff purposes, and their practice was therefore not relevant.

6.28 The **United States** submitted that China had not presented any basis for the Panel either to delete or to modify the discussion of paragraph 93 contained in the Interim Reports. The United States argued that it did not matter whether China created CKD or SKD lines at eight-digit levels or ten-digit levels because regardless of the number of digits China used for the CKD or SKD lines, those lines served to establish where CKD and SKD kits fell within China's tariff schedule. Those lines served to clarify that CKD and SKD kits would be classified in the same eight-digit subheadings as complete vehicles, and would thus receive the same tariff treatment as complete vehicles. The United States further submitted that to the extent that China was implying that ten-digit tariff lines must be statistical, this proposition was not correct. To the contrary, there is nothing in the HS Convention that mandates particular distinctions between eight-digit and ten-digit lines.

6.29 The **European Communities** expressed its support for the comments of Canada and the United States in this regard.

6.30 The **Panel** notes that China's request regarding the Panel's finding in paragraph 7.753 of the Interim Reports is based on two points: (i) "ten-digit customs codes" are solely used for statistical or other customs administration purposes and have no bearing upon the tariff rate to which the goods are subject; and (ii) it is the unanimous practice of all parties to this dispute that ten-digit codes of this type are not "tariff lines". We address these two points in turn below.

(i) Ten-digit customs code – new argument by China

6.31 As noted above, China argued that ten-digit customs codes are solely used for statistical purposes and have no bearing upon the tariff rate which the goods are subject to. First, China has not raised this line of argument during the course of the panel proceeding. In respect of the arguments of the United States and Canada concerning China's commitment under paragraph 93 of the Working Party Report, China's position has been that the condition underlying the commitment made in paragraph 93 of the Working Party Report has not occurred because China has not created separate

[163] The *HS Classification Handbook* was cited in footnote 1092 of the Interim Reports.

tariff lines for CKD and SKD kits, whether through the challenged measures or otherwise.[164] Furthermore, in its response to Panel question No. 254, China provided an import declaration by Shanghai GM in which a CKD kit import was classified and assessed at the tariff rate for motor vehicles under a ten-digit tariff line (8703.2334.90), which belongs to the eight-digit heading for motor vehicles.[165] In relying on the ten-digit tariff line indicated in this import declaration form as the evidence showing China's classification of CKD kits as motor vehicles, China neither distinguished ten-digit tariff lines from eight-digit tariff lines nor argued that ten-digit tariff lines cannot be regarded as "tariff lines". In our view, such an argument should have been raised earlier in the proceeding when China put forward its position on the creation of tariff lines.

6.32 In this regard, the Panel in *US – 1916 Act (EC)* found that parties are obliged not to withhold until the interim review stage arguments that they could be legitimately expected to have raised at a much earlier stage, noting that the limited function of the interim review is confirmed by the existence of an appeal procedure. However, the Panel in that case considered it justifiable to address the new arguments put forward by one of the parties to the dispute in light of Article 15.3 of the DSU and the consequent need to address parties' arguments as well as the possibility of appeal. Accordingly, although we are of the view that China's arguments relating to the ten-digit customs codes put forward in its request for the interim review should and could have been presented during the earlier stage of the proceeding, we will follow the Panel's approach in *US – 1916 Act (EC)* and nevertheless examine whether our analysis of China's creation of tariff lines for CKD and SKD kits should be modified based on the new arguments advanced by China.

6.33 We now turn to the substantive aspect of China's argument. First, as Canada points out, China confirms in its request for the interim review that "complete sets of assemblies" refers to CKD and SKD kits and that it classifies CKD and SKD kits separately at the ten-digit level as a sub-heading of motor vehicles.[166] China submitted that ten-digit tariff codes are only for statistical purposes and cannot constitute a tariff line. The United States and Canada pointed out that there is no distinction or nothing that mandates distinctions in the HS between tariff classification at the eight- or ten-digit level. In this connection, the *HS Classification Handbook* simply notes that because very often the goods or categories of goods referred to in the national customs tariff do not coincide with the HS categories, further subdivisions of the HS nomenclature have to be introduced at the national level. It does not indicate that only subdivisions at the eight-digit level will constitute tariff lines. Furthermore, China's tariff schedule itself does not provide any distinction between items that are statistical and those that are used to determine a tariff rate. We also note China's reference to Canada's statement in response to a Panel question that Canada did not understand China, following its accession, to have created a separate tariff line at the seven- or eight-digit level for CKD or SKD kits. In China's view, the only purpose of this specific clarification in Canada's response to the Panel question would be to distinguish separate tariff lines at the seven- or eight-digit level from the existence of statistical annotations at the ninth- or tenth-digit levels. However, we do not consider that Canada's reference to tariff lines at the seven- or eight-digit level necessarily implies that Canada was distinguishing tariff lines at different levels as China argues. In particular, in its response, Canada was comparing China's customs tariff for 1995 in which China had maintained a separate tariff line at the eight-digit level for CKD and SKD kits to China's customs tariffs since 1996 from which references to CKD and SKD kits are removed.

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[164] China's first written submission, para. 192; second written submission, paras. 141-142.

[165] This argument by China is reflected in paragraph 7.714 of the Interim Reports.

[166] Canada's letter of 5 March 2008, referring to China's comments on the Interim Reports, para. 14 in which China states that "[China] has placed statistical annotations for CKD/SKD kits under its tariff provisions for motor vehicles."

6.34 As the United States pointed out, regardless of the number of digits China used for the CKD or SKD kit lines, those lines serve to establish where such CKD and SKD kits fall within China's tariff schedule. In other words, those ten-digit lines (e.g. 8703.2334.90) clarify that CKD and SKD kits will be classified under the same eight-digit subheadings (e.g. 8703.2334) and subject to the same tariff rate for complete vehicles. Finally, the ten-digit tariff lines in China's tariff schedule (Exhibit CDA-48) do provide the same tariff rates as those for the eight-digit tariff lines under which the ten-digit tariff lines fall. Therefore, the Panel decides to maintain its analysis in paragraphs 7.749-7.753 of the Interim Reports where the Panel discusses the evidence contained in Exhibit CDA-48.

(ii) Complainants' practice – new evidence by China

6.35 To support its position concerning the ten-digit tariff codes, China also relies on the practice of the complainants in the present dispute. Although China did not attach any physical documentary evidence to its request for the interim review, China refers to each complainant's tariff schedule by citing in footnotes relevant website addresses and direct website links to relevant documents in pdf format for the information used in its comments. Specifically, China refers to the following evidence, which was not produced prior to its interim review request:

> – Canada's Customs Tariff sets forth that the term "tariff item" means "a description of goods in the List of Tariff Provisions and the rates of customs duty and the accompanying *eight-digit* number in that List", and Canada Border Services Agency provides that the seventh and eighth digits, for Canadian trade purposes, determine the customs duty rate, while the ninth and tenth digits additional detail for statistical purposes;
>
> – The Harmonized Tariff Schedule of the United States (the "HTS") provides that "the legal provisions" of the HTS include "headings and subheadings through the eight-digit level". The US International Trade Commission also explains on its web site that the structure of the HTS is based on the HS; the 4- and 6-digit HS product categories are subdivided into 8-digit unique U.S. rate lines and 10-digit non-legal statistical reporting categories;
>
> – The European Communities' Combined Nomenclature (the "CN") specifies rates of duty under the Common Customs Tariff at the level of eight-digit "CN subheadings". The CN forms a part of the Integrated Tariff of the European Communities ("Taric"), which consists of the eight-digit CN subheadings plus additional Community Subdivisions, known as Taric subheadings (i.e. the ninth and tenth digits of the Taric code), that are used to implement other Community policies, including the collection of statistical information. The Taric subheadings never alter the applicable rate of duty, which is set forth exclusively at the level of the eight-digit CN subheadings.

6.36 In this regard, previous panels and the Appellate Body refused to consider new evidence provided at the interim review stage because in their view, the interim review stage is not an appropriate time to introduce new evidence. The Appellate Body in *EC – Sardines* states that Article 15 of the DSU, which governs the interim review, permits parties, during that stage of the proceedings, to submit comments on the draft report issued by the panel and to make requests for the panel to review precise aspects of the interim report. In the Appellate Body's view this cannot properly include an assessment of new and unanswered evidence.[167] Based on the same reasoning, the Appellate Body in *EC – Selected Customs Matters* considered that the Panel in that dispute acted

[167] Appellate Body Report on *EC – Sardines*, para. 301.

properly in refusing to take into account the new evidence during the interim review, and did not thereby act inconsistently with Article 11 of the DSU.[168]

6.37 We are of the view that the approach adopted by panels and the Appellate Body above and the principle under Article 15 of the DSU lead us to reject the evidence newly introduced by China at the interim review stage of the present dispute. However, even if we were to assess such new evidence, in particular given the absence of any procedural objection from the complainants, we do not consider that the practice of the complainants as advanced by China constitutes subsequent practice based on which our analysis regarding China's creation of new tariff line at the ten-digit level must be revised. This is because the practice of these three complainants does not establish a common, consistent, and discernible pattern of acts or pronouncements that imply agreement among WTO Members. Furthermore, an example of the practice of Indonesia, which does make distinctions on tariff treatment based on classification differences at the ten-digit level, does not support China's argument based on the practice of the three complainants in this dispute.

(c) Clarification of the term "tariff line" in the context of paragraph 93 of China's Working Party Report

6.38 **China** requested that the Panel clarify its understanding of the term "tariff lines" in the third sentence of paragraph 93 of the Working Party Report as reflected in paragraphs 7.753 to 7.758 of the Interim Reports. In addition, China requested that the Panel clarify footnote 1100 in the Interim Reports.

6.39 The **Panel** notes that no legal definition of "tariff lines" exists. However, the conventional understanding of this term appears to be that a tariff line is a horizontal line in a tariff schedule that provides a specific heading number, regardless of the number of digits (i.e. be it at the eight-digit or ten-digit level) and a specific tariff rate for the product described under that heading. Furthermore, we do not have any basis to conclude that only tariff headings up to the eight-digit level can be considered as tariff lines. The Panel revised paragraph 7.750 to reflect its understanding of the term "tariff line" in the context of paragraph 93 of China's Working Party Report and also modified footnote 1100 for further clarification.

B. OTHER REQUESTS FOR REVIEW

6.40 The **European Communities** requested modifications to paragraphs 7.30 (first and fifth lines); 7.40 to 7.58; 7.294 (last line); 7.374 (first sentence); 7.646 (third sentence) and 7.761 and footnotes 175 (third sentence); 622 and 981 of the Interim Reports and made some clerical observations. China did not object to any of these requests and observations. With the exception of the European Communities' requests regarding paragraph 7.34 (second line) and footnotes 622 and 981, the Panel has accordingly modified the reports to the extent it deemed necessary.

6.41 The **United States** also requested modifications to paragraphs 7.277; 7.668 and 8.7 of the Interim Reports and made some clerical observations. China did not object to any of these requests and observations. The Panel has accordingly modified the reports to the extent it deemed necessary.

6.42 **Canada** also requested modifications to paragraphs 7.85 (second last sentence); 7.357 (starting with the second sentence); 7.543 (first line); 7.602 (second last line); 7.654; 7.655; 7.657; 7.721 (eighth line and second sentence); and 8.10 and footnote 686 of the Interim Reports and made

[168] Appellate Body Report on *EC – Selected Customs Matters*, para. 259.

some clerical observations. China did not object to any of these requests and observations. The Panel has accordingly modified the reports to the extent it deemed necessary.

6.43 **China** also requested paragraph 4.336 and footnote 606 of the interim reports to be modified so as to preserve some confidential information cited therein. The complainants did not object to this request. The Panel has accordingly modified the reports.

6.44 As noted above, the Panel has incorporated all other comments by the parties on typographical errors in the Interim Reports.

VII. FINDINGS

A. PRELIMINARY MATTERS

1. Measures at issue

(a) Identification of the measures at issue

7.1 The European Communities, the United States and Canada have identified Policy Order 8, Decree 125 and Announcement 4 as the measures at issue in this dispute.[169] Before examining the specific aspects of the measures as contested by the complainants, the Panel will first describe these three measures.

7.2 In this connection, we recall that our mandate is, *inter alia*, to make an objective assessment of the meaning of the relevant provisions of the measures that fall within our terms of reference. Although we are mindful that the measures are part of the domestic law of China, we will be required to determine the meaning of particular provisions of the measures if interpretations of such provisions are contested by the parties. Our examination in such cases will be for the sole purpose of determining the conformity of the measures with relevant obligations under the WTO covered agreements in accordance with the Appellate Body's approach in *India – Patents (US)*.[170]

(i) Policy Order 8[171]

7.3 Policy Order 8, entitled "Policy on Development of the Automotive Industry", went into effect on 21 May 2004, at which time the implementation of China's "Policy on Automotive Industry of 1994"[172] ceased. The NDRC[173], at its executive meeting, deliberated and adopted Policy Order 8, which was ultimately reported to and approved by the State Council.

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[169] As indicated in the Descriptive Part of these Reports, when discussing China's measures, the Panel will refer to the terms used in the common translations of China's measures, attached as Annex E to the Reports.

[170] Appellate Body Report on *India – Patents (US)*, paras. 65-68. See also the Panel Report on *EC – Trademarks and Geographical Indications (US)*, para. 7.55.

[171] China submits that legal instruments similar to Policy Order 8 also exist with respect to other industry sectors such as "the Steel Industry Development Policy (8 July 2005)" and "the Cement Industry Development Policy (17 October 2006)" (China's responses to Panel question Nos. 11 and 178).

[172] The preamble to China's former Automotive Policy (1994 Policy Order) states:

> "The policy is aiming at building China's automotive industry (including motorcycle sector) into a pillar industry of the national economy by changing the current scattered investment, small-scale production and backward products in the industry to raise the development capacity of the producer as well as upgrade their product quality and technology and

7.4 Policy Order 8 consists of the preamble, thirteen chapters and two annexes. The preamble to Policy Order 8 sets out, *inter alia*, China's general objective of promoting its automotive industry to make it into a pillar industry of China's national economy by 2010.[174]

7.5 The thirteen chapters comprising Policy Order 8 are Policy Objectives (I); Development Planning (II); Technical Policies (III); Structural Adjustments (IV); Access Management (V); Trademarks and Brands (VI); Product Development (VII); Parts and Related Industries (VIII); Distribution Networks (IX); Investment Management (X); Import Management (XI); Vehicle Consumption (XII); and Others (XIII). In addition, Annex 1 to Policy Order 8 provides "the definitions of terminology used in the Policy", and Annex 2 "contents to be filed for an automotive investment project."

7.6 The Panel notes that various issues ranging from the promotion of China's automotive and auto parts industry to product development to trademarks and to import management are covered in these thirteen chapters of Policy Order 8. We will refer back to specific provisions contained in Policy Order 8, as necessary, in the context of our legal analysis. At this stage, we find it sufficient to mention Chapter XI of Policy Order 8 as it provides an explicit link to the implementation measures to be introduced by the CGA – namely, Decree 125 and Announcement 4.

7.7 In this regard, we note **China**'s argument that Chapter XI is the one chapter of Policy Order 8 that is relevant to the present dispute – the chapter concerning the administration and enforcement of China's tariff provisions for motor vehicles and motor vehicle parts – and that only Chapter XI gave rise to the customs enforcement procedures embodied in Decree 125 and Announcement 4.[175] China also submits that the language in the preamble to Policy Order 8 is not meaningful or relevant to an evaluation of Chapter XI.

7.8 The **complainants** submit that Decree 125 and Announcement 4 implement Policy Order 8 in its entirety, not just Chapter XI of Policy Order 8.[176]

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equipment level in a bit of achieving a reasonable streamline industrial structure and economic scale of production in the industry..."

Further, Article 3 identifies "key parts and components of sedans" as one of the six "key development products". Under Article 43, the assembly of motor vehicles through the importation of completely knock-down (CKD) and semi-knock-down (SKD) kits was prohibited. Article 44 sets out China's policy to provide preferential duties on imported automotive parts depending on the rates of localization of the different automobile products (Exhibit JE-24).

Overall, the terms of the 1994 Policy Order, in particular those concerning the auto parts industry, have some similarities to Policy Order 8 in respect of China's policy objectives.

[173] According to China, the role of the NDRC relating to the measures at issue includes: (i) being a member of the Leading Panel (Article 6.2 of Decree 125); (ii) marking "Characterized as Complete Vehicles" in the *Public Bulletin* (Article 7.4 of Decree 125); and (iii) suspending the relevant vehicle model listing in the *Public Bulletin* in the event that an auto manufacturer violates relevant rules (Article 37 of Decree 125) (China's response to Panel question No. 21).

[174] See paragraph 7.306 for the full text of the preamble of Policy Order 8.

[175] China's responses to Panel question Nos. 49 and 178.

[176] European Communities' comments on China's response to Panel question No. 178, referring to its second written submission, para. 24. Specifically concerning Chapter XI, the European Communities argues that the measures and in particular Chapter XI of Policy Order 8, which even China admits as motivating Decree 125 and Announcement 4, explicitly refer to the objective of nurturing the domestic automotive industry (European Communities' second written submission, para. 122).

7.9 Given that the measures as a whole are as such subject to the dispute and without specific proof that other provisions in Policy Order 8 are not in any manner related to Decree 125 and Announcement 4, the **Panel** will not preclude at this stage the possibility of examining other chapters and provisions of Policy Order 8 when analysing the parties' claims and arguments in respect of Decree 125 and Announcement 4. Having said that, for the purpose of understanding the operation of the measures, we will focus in this section on the structure of Chapter XI of Policy Order 8 without prejudice to the parties' specific arguments on the objectives and functions of Policy Order 8 as a whole in relation to Decree 125 and Announcement 4.

7.10 Chapter XI, entitled "Import Management", consists of nine provisions (Articles 52-60). Article 52 states:

> "The State supports the efforts of vehicle manufacturers to increase their domestic production capacity, giving impetus to the technological progress of auto parts manufacturers and to the development of the automotive manufacturing industry."

7.11 Articles 53 to 59 of Chapter XI address issues relating to the importation of automobiles and auto parts as well as the prohibition of the import of used vehicles and used parts. The final provision of Chapter XI, Article 60[177], as China explains, directs the CGA, together with other relevant agencies, to draw up the specific management measures for the import of whole vehicles and parts. China submits that Decree 125 and Announcement 4 are the specific management measures the CGA drew up pursuant to Article 60.[178]

7.12 We note that the obligations set out in the provisions of Chapter XI, Policy Order 8, in particular Articles 53, 55, 56, and 57, are implemented in specific terms in Decree 125 and Announcement 4. For example, Article 53 provides, *inter alia*, that any vehicle manufacturers using "imported auto parts characterized as complete vehicles" to produce vehicles should report this factually to the Ministry of Commerce, the CGA and the NDRC. Specific procedural requirements relating to this obligation to report are set forth in various provisions in Decree 125, including Articles 2, 3, 5, 6, 7, and 10. For example, motor vehicle manufacturers/importers who produce vehicles with imported auto parts are required to conduct a self-evaluation of whether imported auto parts used in a particular vehicle model should be characterized as complete vehicles and apply to the CGA for verification of such fact. [179]

(ii) Decree 125 and Announcement 4

7.13 Decree 125, entitled "Administrative Rules on Importation of Automobile Parts Characterized as Complete Vehicles", was introduced by the CGA, the NDRC, the Ministry of Finance, and the Ministry of Commerce pursuant to Policy Order 8, in particular Article 60 as noted above. Decree 125 went into effect on 1 April 2005.

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[177] Article 60 provides:

> "Specific management measures for the import of whole vehicles and parts shall be drawn up by the Customs jointly with other relevant departments, and implemented upon approval by the State Council. Sample vehicles sent from abroad for testing and vehicles temporarily imported to be shown at exhibitions shall be managed in accordance with customs management regulations for the temporary import and export of goods."

[178] China's response to Panel question No. 48.

[179] See paragraphs 7.39-7.69 for more detailed description of the administrative requirements under the measures.

7.14 Decree 125 consists of seven chapters (thirty-eight articles) and three annexes and provides the specific rules applicable to the supervision and administration of auto parts and assemblies[180] that are imported to be incorporated for production/assembly[181] of automobiles.[182] The seven chapters comprising Decree 125 are General Provisions (I); Administration of Registration (II); Administration of Customs Clearance (III); Criteria for Whether or Not to be Characterized as Complete Vehicles and the Verification (IV); Duty Collection Principles and Calculation of Duties (V); Legal Liabilities (VI); and Miscellaneous (VII). Decree 125 also includes three annexes: Assembly (System) List (1); Scope of Automobile Parts in Assemblies (Systems) (2); and Purchase List of Automobile Parts of Registered Vehicle Models (3).

7.15 Announcement 4, entitled "Rules on Verification of Imported Automobile Parts Characterized as Complete Vehicles", was also introduced by the CGA in order to implement Decree 125 and became effective as of 1 April 2005. As can be seen from its title, Announcement 4 lays down the specific rules on the verification of "imported auto parts characterized as complete vehicles". The four chapters comprising Announcement 4 are: General Provisions (I); Verification Procedure (II); Verification Criteria (III); and Supplementary Provisions (IV). Announcement 4 also includes 8 annexes.[183]

7.16 A number of the provisions of Announcement 4 overlap with those of Decree 125, in particular the provisions under Chapter IV ("Criteria for Whether or Not to be Characterized as Complete Vehicles and the Verification") of Decree 125. Announcement 4 also provides additional details concerning certain procedures applicable to automobile and auto parts manufacturers importing auto parts with respect to the evaluation of verification process required with respect to certain imported auto parts.[184]

7.17 In sum, Policy Order 8 provides a legal basis for the introduction of Decree 125 and Announcement 4, which set out specific rules relating to the charge imposed on imported auto parts and the administrative procedures necessary for the imposition of the charge. According to China, there is no legal hierarchy between these measures, at least not in the sense that one prevails over the others in case of conflict between them.[185]

7.18 In this regard, **China** states that "the [m]easures do not themselves impose any duty, fee, or charge, but merely define the circumstances under which China will classify imported merchandise as falling under different tariff provisions."[186]

7.19 As explained in more detail below[187], however, the **Panel** considers that the measures do impose both the charge[188] and the administrative procedures attached to the charge. In fact, China

[180] See paragraphs 7.88-7.89 below for the description of the product term "assemblies".
[181] See footnotes 191, 212.
[182] See Article 2(1) of Decree 125.
[183] These 8 annexes to Announcement 4 are: Names and Illustration of the Vehicle Structure and Body Parts (1); Table of HS Codes on the Key Parts and Sub-assemblies of Motor Vehicles (2); Application Form for Review of Complete Vehicle Character (3); Detailed List of Parts for Verification and Review of Complete Vehicle Character (4); Review Report for Complete Vehicle Character (5); Application Form for Verification of Complete Vehicle Character (6); Document List for Verifying Complete Vehicle Character (7); and Report on Verification of Complete Vehicle Character (8).
[184] See Part D.3 of the Factual Background Section jointly submitted by the complainants (European Communities' first written submission, para. 34). Also see Article 20 of Announcement 4.
[185] China's response to Panel question No. 48.
[186] China's first written submission, para. 44.
[187] See paragraphs 7.20-7.69.

itself explained that Decree 125 sets forth the legal obligation of auto parts manufacturers to pay a charge on imports of auto parts characterized as complete vehicles and the procedural requirements adopted to administer and collect the charge.[189] Although other domestic laws or regulations in China may also prove relevant to how the imposition of the charge is operated, the "legal obligation" to pay the charge originates in the measures themselves.[190]

(b) Effects of the measures at issue: charge and administrative procedures

7.20 Article 2 of Chapter I ("General Provisions") of Decree 125 provides:

> "These Rules are applicable to the supervision and administration of the importation of automobile parts characterized as complete vehicles, used to produce/assemble[191] vehicles by automobile manufacturers approved by or registered with relevant state authorities. …"

7.21 The complainants claim that the measures have an impact on imported auto parts in two ways: first, the measures impose on imported auto parts *a charge* equivalent to the tariff rate applicable to motor vehicles if such auto parts are characterized as complete motor vehicles according to the criteria set out in the measures; and, second, the measures impose allegedly burdensome *administrative procedures*[192] on automobile manufacturers importing auto parts to both determine the applicability of the above charge and govern the imposition of the charge on imported auto parts.

7.22 China does not dispute the two above-mentioned effects of the measures – namely, the charge and the administrative procedures, although it does dispute the complainants' claim that the measures

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[188] We note, for example, that the second sentence of Article 28 of Decree 125, as cited below in paragraph 7.28, contains mandatory language directing Customs to impose the charge ("... the customs ... shall base both the tariff and the import VAT on rates applicable to ..."). See also Article 13(1) of Decree 125 ("... an automobile manufacturer ... shall ... pay duties ..."); Article 28(1) ("... Customs shall ... proceed with ... duty collection."); Article 31(1) of Decree 125 ("An automobile manufacturer shall declare duty payment ..."); and Article 34 ("... declaration for duty payment ...").

While the term "tariff (duty)" is used in China's measures, the Panel will use the term "charge", instead of "tariff", as the nature of the charge is one of the legal issues raised by the parties, which will be discussed in the subsequent sections. Thus, the Panel's reference to the term "charge" is without prejudice to the parties' arguments as to whether the charge falls within the meaning of Article II or III of the GATT 1994, which is considered below in Section VII.B.1, and should be understood to mean the "tariff", as used in the measures, that is imposed on "imported auto parts characterized as complete vehicles" under China's measures, unless specified otherwise.

[189] China's responses to Panel question Nos. 48-50.

[190] China has confirmed in many instances throughout this dispute that the charge is imposed "pursuant to Decree 125" (China's second written submission, para. 110). Also see, *inter alia*, China's first written submission, para. 47 ("... duties collected pursuant to Decree 125 are classified as ordinary customs duties ..."); first written submission, para. 48 ("... any duties that China collects pursuant to this measure are ordinary customs duties ..."); response to Panel question No. 79 ("... the challenged measures result in the imposition of ordinary customs duties ..."); second written submission, para. 118 ("... customs duties that the CGA collects pursuant to Decree 125 ...").

[191] The complainants note that the Chinese original text contains the two words "shengchan" and "zuzhuang", which are properly translated into "to produce" for "shengchan", and "to assemble" for "zuzhuang". China considers that the two words are used in an interchangeable sense (footnote 1 of the common translation of Decree 125). The Panel's use of the terms "to assemble" and "to produce" in these reports is without prejudice to the parties' views on these two terms. Also see footnote 212 below.

[192] See paragraphs 7.39-7.69 below for the description of the administrative procedures under the measures.

are adopted to favour domestic auto parts over imported auto parts. China submits that the measures are introduced to strictly enforce correct tariff duties on imported auto parts in order to prevent tariff evasion.[193]

7.23 To the extent that the complainants' claims concern the specific obligations arising from the charge and the administrative procedures relating to such a charge, the Panel considers it important to have at the outset a good understanding of how the measures operate in terms of these two effects of the measures. Having said that, our examination in the following section of how the measures factually operate is without prejudice to the parties' legal claims and arguments concerning the consistency of the measures with China's obligations under the WTO covered agreements, which will be analysed in the subsequent sections of these reports.[194]

(i) Charge under the measures

7.24 In essence, China imposes under the measures a charge equivalent to the amount of the tariff rate applicable to complete vehicles (i.e. 25 per cent on average[195]) on auto parts that are imported by automobile manufacturers and used in the production/assembly of complete vehicles, if those imported auto parts are characterized as complete vehicles according to the criteria set out in the measures.[196] If such imported auto parts used in the production/assembly of motor vehicles are "not characterized as complete vehicles", the tariff rate applicable to auto parts (i.e. 10 per cent on average[197]) will be levied pursuant to China's Customs Law and China's Schedule.

Conditions under which the obligation to pay the charge arises

7.25 As noted above, the obligation to pay the charge under the measures depends on whether imported auto parts are determined to be "auto parts characterized as complete vehicles" according to the criteria set out in the measures. The provisions of Decree 125 that address procedural aspects of the charge are in relevant part:

7.26 Article 5 of Chapter I ("General Provisions") provides:

> "The reference to 'automobile parts characterized as complete vehicles' in these Rules shall mean that the imported automobile parts should be characterized as complete vehicles *at the stage when complete vehicles are assembled*. The reference to

[193] China's first written submission, para. 24.

[194] For example, our reference to the term "*imported* auto parts" in describing how the measures operate is based on the common translations of China's measures as provided by the parties and has no bearing on the question of when goods are considered "imported" within the meaning of the WTO covered agreements. It is our understanding for the purpose of this dispute that "*imported* auto parts" refers to "*foreign* auto parts", as opposed to domestic auto parts, unless specified otherwise.

[195] See China's Schedule CLII (Exhibit JE-2) for the exact tariff rates applicable to products falling under tariff headings 87.02-87.04. Although the exact tariff rates under these tariff headings, in particular at the 8 digit level, slightly vary, the parties agree that 25 per cent is the average tariff rate applicable to motor vehicles at issue in this case.

[196] See, *inter alia*, Articles 2, 5 and 28 of Decree 125.

[197] China's first written submission, para. 15; Part D.2 of the factual background section jointly submitted by the complainants (European Communities' first written submission, footnote 43 to paragraph 31; United States' first written submission, footnote 43 to paragraph 32; Canada's first written submission, footnote 42 to paragraph 30).

> 'automobile parts characterized as assemblies (systems)'[198] shall mean that the imported automobile parts should be characterized as assemblies (systems) at the stage when the assemblies (systems) are assembled." (emphasis added)

7.27 Article 7 of Chapter II ("Administration of Registration") provides:

> "Automobile manufacturers shall conduct *a self-evaluation of whether imported automobile parts used in a particular vehicle model should be characterized as complete vehicles* in accordance with these Rules, if the automobile manufacturers produce vehicles with imported automobile parts for domestic sales. If, through the self-evaluation, an automobile manufacturer determines that the imported automobile parts should be characterized as complete vehicles, the automobile manufacturer *shall register the relevant vehicle models with the CGA prior to the importation of such automobile parts*. Each vehicle model of the same automobile manufacturer shall be registered separately." (emphasis added)

7.28 Article 28 of Chapter V ("Duty Collection Principles and Calculation of Duties") provides:

> "After the imported automobile parts have been assembled into complete vehicles, the automobile manufacturer shall make a declaration of duty payable to Customs and Customs shall, ... , proceed with classification and duty collection.
>
> *If the Verification Center*, after verifications, *concludes that the imported automobile parts should be characterized as complete vehicles, the customs shall classify them as complete vehicles*, and *shall base both the tariff* and the import VAT *on rates applicable to complete vehicles*. If the imported automobile parts should not be characterized as complete vehicles, the customs shall classify them as parts, and shall base the tariff and the import VAT on rates applicable to parts." (emphasis added)

7.29 As shown in the above provisions, to determine whether imported auto parts should be characterized as complete vehicles, automobile manufacturers are required first to conduct a self-evaluation in respect of a specific vehicle model for which they plan to use imported auto parts and to register such a vehicle model with the NDRC. Once the first batch of automobiles for a given vehicle model is assembled in China, imported auto parts used for the assembly of that vehicle model are classified as complete vehicles and assessed at the tariff rate applicable to complete vehicles "if the Verification Center, after verifications, concludes that the imported automobile parts should be characterized as complete vehicles," in accordance with Article 28 of Decree 125. Various administrative procedures in this connection are explained in further detail in Section VII.A.1(b)(ii) below.

7.30 Substantively, whether imported auto parts should be characterized as complete vehicles is determined based on the criteria provided in Articles 21 and 22 of Decree 125: if imported auto parts used in the assembly of a particular vehicle model satisfy any of the criteria indicated in Article 21 of Decree 125, which are in turn affected by the application of the criteria set out in Article 22 of Decree 125, they are characterized as complete vehicles.

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[198] Article 4 of Decree 125 lists eight types of assemblies: the vehicle body (including cabin) assembly, the engine assembly, the transmission assembly, the driving axle assembly, the driven axle assembly, the frame assembly, the steering system, and the braking system.

7.31 In turn, whether imported auto parts used for the assembly of a certain vehicle model meet any of the criteria is determined once such auto parts are "assembled" into motor vehicles in China. This means that the charge is imposed on imported auto parts after their assembly into motor vehicles, regardless of whether such auto parts are imported together in a single shipment or separately in multiple shipments, insofar as they are used in assembling a common registered vehicle model.[199] We will describe these two aspects (criteria and multiple shipments) of the substantive criteria used for the determination of "auto parts characterized as complete vehicles" in turn below.

Criteria for determining whether imported auto parts should be characterized as complete vehicles – *criteria for determining auto parts characterized as complete motor vehicles*

7.32 The criteria for deciding whether certain imported auto parts are to be characterized as complete motor vehicles are provided in Articles 21 and 22 of Chapter IV of Decree 125.[200] Article 21 sets out the thresholds of the imported auto parts that would make those used to produce/assemble a motor vehicle "to be characterized as complete motor vehicles".

> "Imported automobile parts shall be characterized as complete vehicles if one of the following applies:
>
> (1) imports of CKD or SKD kits for the purpose of assembling vehicles;
>
> (2) within the scope identified in Article 4 of these Rules:
>
> (a) imports of a body (including cabin) assembly[201] and an engine assembly for the purpose of assembling vehicles;
>
> (b) imports of a body (including cabin) assembly or an engine assembly, plus at least three other assemblies (systems), for the purpose of assembling vehicles;
>
> (c) imports of at least five assemblies (systems) other than the body (including cabin) and engine assemblies for the purpose of assembling vehicles; or
>
> (3) the total price of imported parts accounts for at least 60% of the total price of a complete vehicle of that vehicle model. This criterion shall enter into force on July 1, 2006."[202]

[199] See China's response to Panel question No. 40. China submits that "[t]he structure of the import transactions is not relevant; what matters is whether the imported part and components in a particular vehicle model, in their entirety, have the essential character of a motor vehicle."

[200] Articles 13 and 14 of Announcement 4 are identical to Articles 21 and 22 of Decree 125. Also, Article 23 of Decree 125 provides:

> "An assembly (system) manufactured by a domestic automobile assembly (system) manufacturer shall be considered a domestic assembly (system), if the imported automobile parts used in the manufacturing of the assembly (system) are not characterized as an assembly (system)."

[201] For the term "assembly", see paragraphs 7.88-7.89 below.

7.33 Article 22 sets out the criteria according to which imported auto parts used to produce an "assembly" (of a motor vehicle) would make such an assembly a "Deemed Imported Assembly". Under Article 22, therefore, if an "assembly" is produced with imported auto parts above the thresholds specified therein, such an assembly itself is considered as imported assembly ("a Deemed Imported Assembly").[203]

> "Article 22 Imported automobile parts shall be characterized as an assembly (system) if one of the following applies:
>
> (1) imports of a complete set of parts for the purpose of assembling assemblies (systems);
>
> (2) imports of key parts or sub-assemblies for the purpose of assembling assemblies (systems), if the quantity of the imported key parts or sub-assemblies reaches or exceeds the specified level as set forth in Annexes 1 and 2[204]; or

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[202] The entry into force of this third criterion is postponed until 1 July 2008 (CGA Joint Bulletin No. 38 of 5 July 2005) (Exhibit JE-28). In response to the Panel's question concerning the postponing of this criterion, China has explained that it is primarily because of the administrative complexity of implementing this particular criterion and that once auto manufacturers and customs officials have gained more experience with the implementation of Decree 125, and have laid a solid foundation of record-keeping and reporting for the administration of the measure, it will be easier for manufacturers and customs authorities to determine and account for the value of imported parts and components (China's response to Panel question No. 59). Further, concerning the specific nature of the complexity relating to the implementation of Article 21(3) of Decree 125, China submits that the specific difficulty encountered by the customs is how to identify the fair value of the parts (China's response to Panel question No. 170).

We note that the complainants have challenged the measures as such and in their entirety. We do not consider therefore that the postponement of the applicability of this criterion in any way affects the scope of the measures falling within our terms of reference. We recall that previous panels "have always considered that mandatory legislation of a Member, even if not yet in force or not applied, can be challenged by another WTO Member" (Panel Report on *Turkey – Textiles*, para. 9.37, citing GATT Panels on *US – Superfund*, *EEC – Parts and Components* and *US – Malt Beverages*). See also the Panel Report on *US – Countervailing Measures on Certain EC Products (Article 21.5 – EC)*, para. 7.37.

[203] As noted in footnote 169, the Panel uses the terms as indicated in the common translations of the measures at issue in these reports. For "an assembly characterized as imported assembly" in the context of Article 22 of Decree 125, however, we will instead use the term "a Deemed Imported Assembly" as suggested by Canada in its letter of 4 October 2007.

[204] As of 1 July 2008, lower quantity thresholds will apply to those key parts identified as class A in Annex 1 to Decree 125. If those thresholds are met, the assembly will be characterized as an "imported assembly" (Note 5 of Annex I to Decree 125 and Article 19 of Announcement 4). The entry into force of this class A/B distinction was initially foreseen on 1 July 2006, but was postponed until 1 July 2008 (CGA Joint Bulletin No. 38 of 5 July 2005) (Exhibit JE-29). For the same reason explained above at footnote 202, such postponement does not affect the scope of the measures falling within our terms of reference.

Further, Article 20 of Announcement 4 provides:

> "If the imported parts account for more than 60% of the price of the key parts or sub-assemblies, such key parts or sub-assemblies shall be deemed as imported key parts or sub-assemblies. Manufacturers shall provide a list of price ratios of parts needed.
>
> Key parts or sub-assemblies, in principle, shall only be traced back to the secondary suppliers of the manufacturers of complete vehicles.

(3) the total price of imported parts accounts for at least 60% of the total price of that assembly (system)."

7.34 Based on the criteria set out in the above provisions, the Verification Centre[205], entrusted by the CGA, makes a determination of whether certain imported auto parts should be characterized as complete vehicles and thus should be charged at the tariff rate applicable to complete vehicles after vehicles are produced/assembled using such auto parts.

Criteria for determining whether imported auto parts are characterized as complete vehicles – *auto parts imported in multiple shipments*

7.35 To apply the thresholds set out in Articles 21 and 22 of Decree 125 to imported auto parts used in the assembly of motor vehicles, China's customs authorities wait until auto manufacturers finish the assembly of motor vehicles. As a result, auto parts, which might have been imported in multiple shipments, meaning imported at various times, in various shipments, from various suppliers, and/or from various countries, can still be characterized as a complete vehicle. In other words, the charge under the measures is assessed for auto parts assembled into a particular vehicle model, regardless of whether those parts are imported separately "in multiple shipments" or together "in a single shipment".[206]

Charge imposed on auto parts imported by third party suppliers – Article 29 of Decree 125

7.36 As described above, the measures impose the charge on auto parts imported by *automobile manufacturers*.[207] Auto part suppliers or auto part manufacturers that are not also automobile manufacturers are not subject to the obligations under the measures when they import auto parts. Auto part suppliers or manufacturers will pay the duty for imported auto parts at the tariff rates applicable to auto parts pursuant to China's regular customs law and China's Schedule. In this regard, China submits that in most cases, imported parts that the auto manufacturer purchases from a third-party supplier in China (either auto part suppliers or auto part manufacturers) will have completed the necessary customs formalities and are no longer subject to customs control.[208] Further, the rules for

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Imported parts purchased by domestic suppliers or trading companies shall be counted as imported parts."

[205] According to Articles 3 and 4 of Announcement 4, the "Verification Centre" is responsible for, *inter alia*, (i) prior to the importation of subject auto parts, conducting simplified or on-site reviews of the conclusions of self-evaluations to be filed by automobile manufacturers; and (ii) after the importation of subject auto parts, conducting on-site verifications of the registered vehicle models that have been assembled into complete vehicles using such imported auto parts and issuing verification reports (i.e. the verification of whether the auto parts concerned should be characterized as complete vehicles).

The actual verifications under the measures are performed by "Special Verification Teams" formed by 3 or 5 automobile experts and established by the "Verification Centre". In case a manufacturer disputes the conclusion of a verification, it can still request a review under the so-called "appraisal meeting", which encompasses all interested parties. This review can result in the determination of a "re-verification", which shall be conducted by a new "Verification Team" formed by no more than 1/3 of the original "Special Verification Team" (Articles 5 and 12 of Announcement 4).

[206] See also footnote 199.

[207] Article 2(1) of Decree 125 provides that "[t]hese Rules are applicable to … automobile parts …, used to produce/assemble vehicles by automobile manufacturers …"

[208] China's responses to Panel question Nos. 65, 66, 83, 92, 101. In this connection, the complainants explain the consequence of this requirements as follows:

bonded goods do not apply to auto parts imported by a third party and subsequently sold to the automobile manufacturer. These auto parts are thus in free circulation in China.[209]

7.37 However, if an automobile manufacturer subsequently purchases parts from third party suppliers, Article 29 provides:

> "Article 29 If the customs treats the imported automobile parts used by an automobile manufacturer as complete vehicles for the purpose of classification and duty collection, and if the supplier of the automobile manufacturer imported some of the automobile parts used by the automobile manufacturer and already paid import duty and import VAT upon importation, such paid import duty and import VAT shall be deducted from the total amounts of import duty and import VAT due from the automobile manufacturer, provided that the automobile manufacturer provides relevant proof of payment of import duty and import VAT. ..."

7.38 In other words, in determining whether imported auto parts used in the assembly of vehicles in China should be characterized as complete vehicles, imported auto parts purchased by manufacturers from domestic suppliers or domestic part manufacturers are also counted toward the thresholds set out in Articles 21 and 22 of Decree 125. In such a case, pursuant to Article 29 of Decree 125, automobile manufacturers are liable for the difference between the amount of duty for a complete motor vehicle and the amount of duty that was assessed on the imported auto parts at the time of importation, provided that the automobile manufacturers can prove that the auto part suppliers or auto part manufacturers paid, at the time of importation, the amount of duty owed for the parts at the tariff rates applicable to the auto parts.[210]

(ii) Administrative procedures

7.39 Now, the Panel will turn to the administrative procedures required in relation to the imposition of the charge at issue.[211] These procedures, as indicated in Decree 125 and Announcement 4, are explained in chronological order below.

> "As a result of Article 22 of Decree 125 and Article 20 of Announcement 4, the level of imported content will have to be tracked down the chain of supply to determine whether individual Assemblies and key parts are to be treated as imported for purposes of the Measures. Such tracking will be made first at the level of the Assembly to determine if the Assembly is Deemed Imported, and subsequently at the level of 'second-tier' suppliers for key parts.
>
> 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. They 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. They may also be required to provide details to Customs about the purpose for which the imported product will be used. This information may be provided directly to Customs or indirectly by providing the information to the vehicle manufacturer."

(See Part F.6 of the Factual Background Section provided jointly by the complainants, European Communities' first written submission, paras. 63, 64).

[209] China's response to Panel question No. 20(b).

[210] China's first written submission, footnote 20 to para. 46.

[211] The relevant departments of the Chinese government responsible for the administration of these procedures include the following: (1) CGA; (2) NDRC; (3) the Ministry of Commerce; (4) the Ministry of

Self-evaluation by the automobile manufacturers who assemble/produce[212] vehicles with imported auto parts for domestic sales

7.40 Under Article 7 of Decree 125 and Article 6 of Announcement 4, automobile manufacturers who plan to produce, for domestic sales[213], vehicles using imported auto parts are required to conduct a self-evaluation of whether imported auto parts used in a particular vehicle model are characterized as complete vehicles in accordance with the rules under Decree 125, including the substantive criteria indicated above in paragraphs 7.32-7.33.[214]

7.41 If the self-evaluation suggests that the imported auto parts should not be characterized as complete vehicles, the automobile manufacturer shall request the CGA to conduct a review. Upon such a request, the CGA will designate the Verification Centre to conduct a simplified or on-site review of the auto manufacturer's self-evaluation.

7.42 In this regard, in response to a question from the Panel, **China** has stated that even if the manufacturer's self-evaluation is positive, such conclusion is still subject to review.[215] The **European Communities** comments that China's reply is contrary to the text of Article 7 of Decree 125 and Article 6(2) and (3) of Announcement 4, according to which review by the Verification Centre seems to take place only when the result of the self-evaluation is negative. **Canada** also takes note of China's response, which Canada submits confirms that the Verification Centre reviews determinations of vehicle manufacturers under the measures, whether positive or negative.[216]

7.43 Article 7 of Decree 125 provides:

> "[I]f the self-evaluation suggests that the imported automobile parts should not be characterized as complete vehicle, the automobile manufacturer shall request the CGA to conduct a review. ..."

7.44 Based on the text of Article 7 of Decree 125 and Article 6(2) and (3) of Announcement 4, the **Panel** agrees with the European Communities' view on the content of the obligation arising under Article 7 of Decree 125, namely, review by the Verification Centre takes place only when the result of

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Finance; (5) the Leading Panel for the administration of the importation of automobile parts characterized as complete vehicles, which is represented by the CGA, the NDRC, the Ministry of Commerce; and the Ministry of Finance; and (6) the Verification Centre. See China's response to Panel question No. 21. Also see footnote 191 above.

[212] The complainants note that the Chinese original text contains the word "shengchan", which is properly translated into "to produce", whereas China considers that this word is used interchangeably with "zuzhuang", "to assemble" (footnote 2 of the common translation of Decree 125). The Panel's use of the terms "to assemble" and "to produce" in these reports is without prejudice to the parties' views on these two terms. Also see footnote 191 above.

[213] According to China, automobile manufacturers operating under the processing trade, including those located in special customs zone such as "bonded-zone", "export processing zone" or "other special zones special zones supervised by the customs under Article 30 of Decree 125" are outside the scope of Decree 125 *unless* they sell such motor vehicles into the domestic Chinese market (China's response to Panel question No. 16). Such a situation is addressed in Article 30 of Decree 125.

[214] In addition, Article 6(5) of Announcement 4 provides that "[i]f the status of whether imported automobile parts can be characterized as complete vehicles changes due to the fact that the composition of such parts is altered, the relevant vehicle model shall be registered as a new model." (See also Article 25 of Announcement 4).

[215] China's response to Panel question No. 167.

[216] Canada's response to Panel question No. 304, footnote 15.

the self-evaluation is negative. China appears to have misunderstood the Panel question concerning Article 7 of Decree 125 and uses the word "review" in a general sense rather than in the context of "review" required under Article 7 of Decree 125. Further, China's response regarding which the Panel sought further confirmation in Panel question No. 167 was related to Panel question No. 5, which concerned Articles 17 and 18 of Decree 125, provisions on verification by the Verification Centre, not review of the automobile manufacturers' self-evaluation results addressed by Article 7 of Decree 125.

7.45 Further, under Article 7 of Decree 125, the self-evaluation results for the vehicle models concerned must be submitted when automobile manufacturers apply to the NDRC to be listed in *Public Bulletin on On-Road Motor Vehicle Manufacturers and Products* (the "*Public Bulletin*") and apply to the Ministry of Commerce for an Automatic Importation Licence.[217] If auto parts to be imported are not characterized as complete vehicles as a result of the self-evaluation, the automobile manufacturer must also submit the review opinion of the CGA.

7.46 For those vehicle models assembled with imported auto parts characterized as complete vehicles, the NDRC will then mark "Characterized as Complete Vehicles" in the *Public Bulletin* and the Ministry of Commerce will mark the same in the Automatic Importation Licence.

7.47 In this connection, applications to the NDRC and to the Ministry of Commerce above appear to take place in no specific order.

Registration with the CGA prior to the importation of auto parts characterized as complete vehicles

7.48 Article 7 of Decree 125 also requires that, if an automobile manufacturer determines as a result of self-evaluation that the imported auto parts contained in a vehicle model should be characterized as complete vehicles, the automobile manufacturer must register the relevant vehicle

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[217] China submits that being listed in the *Public Bulletin* is required for automobile manufacturers to produce and sell motor vehicles in China and that one of the regulatory characteristics that is listed in the *Public Bulletin* with respect to a specific vehicle is its customs status under Decree 125 (China's response to Panel question No. 28).

Further, according to China, the purpose of establishing the alleged automatic licence system is to monitor the importation of motor vehicle products and, if the automobile manufacturer is planning to import auto parts which are subject to an automatic import licence requirement, it must apply to the Ministry of Commerce for this purpose. China explains that this process is unrelated to the listing in the *Public Bulletin* (China's response to Panel question No. 28).

Concerning the import licence system in relation to auto parts imports, see China's responses to Panel question Nos. 171, 173 and the comments by the European Communities and Canada on China's response. In particular, China states in its response to a Panel question, *inter alia*, that the evaluation and verification process does not prevent the auto manufacturer from importing parts and components to assemble a particular vehicle model (China's response to Panel question No. 171). The European Communities argues in its comments on China's response that China's reply is difficult to reconcile with the text of Article 7(3) of Decree 125, which provides:

> "When an automobile manufacturer applies…to the Ministry of Commerce for an Automatic Importation License, it shall submit the self-evaluation results for the vehicle models concerned. If the imported automobile parts are not characterized as complete vehicles, the automobile manufacturer shall also submit the review opinion by the CGA."

Thus, according to the European Communities, to get the import licence allowing the import, the auto manufacturer will need to go first through the self-evaluation and the review by Customs when the self-evaluation has concluded that the imported auto parts are not characterized as complete vehicles.

models with the CGA prior to the importation of auto parts. If the imported auto parts are determined not to constitute "auto parts characterized as complete vehicles" (after self-evaluation and review by the Verification Centre as designated by the CGA), registration with the CGA is unnecessary.[218]

7.49 When registering with the CGA, an auto manufacturer must submit the following documents pursuant to Article 9 of Decree 125:

> (1) a brief introduction of the manufacturer;
>
> (2) an annual production plan for the vehicle model to be registered;
>
> (3) a classification and price ratio schedule of the auto parts of the vehicle model to be registered, the total price of the vehicle model to be registered, and the itemized prices of domestic parts and imported parts used in the vehicle model to be registered (each of the above shall exclude relevant taxes);
>
> (4) a complete list of the domestic and foreign suppliers that supply the auto parts used in the vehicle model to be registered, and a list of the auto parts supplied by each supplier; and
>
> (5) evidence that the vehicle model to be registered has been included in the *Public Bulletin*.

7.50 Under Article 10 of Decree 125, upon receipt of a registration application, the CGA distributes relevant documents to the NDRC, the Ministry of Commerce and district customs offices in charge of the area where the manufacturer is located for the administration of their respective responsibilities.[219] For example, Article 11 of Decree 125 indicates that once a district customs office in charge of the area where the manufacturer is located receives a manufacturer's registration documents distributed by the CGA, it examines the registration documents, and if the criteria are met, registers the auto manufacturer and its vehicle models, and notifies the manufacturer.

Provision of duty bonds prior to the importation of auto parts

7.51 After a vehicle model has been registered, an automobile manufacturer, pursuant to Article 12 of Decree 125, must provide duty bonds commensurate with its importation plans to the district customs office prior to the importation of auto parts. The amount of the comprehensive duty bonds should not be less than the manufacturer's monthly average of duties payable on the importation of such parts.[220] Third-party auto part suppliers and auto part manufacturers that import auto parts are not covered by this requirement, as they are subject to the normal customs process and thus pay the customs the import duty for the imported auto parts at the tariff rate applicable to auto parts at the time of importation.[221]

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[218] "Registered vehicle models" are those that have been listed on the *Public Bulletin* published by the NDRC (Article 8 of Decree 125).

[219] See China's response to Panel question No. 21 for China's explanation of the respective roles played by various Chinese government authorities concerned.

[220] If importation plans are modified or if the number of registered vehicle models is changed, the automobile manufacturer must apply for an adjustment of the amount of the comprehensive duty bonds to the district customs office in charge of the area where the manufacturer is located (Article 12 of Decree 125).

[221] China's responses to Panel question Nos. 20(b), 83, 185(a) and (b).

7.52 China has explained that the amount of the comprehensive duty bonds is based on the projected amount of duties that the importer will pay each month, which is, in practice, calculated based on the applicable rates for auto parts (i.e. 10 per cent on average).[222] China explains that such calculation is made to minimize the burden on auto manufacturers[223] and that, contrary to what the complainants submit, there is no necessary concordance between a bonding rate and the rate of duty at which the imported good will be assessed.[224]

Customs clearance by the auto manufacturers concerned at the time of importation

7.53 Article 13 of Decree 125 states that auto manufacturers importing auto parts characterized as complete vehicles must declare their importation of such auto parts and pay duties to the district customs office. According to Article 14 of Decree 125, at the time of declaration, the following should be submitted: (1) an importation declaration form, (2) the Automatic Importation Licence marked with "Characterized as Complete Vehicles", (3) other relevant licence, and (4) accompanying documents required by the customs. Article 13 refers to the obligation not only to declare the importation of auto parts, but also to pay duties. However, as noted below in paragraphs 7.59-7.65, actual payment of the charge under the measures does not occur until the Verification Centre has completed the verification after the manufacturers finish the assembly of auto parts into complete vehicles.

7.54 Then, under Article 16 of Decree 125, upon entry of auto parts characterized as complete vehicles into China's customs territory, the customs handles the importation formalities by reference to relevant regulations regarding *the administration of bonded goods*.[225] Similarly, Article 27 of Decree 125 stipulates that the customs in charge of the area where the manufacturer is located shall administer, by reference to *the rules for bonded goods*, the imported automobile parts that are characterized as complete vehicles, during the period from the customs declaration and clearance of the goods to the payment of duties.

7.55 In response to a question from the Panel regarding the administration of bonded goods and the rules for bonded goods referred to in the above mentioned provisions, China explained during the first meeting with the Panel that "bonded goods" in this context means the requirement imposed on automobile manufacturers to pay bonds for imported auto parts and does not mean physical control of

[222] China's response to Panel question No. 18.
[223] China's response to Panel question No. 18.
[224] China's response to Panel question No. 201.
[225] In response to a question from the Panel what procedural requirements "the administration of bonded goods" under Article 16 of Decree 125 entail, China submits that the "the administration of bonded goods" may vary from one type of customs matter to another and provides an outline of the procedure relating to the administration of bonded goods in a typical scenario (China's response to Panel question No. 19). China also provides the categories of goods that are defined under Article 100 of China's Customs Law as "goods remaining under customs control", which include "goods in bonded status" or "goods not fulfilling all necessary customs requirements".

We take from China's responses in this connection (Panel question No. 19) as well as in relation to "the rules for bonded goods" under Article 27 of Decree 125 (Panel question No. 20(a)) that the procedural requirements relating to the administration of bonded goods in a typical scenario as explained in China's response to Panel question No. 19 is not applicable to the importation of auto parts under the measures.

Rather, China explains in its response to Panel question No. 20(a) that the bonding requirements under the measures at issue include the elements listed in paragraph 7.55 above.

imported auto parts themselves.[226] China further elaborates that the bonding requirements under the measures at issue include the following elements:[227]

- the registration of vehicle models for which the imported auto parts have the essential character of a motor vehicle;

- a requirement that the auto manufacturer keep accurate records of the parts and components that it imports in bond, and account for their assembly into registered vehicle models;

- the establishment of the Q-account, which connects the auto manufacturer to the relevant customs office via the Internet; recording each entry of bonded auto parts for the registered vehicle models in the Q-account; and making adjustments to the Q-account as parts and components that entered in bond are assembled into registered vehicle models and the applicable duties are paid.

Verification of whether imported auto parts should be characterized as complete vehicles

7.56 Auto manufacturers must submit a verification application[228] to the CGA within 10 days after the first batch of vehicles of the registered model has been assembled. Upon receiving a verification application, the CGA entrusts the Verification Centre to conduct verifications. Pursuant to Articles 17 and 19 of Decree 125 and Articles 7 and 9 of Announcement 4, within one month of receiving these instructions, the Verification Centre must conduct verifications to determine whether imported auto parts should be characterized as complete vehicles, i.e. whether the imported auto parts in a given relevant vehicle model meet one or more of the thresholds set forth in Article 21 of Decree 125.[229]

7.57 In this connection, the Panel notes a clarification by China, which has not been disputed by the complainants, that the verification process under Article 17 of Decree 125 is conducted on a

[226] China also submits that Article 27 of Decree 125 does not refer to "the Procedures on Customs Control over Bonded Areas (provided by the complainants in Exhibit JE-31)", which is only one of many types of "rules for bonded goods" and that as is the case in the customs practices of other WTO Members, China's "rules for bonded goods" vary from one customs procedure to another, depending on the nature of the procedure and the degree of customs control that is required (China's response to Panel question No. 20(a)).

See also China's response to Panel question No. 19 concerning the administration of bonded goods under China's customs law.

[227] China's responses to Panel question Nos. 19, 20(a).

[228] The documents to be provided are as follows: (1) application form for verification; (2) report of self-verification; (3) procurement list of parts; (4) document list for verifying "deemed whole vehicles"; and (5) other documents as required (Article 25 of Decree 125 and Article 7 of Announcement 4).

[229] See also China's response to Panel question No. 304. In addition, if a vehicle manufacturer objects to the results of the verification, a meeting is held between the manufacturer, government officials and technical experts to determine whether the Verification Centre must perform a re-verification of the registered model and the re-verification must occur within one month of the instruction of the Center to conduct it (Article 12 of Announcement 4).

The complainants argue that a manufacturer may incur significant administrative delay in the final assessment of a charge as it could take up to 48 days from submission of the application after the first batch of vehicles is complete until the verification is actually carried out (Part F.3 of the Factual Background Section submitted jointly by the complainants). See paragraphs 7.61-7.65 below for a more detailed discussion on this issue.

Article 26 of Announcement 4 stipulates that certain on-site review reports themselves may serve as the Verification Report, provided that the manufacturer agrees to and the Leading Panel approves doing so. At least in this circumstance, the alleged delay in the final assessment of a charge may not exist.

vehicle model basis.[230] According to China, the manufacturer may request, pursuant to Article 19 of Decree 125, verification after the first batch of complete vehicles is assembled and the first batch can be one vehicle or a small quantity of vehicles, a number that the manufacturer may choose at its discretion. The verification findings based on the first batch of vehicles of the registered model will then apply to all subsequent importation of auto parts for the same vehicle model until the manufacturer can demonstrate, under Article 20, second paragraph of Decree 125, that the imported auto parts in that vehicle model no longer have the essential character of a motor vehicle.

7.58 Also, Article 20, first paragraph of Decree 125 provides that if optional parts are installed on a vehicle, the manufacturer must report the options to the Verification Centre and make declarations at the time of the actual installation of the optional parts.

Payment of the charge by the auto manufacturers concerned

7.59 Pursuant to Articles 28 and 31 of Decree 125, after the imported automobile parts have been assembled into complete vehicles, the automobile manufacturer shall make a declaration of duty (charge) payable to the customs office by the tenth working day of each month subsequent to the month in which the Verification Centre issues a verification report on whether imported auto parts should be characterized as complete vehicles.

7.60 At the time of declaration of payment of the charge, the auto manufacturer must submit the following information in accordance with Article 34 of Decree 125: (1) verification report by the Verification Centre; (2) the quantity of the complete vehicles of relevant vehicle models that were assembled by the manufacturer in the last month, except for those models for which the imported auto parts should not be characterized as complete vehicles; (3) the list of imported auto parts used in the assembling of complete vehicles of relevant vehicle models in the last month, except for those parts that are not characterized as complete vehicles in the Verification Report; and (4) other documents deemed necessary by the customs. The district customs office then classifies such imported auto parts as complete motor vehicles and collects an amount of duty equivalent to the tariff rates applicable to complete vehicles.

7.61 In this regard, the parties do not dispute the overall timeline of the procedures listed above, namely, first, the assembly of imported auto parts into the first batch of complete motor vehicles, second, verification by the Verification Centre of whether imported auto parts used in the assembly of motor vehicles should be characterized as complete motor vehicles, third, declaration by auto manufacturers for the payment of the amount of duty owed under the measures for imported auto parts, and finally, the customs' authorities' classification and collection of duties for such imported auto parts.[231]

[230] China's responses to Panel question Nos. 167(b) and 304; the complainants' responses to Panel question No. 304. China submits that the same principle applies to self-evaluation and review by the Verification Centre. The parties, however, dispute the ramifications of this rule. For example, the United States submits that, contrary to what China seems to suggest in its response to Panel question No. 167, an initial decision on the first batch of assembled vehicles does not establish certainty on all future imports. The United States considers that in the entire period prior to the issuance of the verification report, which can take weeks or months, the level of charges to be imposed on imported parts used in the vehicle model is unsettled. Also, according to the United States, a "vehicle model" is not a static concept.

[231] Parties' responses to Panel question No. 304. In their response, the complainants provide various scenarios under the measures concerning the assembly of motor vehicles using imported auto parts and/or domestic auto parts.

7.62 However, the parties do dispute the period of time that each step of the above procedures may take.

Time taken for the administrative procedures under the measures

7.63 In response to a question from the Panel in this regard, **China** has stated that it is not possible to calculate an average period of time or provide another form of estimate because China does not maintain these statistics.[232] China submits that the Verification Centre is to complete the verification and issue a verification report within 30 days from the receipt of a complete set of documentation from the CGA under Article 19 of Decree 125, but the verification of a vehicle model can take longer than 30 days in cases where the documentation submitted by the auto manufacturer may give rise to further inquiries and on-site reviews, or may require the submission of additional documentation.

7.64 The **European Communities** submits that a sample of currently pending applications for review and verification under the measures demonstrates that the completion of the various procedures under the measures can take years.[233]

7.65 The sample of pending applications for review and verification, submitted by the European Communities, does indicate that among the applications made in 2005, certain applications dated 29 September 2005 for review[234] by the Verification Centre were still pending as of the research date, 16 July 2007.[235] Also, certain applications filed on 22 August 2006 for verification, not to mention all applications made during January-February 2007 shown on this sample table, were not completed as of 16 July 2007.

7.66 Therefore, the evidence on the record shows that the period for review and verification by the Verification Centre can take from 30 days to a couple of years.

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[232] China's response to Panel question No. 171.

[233] The European Communities' response to Panel question No. 171, referring to Exhibit EC-26. Also see footnote 229. Further, according to the **European Communities**, the complexity of the measures in itself affects the launching of a new model in the Chinese market. The European Communities argues that the conception and launching of a new model can be delayed by 2-3 years, as automobile manufacturers will have to look for domestic suppliers who are able to provide the required proportion of domestic parts or assemblies, and test their reliability. Establishing self-verification report required by Article 7 of Decree 125 may take an additional 6 months for a team of 10-15 highly skilled experts. Even after a manufacturer decides to begin the procedures for introducing a new model, it can in reality take up to one year before all the procedures are finalized (European Communities' response to Panel question No. 8).

The **United States** submits that information on the average period of delay resulting from China's measures was not an element of the United States' prima facie case on this issue, and the United States does not have such information readily available (United States' response to Panel question No. 8).

Canada submits that it is not possible to describe, as a general rule, the effect that the measures have on the average period necessary to assemble a vehicle. The overall effect will vary based upon, e.g. the web of suppliers and the particular sourcing of parts. The most significant delay results from a combination of the procedural and substantive requirements (Canada's response to Panel question No. 8).

[234] It is not clear on the face of the status of these applications what stage of the procedures under the measures is covered by "review" by the Verification Centre. As we examined above in paragraph 7.41, the Verification Centre conducts a review when the result of a self-evaluation by an automobile manufacturer is negative. We will thus assume that "review" indicated in respect of the status of these pending applications refers to the type of review to be conducted by the Verification Centre if a negative result is obtained after self-evaluation by an automobile manufacturer.

[235] "On-Line Administration of Automobile Parts Deemed Whole Vehicles – The leading group office of import administration of automobile parts deemed whole vehicles" (http://autoadmin.chinaport.gov.cn/autoadmin/search.do) (Exhibit EC-26).

(iii) Overall operation of the measures

7.67 Overall, the measures at issue impose a charge and the administrative procedures necessary to impose the charge on imported auto parts used in the assembly of complete motor vehicles.

7.68 The charge is imposed on imported auto parts that are characterized as complete motor vehicles, which in turn is determined based on the criteria set out in the measures: if the imported auto parts used in the assembly of a vehicle model meet one of the categories of the criteria under Article 21 of Decree 125, then such auto parts are characterized as complete motor vehicles and thus assessed at the tariff rates applicable to motor vehicles, not auto parts.

7.69 In this connection, to determine the applicability of the charge, customs officials wait pursuant to Article 28 of Decree 125 until automobile manufacturers finish assembling auto parts into motor vehicles and then the Verification Centre finishes its verification of whether the imported auto parts used in the assembly of a certain vehicle model should be characterized as complete motor vehicles within the meaning of the measures. This is because what is pertinent for the purpose of imposing the charge under the measures is whether imported auto parts used for the "assembly" of a vehicle model meet the criteria set out in the measures. This process is based on the assessment of auto parts imported at different times, in different shipments, from different exporters, and/or from different countries. The parties to the dispute refer to this situation as auto parts imported in "multiple shipments".[236]

(c) Exceptions under the measures

7.70 Decree 125 provides certain exceptions from the administrative procedures and from the application of the substantive criteria under Articles 21 and 22. The Panel will first look at the exemption provided in Article 2 of Decree 125 from the administrative procedures under the measures.

(i) Exemption of CKD and SKD kits from the administrative procedures - Article 2(2) of Decree 125

7.71 Article 2, second paragraph ("Article 2(2)") of Decree 125 provides:

> "[A]utomobile manufacturers importing completely knocked-down (CKD) or semi-knocked-down (SKD) kits may declare such importation to the Customs in charge of the area where the manufacturer is located and pay duties, and these Rules shall not apply."

7.72 China submits that under Article 2(2) of Decree 125, an automobile manufacturer declares imports of CKD or SKD kits as "auto parts characterized as complete vehicles" and pays the duty at the tariff rates applicable to complete vehicles at the time of importation. Regarding the scope of this provision, however, we note some evolution in China's explanation throughout the course of this proceeding. **China** initially explained that the importers who *opt for* the exemption under this provision would be importing CKD or SKD kits in accordance with the ordinary provisions of China's

[236] Article 37 of Chapter VI ("Legal Liabilities") of Decree 125 also refers to "multiple shipments". The relevant part of Article 37 reads, "...or if an automobile manufacturer imports automobile parts that should be characterized as complete vehicles in *multiple shipments* without applying for registration with the CGA prior to the importation, the NDRC shall temporarily take relevant vehicle models off the *Public Bulletin on On-Road Motor Vehicle Manufacturers and Products* until such automobile manufacturer corrects its failures" (emphasis added).

customs law.[237] China also submitted that since its adoption of the measures, all imports of CKD and SKD kits have been made under this provision.[238]

7.73 In response to a question from the Panel after the second substantive meeting, however, **China** submits that to import CKD and SKD kits, the importer *shall* make customs clearance at the customs where the auto manufacturer is located and pay import duties under the normal customs procedure for imports. China explains that there are no other customs procedures for the importation of CKD and SKD kits but the ordinary customs procedures.[239] This is so because there is no doubt that the proper classification of imported CKD or SKD kits is that of complete vehicles.[240]

7.74 The **European Communities** and the **United States** argue that Article 2(2) is an optional provision. The European Communities and the United States argue that China's explanation is manifestly erroneous on the face of the measures and in contradiction with China's own initial explanation of this provision given in its first written submission. The language of Article 2(2) itself, which uses "may" instead of "shall", and that of Articles 7 and 21(1) of Decree 125 confirm their point.

7.75 In the **Panel's** view, the language of Article 2(2) and China's own explanation provided earlier in the proceeding of this dispute do not support China's subsequent position that the importation of CKD or SKD kits under Article 2(2) is mandatory. Article 2(2), on its face, indicates that automobile manufacturers importing CKD or SKD kits *may* declare the kits as such and pay the duties. The use of an auxiliary verb "may" expresses only an objective possibility, rather than command or exhortation connoted by the verbs "shall" or "should." Furthermore, the phrase "... *and* these Rules shall not apply" in Article 2(2) indicates that the inapplicability of the measures to CKD or SKD imports depends on the importer's decision to exercise the option provided in Article 2(2) of Decree 125 and to declare the importation of CKD or SKD kits as such to Customs and pay the duties. China itself shared the same understanding and stated in its first submission: "Article 2 of Decree 125 states that importers of CKD/SKD kits *can* declare these imports to the relevant Customs authorities, and the provisions of Decree 125 will not apply. Thus, the importer of CKD/SKD kits *can* declare these imports as complete vehicles at the time of importation, pay the complete vehicle duty rate, and avoid the bonding and record-keeping requirements of Decree 125."[241]

7.76 Furthermore, the context of Article 2(2), in particular Article 21(1) of Decree 125, also confirms our conclusion. China argues that the existence of Article 21(1) does not conflict with Article 2(2), but in fact confirms Article 2(2) by reiterating that CKD or SKD kits are always classified as complete vehicles.[242] According to China, Article 21 defines the collections of parts and

[237] The procedures to be followed by an importer of CKD or SKD kits under China's Customs Law are: (1) to apply to the Ministry of Commerce for an automatic import licence; (2) to declare, at the time of importation, the imports of CKD or SKD kits to the customs and provide the relevant import documentation, including the declaration form, the automatic import licence, and the certificate of origin; and (3) to pay the applicable motor vehicle duty rate for the CKD or SKD kits in accordance with the regular procedures for the payment of customs duties, following the classification by the customs of the imported CKD or SKD kits (China's response to Panel question No. 58).

[238] China's response to Panel question No. 15.

[239] China's response to Panel question No. 193.

[240] China's first written submission, para. 195.

[241] China's first submission, para. 38 (emphasis added). China also stated, "[M]anufacturers *may* therefore import CKD/SKD kits, pay the appropriate motor vehicle duties at the time of importation, and bypass the procedures established under Decree 125" (China's first written submission, para. 195) (emphasis added).

[242] China's first submission, footnote 136 to para. 195.

components that have the essential character of a motor vehicle, which includes CKD/SKD kits.[243] However, in our view, if Article 2(2) were to be understood as automatically excluding CKD or SKD kits from the measures, it would make Article 21(1) of Decree 125 inutile, which categorizes CKD or SKD kits as auto parts characterized as complete vehicles under the measures. In other words, it would make meaningless the only logical explanation for the *raison d'être* of Article 21(1), which is to apply the measures to CKD or SKD kits imports if they were to be imported without recourse to the exceptional option under Article 2(2). Article 21 of Decree 125 is a provision setting forth the thresholds for auto parts that should be characterized as complete vehicles under the measures and no language in this provision shows any other meaning.

7.77 We therefore consider that Article 2(2) of Decree 125 is a provision that gives auto manufacturers an option to have their CKD or SKD kits imports excluded from the "administrative procedures" under the measures and to import them under regular customs procedures and pay the duties applicable to motor vehicles at the time of importation. This, however, does not affect the fact that CKD and SKD kits imports are in principle subject to "the charge" under the measures by falling within the scope of the substantive criteria provided in Article 21(1) of Decree 125. Our reference to "the measures" in these reports therefore should be understood as including within its scope CKD and SKD kits.[244]

7.78 Furthermore, we understand that an exemption provided for CKD and SKD kits in Article2(2) of Decree 125 is limited to the administrative procedures under the measures, not the substantive criteria under Article 21(1) of Decree 125. In particular, China itself submits, "[M]anufacturers may therefore import CKD or SKD kits, pay the appropriate motor vehicle duties at the time of importation, and bypass *the procedures* established under Decree 125. ..."[245] We note China's statement that Article 21(1) of Decree 125 simply reiterates that CKD and SKD kits are always classified as complete vehicles and that vehicles that are assembled entirely from CKD or SKD kits can be imported as complete vehicles, consistent with GIR 2(a), and the challenged measures do not apply. However, we do not find any support in the text of Decree 125 for China's proposition that Article 21(1) of Decree 125 exists simply to reiterate the alleged general principle that CKD and SKD kits are always classified as complete vehicles. Therefore, for the purpose of this dispute, we will consider that although importers of CKD or SKD kits can opt in accordance with Article 2(2) of Decree 125 to be exempted from "the administrative procedures" under the measures, their obligation to pay the charge under the measures for CKD and SKD kits arises from Article 21(1) of Decree 125.

7.79 Next, we will briefly describe a provision under the measures that provides an exception for the imported auto parts that have been substantially processed in China.

(ii) Imported auto parts that have been substantially processed in China – Article 24 of Decree 125

7.80 Under Article 24 of Decree 125 (and Articles 16-18 of Announcement 4), if domestic automobile manufacturers or domestic auto parts manufacturers substantially process imported auto parts or imported unfinished auto parts to manufacture auto parts, the auto parts manufactured by such domestic manufacturers are considered as domestic auto parts.

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[243] China's response to Panel question No. 193.

[244] To the extent that an importer exercises the option provided in Article 2(2) of Decree 125 and imports CKD or SKD kits under the regular customs procedures, the parties agree, as we find in paragraph 7.636, that the treatment of CKD and SKD kits imports under the measures (i.e. imposition of the charge on CKD and SKD kits) falls under the disciplines of Article II, not Article III of the GATT 1994.

[245] China's first written submission, para. 195 (emphasis added).

7.81 The provision excludes assemblies and sub-assemblies[246] from its application, which is understood to mean that the substantial processing exception does not apply to the processing of the imported assemblies or sub-assemblies themselves, but applies to imported parts incorporated into assemblies and sub-assemblies.[247]

2. Products at issue

(a) Scope of the products at issue

7.82 The scope of the products at issue in a given case is determined by the measures falling within a panel's terms of reference. In the present dispute, therefore, the products at issue are those subject to Policy Order 8, Decree 125 and Announcement 4.[248]

7.83 The text of the measures does not provide any specific categories of auto parts falling within the measures. Article 1 of Decree 125 simply refers to "automobile parts", and Article 21 of Decree 125, a provision on the substantive criteria for determining whether certain imports of auto parts should be characterized as complete vehicles, refers to, *inter alia*, "assemblies" and "CKD and SKD kits".

7.84 Based on the parties' arguments in their written submissions and their responses to the Panel questions, auto parts subject to the measures at issue can be generally categorized into the following four groups of the HS headings at the four-digit level:[249]

(1) complete vehicles under tariff headings 87.02, 87.03 and 87.04[250];

(2) the body and the chassis fitted with engine under tariff headings 87.06 and 87.07;

(3) parts and accessories of motor vehicles under tariff heading 87.08; and

(4) parts and accessories of motor vehicles under chapters other than chapter 87, in particular under tariff headings 84.07, 84.08, 84.09, 84.83, 85.01, 85.03, 85.06, 85.11, 85.12 and 85.39.

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[246] See paragraphs 7.88-7.89 below for the discussion on "assemblies" and "sub-assemblies".

[247] Further, in response to the Panel's question of whether assemblies and sub-assemblies are not excluded in "imported *unfinished* automobile parts" under Article 24 of Decree 125, China has stated that they are excluded from "imported unfinished automobile parts" and that assemblies and sub-assemblies are not susceptible to substantive transformation since they already constitute a finished portion of the motor vehicle and will not undergo further transformation prior to their assembly into the vehicle (China's response to Panel question No. 41). The complainants have not raised any issue with this explanation from China.

[248] The United States and Canada also submit that the products encompassed in this case are all products that are, or could be, subject to the measures at issue (Responses of the United States and Canada to Panel question No. 73).

[249] Parties' response to Panel question No. 73.

[250] Article 3 of Decree 125 provides:

> "The reference to 'vehicles' in these Rules shall mean the classes M and N vehicles as defined in the *Classification of Vehicles and Trailers* (National Standard of China, GB/T15089-2001).
> 'Class M Vehicles' shall mean passenger vehicles with at least four wheels.
> 'Class N Vehicles' shall mean cargo vehicles with at least four wheels."

7.85 The Panel notes in this regard that "the body" and "the chassis fitted with engine" respectively under tariff headings 87.06 and 87.07 are referred to by the complainants as "intermediate products", in the sense that they are the products that are more than basic units of auto parts or accessories falling under the tariff headings such as those listed in (3) and (4) above, but are not complete motor vehicles. Specifically, a chassis fitted with an engine under 87.06 is composed of, *inter alia*, the individual parts that make up the chassis and the parts that make up the engine.[251] Likewise, the body under 87.07 is composed of the individual auto parts that make up the body.

7.86 In conclusion, the products at issue in this case are all imported auto parts that are potentially subject to the measures, and they generally fall under the four categories listed above.

(b) Product terms referenced in the measures at issue

7.87 Aside from the scope of the products at issue, the Panel notes that certain product terms are referred to in China's measures. We will briefly examine these terms.

7.88 We recall that the second criterion for the determination on "auto parts characterized as complete vehicles" under Article 21 of Decree 125 uses the term "assembly (system)". Article 4 of Decree 125 in turn provides the list of the eight assemblies:

> "The reference to 'assembly (system)' in these Rules shall include the vehicle body (including cabin) assembly, the engine assembly, the transmission assembly, the driving axle assembly, the driven axle assembly, the frame assembly, the steering system, and the braking system."

7.89 According to the complainants, "assembly", a key concept in the measures, corresponds roughly to major parts of a vehicle.[252] China submits that it is a convention in the automobile industry to group these parts into "assemblies", such as all of the constituent parts that make up the "transmission assembly".[253]

7.90 Article 22(2) of Decree 125 refers to "key parts or sub-assemblies" when it sets out, "[i]mported automobile parts shall be characterized as an assembly (system) if ... the quantity of the imported key parts or sub-assemblies [for purpose of assembling assemblies (systems)] reaches or exceeds the specified level as set forth in Annexes 1 and 2." In turn, Annex 1 to Decree 125 specifies auto parts considered under China's measures as key parts and sub-assemblies for each assembly (system). For example, a vehicle body – a type of assembly – will consist of key parts and sub-assemblies such as side panel, door, bonnet, roof box, or luggage compartment. Therefore, we understand for the purpose of this dispute that the product terms "key parts" and "sub-assemblies" refer to certain units of auto parts constituting "assemblies" as defined under the measures.

7.91 Furthermore, the first group of auto parts characterized as complete vehicles under Article 21 of Decree 125 is CKD and SKD kits.[254] At the outset, we note that all parties agree that there exists no standard definition of what constitutes a CKD or SKD kit, although they generally agree that these product terms refer to "auto parts that are either fully or partly unassembled and that are shipped

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[251] The European Communities' first written submission, paras. 226-230. See also paragraph 7.583 below.

[252] Part E.1 of the factual background section submitted jointly by the complainants.

[253] China's response to Panel question No. 63.

[254] As noted in paragraphs 7.71-7.77 above, Article 2(2) of Decree 125 is an optional provision that exempts CKD and SKD kit imports from the administrative procedures under the measures.

together for assembly and further processing into a whole vehicle [in an importing country]." [255] We will examine CKD and SKD kits in more detail when we address the parties' claims and arguments pertinent to these products.[256]

3. Burden of proof

7.92 As the Appellate Body explained in *US – Wool Shirts and Blouses*, the general rule of burden of proof is that the burden rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence.[257] Given this general rule, it is the complainant in a given case who initially bears the burden of proof to establish a prima facie case of inconsistency of a measure with a provision of the WTO covered agreement, before the burden of showing consistency with a provision or defending it under an exceptional provision (e.g. Article XX of the GATT 1994) shifts to the defending party.

7.93 In the present case, therefore, it is the complainants who have the initial burden of proof to establish a prima facie case of alleged inconsistencies of China's measures with, *inter alia*, Article III of the GATT 1994, or alternatively, Article II of the GATT 1994. China, then, as a party making an affirmative defence of its measures under Article XX(d) of the GATT 1994, bears the initial burden to prove that its measures are justified under this provision.

7.94 In this connection, a prima facie case is "one which, in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the prima facie case".[258] To establish a prima facie case, the party asserting a particular claim must adduce evidence sufficient to raise a presumption that what is claimed is true, although precisely how much and precisely what kind of evidence will be required to establish a presumption that a claim is valid will necessarily vary from case to case.[259]

7.95 Bearing in mind the above, we will commence our analysis of the complainants' claims in respect of the measures in the order indicated in the following section.

4. Panel's order of analysis

7.96 As set out in paragraphs 3.1-3.10 of the Descriptive Part of these Reports, the complainants in this dispute have presented their claims in respect of the measures at issue under the GATT 1994, TRIMs Agreement, SCM Agreement and China's Accession Protocol.

7.97 We note that the parties, with the exception of the European Communities, have not requested the Panel to examine these claims in any specific order.

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[255] Part C of the factual background section submitted jointly by the complainants. China submits that a CKD kit consists of all, or nearly all, of the parts and components necessary to assemble a complete vehicle, and that an SKD kit differs from a CKD kit in the extent of its prior assembly (i.e. unlike a CKD kit, an SKD kit includes significant parts and components that have already been assembled) (China's first written submission, paras. 35-36). China also submits that there is no particular relationship between CKD or SKD kits and the assemblies referred to in Article 21(2) of Decree 125, other than they all consist of auto parts in various states of assembly (China's response to Panel question No. 63).

[256] See Section VII.F of these reports.

[257] Appellate Body Report on *US – Wool Shirts and Blouses*, page 14.

[258] Appellate Body Report on *EC – Hormones*, para. 104.

[259] Appellate Body Report on *US – Wool Shirts and Blouses*, page 14.

7.98 The **European Communities**, citing the Appellate Body Report on *EC Bananas III*, submits that the TRIMs Agreement, as "the agreement which is more specific to the claim before the Panel" should be considered first[260], followed by its claims under Article III of the GATT 1994. The **United States** and **Canada**, on the other hand, have presented their claims under Article III of the GATT 1994 first, followed by their claims under the TRIMs Agreement. The United States and Canada have not indicated a particular view on the order of analysis to be followed by the Panel in respect of their claims under Article III of the GATT 1994 and the TRIMs Agreement.[261]

7.99 The **Panel** notes that in *EC – Bananas III* the Appellate Body enunciated a test to be applied in order to decide the Panel's order of analysis where two or more provisions from different covered agreements appear *a priori* to apply to the measure in question. According to the Appellate Body, the provision from the agreement that "deals specifically, and in detail" with the measures at issue should be analysed first.[262] However, regarding the order of analysis between the GATT 1994 and the TRIMs Agreement, as a previous panel has pointed out[263], WTO jurisprudence is not uniform on the question of which one of these two agreements is more specific.[264] Furthermore, we do not consider that the present case is one in which the relationship of the various provisions under which the complainants base their claims requires us to follow a particular mandatory sequence of analysis, which, "if not followed, would amount to an error in law."[265]

7.100 In light of the foregoing, we will start our analysis with the complainants' claims under Article III of the GATT 1994 with respect to imported auto parts in general. Specifically, we will analyse the complainants' claims in the following order:

– Article III of the GATT 1994;

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[260] European Communities' first written submission, para. 76 (citing the Appellate Body Report on *EC-Bananas III*, paras. 202-204).

[261] See the United States' and Canada's respective responses to Panel question No. 153. The United States, for instance, says that it "considers that the order of analysis is within the discretion of the Panel." *Ibid*.

[262] Appellate Body Report on *EC – Bananas III* , para. 204.

[263] See Panel Report on *India – Autos*, para. 7.156.

[264] In *Canada – Autos*, the Panel analysed the measures at issue, including a duty exemption accorded based on the local content requirements, under the GATT 1994 first on the grounds that: 1) the TRIMs Agreement could not be properly characterised as being more specific than Article III:4 of the GATT 1994 in respect of the claims raised in that case; 2) there was *disagreement between the parties* on whether the measures under consideration could be considered to be "trade-related-investment measures" and on whether they were explicitly covered by the Illustrative List. (Panel Report on *Canada – Autos*, paras. 10.63 and 10.91).

The Panel in *India – Autos* held that as a general matter, even if there was some guiding principle to the effect that a specific agreement might appropriately be examined before a more general agreement, the TRIMs Agreement should not be inherently characterised as more specific than the relevant GATT provisions. Thus, the Panel analysed the measures at issue, including the localization requirements attached to the importation of CKD/SKD kits, under the GATT 1994 first. The Panel concluded that, having found that the "indigenization requirement" was in violation of Article III:4 of the GATT 1994, it was not necessary to consider separately whether it was also inconsistent with Article 2 of the TRIMs Agreement. (Panel Report on *India – Autos*, paras. 7.156, 7.157, 7.159-7.161 and 7.324, and footnote 377).

After noting that the TRIMs Agreement is a fully-fledged agreement in the WTO system, the Panel in *Indonesia – Autos* considered that this agreement was *more specific* than Article III:4 of the GATT 1994 in addressing the claims relating to the Indonesian car programme under which tariff and tax benefits were granted contingent upon meeting specified local content requirements. Having found that the measures were inconsistent with Article 2 of the TRIMs Agreement, the Panel exercised judicial economy with respect to complainants' claims under Article III of the GATT 1994. This has been the only dispute in which a panel examined the TRIMs Agreement first (Panel Report on *Indonesia Autos*, paras. 14.61-14.63 and 14.93).

[265] See Appellate Body Report on *Canada – Wheat Exports and Grain Imports*, para. 109.

– TRIMs Agreement;

– Article II of the GATT 1994; and

– SCM Agreement.

7.101 Then, we will address the complainants' claims with respect to the treatment of CKD and SKD kits under the measures in the following order;

– Article II of the GATT 1994; and

– Paragraph 93 of China's Working Party Report.

B. ARTICLE III OF THE GATT 1994

1. Are the measures consistent with Article III:2, first sentence, of the GATT 1994?

7.102 The **complainants** submit that the measures impose an internal charge in a manner inconsistent with Article III:2, first sentence, of the GATT 1994. **China** rejects these arguments, claiming instead that the charge imposed under the measures is an "ordinary customs duty" under Article II:1(b), first sentence, of the GATT 1994.

7.103 Article III:2, first sentence, of the GATT 1994 provides:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, 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."

7.104 The Appellate Body in *Canada – Periodicals* clarified that the analysis of whether a measure is inconsistent with the first sentence of Article III:2 of the GATT 1994 involves a two-step test:

> "[T]here are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence."[266]

7.105 However, before we can proceed with the analysis as explained in *Canada – Periodicals* we must preliminarily determine whether the charge under the measures indeed falls within the scope of Article III:2 of the GATT 1994. This is because the parties dispute from the outset whether such charge is an "internal charge" under Article III:2 of the GATT 1994, as the complainants contend, or an "ordinary customs duty" under Article II:1(b) of the GATT 1994, as China asserts.[267] This is

[266] Appellate Body Report on *Canada – Periodicals*, DSR 1997:I, page 468.

[267] We note that the parties agree that the question before us is whether such charge is an "ordinary customs duties" under the *first sentence* of Article II:1(b) of the GATT 1994, not an "other duty or charge" under the *second sentence* of this provision. (See, e.g., European Communities' second written submission, para. 36 and footnote 34; United States' second written submission, para. 23; Canada's second written submission, para. 27; and China's responses to Panel question Nos. 79 and 88).

indeed a crucial question for a charge cannot be at the same time an "ordinary customs duty" under Article II:1(b) of the GATT 1994 and an "internal tax or other internal charge" under Article III:2 of the GATT.[268] Therefore, as panels before us have similarly decided,[269] we must first decide which of these two provisions is applicable to the charge under the measures.[270]

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[268] We see no objection from any of the parties to this dispute in starting our analysis of the claim under Article III:2 of the GATT 1994 with this preliminary determination as China and the complainants agree that the "charges in this dispute are either internal ones (as complainants contend), or customs duties (as China asserts)." (United States' response to Panel question No. 88; second written submission, para. 13 and second oral statement, para. 9). See also Canada's response to Panel question No. 103. China also notices this nuanced position of the complainants on the binary character of Article II and Article III of the GATT 1994 and claims that "Canada, at a minimum, appears to accept that a measure or charge that is validly within the scope of Article II cannot be analysed under Article III" (China's response to Panel question No. 179(a) and second written submission, para. 123). However, China considers that the "threshold question" before the Panel is in relation to the nature of the *entirety* of the measures, although it also specifically states, only in relation to the *charge*, that "... a customs duty under Article II cannot simultaneously be analysed as an 'internal charge' under the disciplines of Article III ..." (China's response to Panel question No. 203). We also recall that the complainants have respectively made alternative claims, *inter alia*, under Article II:1(a) and (b) of the GATT 1994, in case the Panel were to find that the *charge* under the measures were a border charge (see European Communities' first written submission, paras. 210-213; United States' first written submission, para. 117; and Canada's first written submission, para. 132). We consider that the complainants' focus on the *charge* in their alternative claims under Article II:1(a) and (b) of the GATT 1994 reinforces our understanding that they accept that the question whether the *charge* under the measures is within the meaning of the first sentence of Article II:1(b) or Article III:2 of the GATT 1994 is indeed a binary one.

[269] See GATT Panel Report on *EEC – Parts and Components*, para. 5.4. See also the GATT Panel Report on *Greece – Import Taxes*, which stated that the "... principal question arising for determination was whether or not the Greek tax was an internal tax or charge on imported products within the meaning of paragraph 2 of Article III. If the finding on this point were affirmative, the Panel considered that it would be subject to the provisions of Article III ..." (para. 5). In the unadopted GATT Panel Report on *Canada – Gold Coins* the parties themselves agreed to include in the terms of reference of the Panel "the understanding that the Panel would provide its views ... on the question of whether the Ontario provincial sales tax measure on gold coins accorded with the provisions of Articles III [or] II of the General Agreement before proceeding to hear additional arguments relating to the remaining elements outlined in the terms of reference" (para. 49 – from the context of this sentence we understand that the panel meant "or" instead of "and"). See also the Panel Report on *Argentina – Hides and Leather*, para. 11.139. With regard to our citation of the unadopted GATT Panel Report on *Canada – Gold Coins* above, we recall the Appellate Body's statement in *Argentina – Textiles and Apparel* that although "unadopted panel Reports have no legal status in the GATT or WTO system ... a panel could nevertheless find useful guidance in the reasoning [of such Reports] ... that it considered to be relevant" (para. 43).

[270] In doing so we would be fulfilling our duty under Article 11 of the DSU to determine the applicability of the provisions cited by the complainants to the contested measures. Furthermore, we believe that in the present case, answering such a preliminary question does not require us to provide positive definitions of what constitutes an "internal charge" and an "ordinary customs duty" under respectively Article III:2 and Article II:1(b) of the GATT 1994 as it would suffice for us to examine the elements that differentiate these two kind of charges. We will then apply these elements to the specific aspects of the charge under the measures to determine under which provision it should fall. We also believe that such preliminary analysis is without prejudice to our separate analysis, below, on whether certain aspects of the measures fall within the scope of Article III:4 of the GATT 1994. We believe however that our finding here on whether the charge is within the meaning of Article III:2 or Article II:1(b) of the GATT 1994 may have an impact on that other preliminary analysis. Finally, as the parties do not dispute that the charge imposed under the measures is *not* covered by the term "all other duties and charges of any kind imposed on or in connection with the importation" within the meaning of Article II:1(b), second sentence, of the GATT 1994, we consider that the object of our analysis in this section is not to delineate "ordinary customs duties" under the first sentence of Article II:1(b) of the GATT 1994 from "all other duties and charges of any kind" under the second sentence of this provision. As

7.106 We will thus begin our preliminary analysis by recalling how the charge is imposed under the measures.[271]

(a) Charge under the measures

7.107 The **Panel** recalls that China, as described above in paragraph 7.24, imposes under the measures a charge in the amount equivalent to the tariff rate applicable to motor vehicles (25 per cent on average) on auto parts that are imported and used by automobile manufacturers for the assembly of motor vehicles, if such auto parts are characterized as complete vehicles based on the thresholds set out in the measures. As we have explained above in Section VII.A.1(b)(i), under the measures, the final determination of whether certain auto parts are characterized as complete vehicles and thus subject to the charge is made once the auto parts, imported in a single or multiple shipments, are assembled into complete vehicles in China.

7.108 We also recall that Article 29 of Decree 125[272] provides that auto parts imported by a third-party supplier and subsequently purchased by an automobile manufacturer for their assembly into motor vehicles in China, will also be counted towards the thresholds set out in the measures. China has explained that imported auto parts that the auto manufacturer purchases from a third-party supplier in China will have completed the necessary customs formalities and are no longer subject to customs control. China further explains that the rules for bonded goods do not apply to auto parts imported by a third-party supplier. Pursuant to Article 29 of Decree 125, automobile manufacturers are then liable in respect of imported auto parts purchased from a third-party supplier for the difference between a charge equivalent to the amount of the tariff rates for motor vehicles and the amount of duty for auto parts that would have already been paid by a third-party supplier at the time of importation.[273]

7.109 Given that China submits that the imposition of the charge on imported auto parts purchased from a third-party supplier operates under the measures in a different manner from the charge on auto parts imported by automobile manufacturers, we will first examine whether we must consider the charge imposed pursuant to Article 29 of Decree 125 separately from the charge imposed in general under the measures for the purpose of examining the complainants' claim under Article III:2 of the GATT 1994.

(i) Arguments of the parties

7.110 The **complainants** argue that the charge under Article 29 of Decree 125 cannot be separated from the charge imposed under the other provisions of Decree 125.

7.111 The **European Communities** submits that Article 29 is a general provision that applies to automobile manufacturers that purchase automotive parts from suppliers. Article 29 uses the general language of the measures on parts "characterized as complete vehicles" and is directly connected with the overall logic of the measures according to which the classification of the imported parts depends on their internal use in China.[274] Additionally, the fact that customs duties and the 15 per cent internal

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analysed in more detail below, the second sentence of Article II:1(b) of the GATT 1994 is only relevant to the present case insofar as it confers contextual support for the interpretation of "on their importation" in the first sentence of Article II:1(b) of the GATT 1994.

[271] See also Section VII.A.1(b)(i) above.

[272] The text of Article 29 of Decree 125 is partially cited above at paragraph 7.37.

[273] See China's responses to Panel question Nos. 20, 20(b), 31, 65, 83, 92 and 101.

[274] European Communities' response to Panel question No. 101; second written submission, para. 54; second oral statement, para. 21.

charges are due by the *same* person when the importer is the automobile manufacturer, and can thus be hidden under a global 25 per cent charge, cannot affect the legal assessment under Articles II and III of the GATT 1994.[275]

7.112 The **United States** argues that the number or value of parts imported by third parties can be determinative of whether charges are imposed on all imported parts used in a domestically produced vehicle. Under Decree 125, if the number or value of imported parts in a specific vehicle exceeds the designated thresholds, all imported parts in that vehicle will be assessed a 25 per cent charge. Article 29 of Decree 125 allows a manufacturer to *deduct* from that charge the value of any customs duties that another supplier has paid on one of the parts assembled into the vehicle. Accordingly, there is no "separate charge," only a permissible deduction upon provision of sufficient evidence that the payment was made at the border by the third-party supplier. Similarly, all imported parts, regardless of their source, are counted together in determining whether the thresholds in Articles 21 and 22 of Decree 125 have been met. Hence, 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 third-party parts is an internal charge, the charge on the manufacturer's parts must be as well.[276]

7.113 **Canada** argues that all imported parts (regardless of the importer) are considered collectively for purposes of the thresholds under the measures. As such, the measures are not even applied to imported parts in accordance with the express intention of the measures to enforce China's Schedule. This demonstrates how arbitrary and discriminatory the measures truly are as the volume and value thresholds, clear domestic-content requirements in themselves, are applied to products that even China admits should be the subject of national treatment.[277]

7.114 **China**, on the one hand, submits that Article 29 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 customs control. On the other hand, China submits that the charges collected pursuant to Article 29 are nevertheless ordinary customs duties under Article II of the GATT 1994, in that they objectively relate to the proper classification of the imported parts and components as part of a collection of imported parts and components that, in their entirety, have the essential character of a motor vehicle. Article 29 therefore results in the application of the motor vehicle duty to imported auto parts regardless of who imported them.[278]

(ii) Consideration by the Panel

7.115 The **Panel** considers that Article 29 does not administer a charge that is different from the charge imposed in general under the measures: automobile manufacturers use auto parts imported by a third-party supplier in the same manner as auto parts the manufacturers themselves directly import for the assembly of motor vehicles; and auto parts imported either by vehicle manufacturers or by third-party suppliers are subject to the same thresholds set out in the measures.[279] In the Panel's view,

[275] European Communities' comments on China's response to Panel question No. 185(d).

[276] United States' responses to Panel question Nos. 185(e) and 198; comments on China's response to Panel question No. 185(c); first oral statement, para. 28.

[277] Canada's second written submission, paras. 4-5; responses to Panel question Nos. 101, 185(e) and 198.

[278] China's responses to Panel question Nos. 83, 92 and 101; second written submission, para. 186.

[279] We see, for example, nothing in Articles 21 and 22 of Decree 125 (which establish the thresholds for determining, respectively, whether auto parts should be "characterized as complete vehicles" and "deemed imported assemblies") distinguishing parts imported under Article 29 from parts imported in general under the

the elements cited by China, such as those described above in paragraph 7.108, in an effort to argue that the charge imposed on auto parts in the context of Article 29 is conceptually different from the charge in general[280], do not change our conclusion that there is only one charge, which is ultimately triggered by the application of the thresholds after the assembly of the imported parts into complete vehicles in China. For these reasons, we do not consider that the charge imposed under Article 29 of Decree 125 should be analysed separately from the charge imposed in general under the measures. In fact, they are the same charge.

(b) Is the charge an "internal charge" within the meaning of Article III:2 of the GATT 1994?

(i) Overview of the arguments of the parties

7.116 The **European Communities** argues that the charges are internal, and thus subject to Article III of the GATT 1994, because the application of the measures is only triggered by the actual manufacturing process taking place inside China by which imported automobile parts are used to produce vehicles for domestic sale in China (Article 7 of Decree 125). China's charges are not collected at the time or point of importation, but internally after assembly and manufacture, as confirmed by the language of Article 28 of Decree 125. More specifically, the European Communities maintains that the charges under China's measures are not imposed on the basis of how auto parts are presented *on importation*, but on the basis of how they are used *after* importation and, in particular, whether they are subsequently assembled and manufactured in China into vehicles with an insufficient level of local content. The *reason* or *event* that triggers the charges under the measures is not the importation of the parts into China but the assembly, fitting, equipping and manufacture of such parts into a complete vehicle after importation.[281]

7.117 The **United States** also argues that China's measures apply *after* importation of the product and cannot therefore be considered to impose an ordinary customs duty. China's charges are thus not imposed at the time of, or as a condition to, the entry of the parts into China, but are rather internal charges the application of which turns on the details of the manufacturing operations conducted in China. They are therefore internal charges. For the United States, the internal nature of the measures and the charges is confirmed, *inter alia*, by the following factors: first, 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 (Article 5 of Decree 125);[282] second, under the measures, all of the parts of a completed

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measures. See paragraphs 7.32 and 7.33 for a description of these two provisions of Decree 125. See also paragraph 7.37.

[280] As China itself explains, the 10 per cent a third-party supplier pays at the border when importing auto parts is simply "deducted" from the final charge liability the manufacturer eventually incurs after these parts, together with other parts, domestic and/or imported, are assembled/produced into whole vehicles in China. See China's responses to Panel question Nos. 31 and 65.

[281] European Communities' first written submission, para. 139; first oral statement, paras. 25-26; second written submission, para. 51; second oral statement, para. 18; responses to Panel question Nos. 90, 90(b) and 181.

[282] In this regard, the United States emphasizes that even if a manufacturer could identify that certain auto parts are going to be used in a specific vehicle *model*, given the assembly-line process, the manufacturer would have no idea into which particular *vehicle* a particular part is going to be incorporated. Moreover, within a bulk shipment of parts, one cannot identify in advance which parts will actually be used in production, as opposed to being discarded as defective, damaged in processing, or being held in inventory for eventual use as replacement parts. Thus, there is not – and cannot be – a specific vehicle identified with a collection of specific parts until that vehicle has actually been assembled within China. The Unites States recalls that China asserts that it can identify parts of a specific *model* at the border, but it does not assert that it can identify *parts* of a

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; third, 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 (therefore, identical imported parts *included in the same shipment* can be subject to different charges depending on their internal use); fourth, 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; and fifth, the official verification is performed by Chinese authorities at the manufacturer's site, not at the border (Article 7 of Decree 125). Finally, also relevant is that determinations under the measures are not made by Chinese Customs through normal customs procedures, but by a special administrative body pursuant to measures developed by agencies with industrial policy functions.[283]

7.118 **Canada** submits that the measures impose charges and administrative requirements on imported auto parts based not on the state of the product upon presentation at the border, but upon the use of those imported parts in vehicle manufacturing that takes place after importation. In other words, the liability that applies to imported products under the measures occurs only after the final related product, the complete automobile, rolls off the assembly line. As a result, Canada sees nothing in the measures to suggest a relationship with the administration and enforcement of valid customs liabilities. For auto parts manufacturers using imported parts, the bound tariff rate for parts (usually 10 per cent) is paid at the border. If that imported auto part is then used in manufacturing a vehicle of which the imported content exceeds the value or quantity thresholds set out in the measures, then an additional internal charge (usually an additional 15 per cent) is assessed on the value of the imported auto part. If the vehicle manufacturer can establish that the tariff was already paid by the auto parts manufacturer, the original importer, then the vehicle manufacturer will receive a 10 per cent credit, in effect paying an internal charge of 15 per cent. If the vehicle manufacturer is not able to establish this to the satisfaction of Customs, it would then be subject to a 25 per cent internal charge. This shows that the measures apply to auto parts only once they are in free circulation in the internal Chinese automotive market, and are based entirely on their use after importation.[284]

7.119 In sum, the core of the **complainants**' arguments[285] under this issue is that the charge on imported auto parts resulting from the measures is an internal charge subject to the first sentence of Article III:2 of the GATT 1994 because it is triggered by the actual use of these parts in the assembling of complete vehicles taking place inside China after importation. The complainants argue that if the charge were truly an "ordinary customs duty", it would be assessed solely on the *status* or *condition* of these goods at the moment they were presented at the border "on their importation" into

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specific *vehicle*. As a result, concludes the United States, the measures wait until the vehicle has been assembled before making the final assessment of charges (United States' response to Panel question No. 176).

[283] United States' first written submission, para. 76-80; first oral statement, paras. 23-26; second oral statement, paras. 14 and 16-17; second written submission, para. 22 and footnote 13 to para. 22; responses to Panel question Nos. 87, 90 and 186; comments on China's response to Panel question No. 134.

[284] Canada's first written submission, para. 84 and footnote 114 to this paragraph; response to Panel question No. 90(a).

[285] Argentina, Australia, Japan and Mexico, who participated in the Panel's proceeding as third parties and submitted written submissions, support the complainants' view on this issue. (see Argentina's third party submission, paras. 8-17; Argentina's oral statement, paras. 2-7; Australia's oral statement, paras. 4-16; Japan's third party submission, paras. 4-22; Japan's oral statement, paras. 2-11; and Mexico's third party submission, paras. 4-6). Brazil did not express any views on the proper characterization of the measures at issue but highlighted key considerations regarding the differences between Article II and III of the GATT 1994 (see Brazil's oral statement, paras. 2-9).

China[286], as required by a proper interpretation of the first sentence of Article II:1(b) of the GATT 1994, not on their use inside China in the assembly of complete vehicles. To the complainants, an "ordinary customs duty", even if collected after the time or point of importation, must be assessed taking into consideration only the state of the product at the moment of importation. The stated policy purpose of the measures, the description and characterization of the charge under the measures as well as the fact that the charge is collected by the customs authority are all irrelevant factors to the determination of whether the charge is an "ordinary customs duty".

7.120 **China**, however, submits various arguments in support of its defence that the challenged measures impose ordinary customs duties under Article II:1(b), first sentence, of the GATT 1994. First, because the charges are imposed *conditioned upon the entry* of goods into China. Additionally, because these charges are imposed "on their importation" within the meaning of Article II:1(b), first sentence, because they *relate to, or fulfil, a condition of liability that attaches at the time of importation*.[287] Further, these charges are ordinary customs duties also because they are charges China is *allowed* to impose *by reason of*, or *as a condition of*, the importation of the product, irrespective of the precise time and place when and where they are imposed or collected.[288] Finally, China explains that an important factor in the characterization of the charges as ordinary customs duties is that they are imposed by measures that implement and enforce China's Schedule of Concessions by giving effect to the provisions of China's Schedule relating to "motor vehicles." They do so by defining the circumstances under which China will classify imported auto parts and assemblies as having the essential character of a complete motor vehicle under these tariff provisions.[289] This is done irrespective of how importers choose to structure such auto part importations: either in a single or in multiple shipments. It is therefore the importation of parts of registered vehicle models, i.e. those containing imported parts that assembled together have the essential character of a complete vehicle, that triggers the imposition of the charge, not their internal use.

7.121 In light of the parties arguments on whether the charge falls within the scope of the first sentence of Article III:2 of the GATT 1994 or the first sentence of Article II:1(b) of the GATT 1994[290], the **Panel** considers that it must examine these two provisions in accordance with the customary rules of treaty interpretation under the *Vienna Convention on the Law of Treaties* ("*Vienna Convention*")[291]. In doing so, we will also follow the interpretative approach taken by the Panel in *India – Autos*:

> "The Panel feels that it is vital that the task be approached solely through an application of the customary rules of interpretation of public international law as

[286] Or based on their "snapshot", as Canada calls it (see Canada's response to Panel question No.90(b)); or based on the goods "as entered" (see United States' second written submission, para. 22).

[287] China's first written submission, para. 67; second written submission, para. 112.

[288] China's first written submission, para. 7; second written submission, para. 115; responses to Panel question Nos. 87 and 109.

[289] China's first written submission, para. 43; first oral statement, para. 28.

[290] European Communities' second written submission, para. 36 and footnote 34; United States' second written submission, para. 23; Canada's second written submission, para. 27; and China's responses to Panel question Nos. 79 and 88.

[291] See Article 3.2 of the DSU. These rules require an interpretation in good faith in accordance with the ordinary meaning to be given to the terms in their context and in the light of the object and purpose of the agreement (Article 31 of the *Vienna Convention*). Recourse may be had to supplementary means of interpretation in accordance with Article 32 of the *Vienna Convention*. See, e.g., the Appellate Body Report on *US – Gasoline*, DSR 1996:I, page 16-17; Appellate Body Report on *Japan – Alcoholic Beverages II*, DSR 1996:I, page 104; and Appellate Body Report on *India – Patents (US)*, paras. 45-46.

> required by Article 3.2 of the DSU. This should occur without any presumption as to some preordained or systemic balance between the two Articles. The customary rules provide sufficient mechanisms to ensure an appropriate outcome that should deal with such concerns, as they require consideration of ordinary meaning in context and in the light of object and purpose of the treaty. In this regard, context includes a reading of each Article in relation to other potentially relevant provisions and an analysis, where necessary, of any differences in terminology. The principle of effectiveness would also apply to prevent reducing any provision to inutility.
>
> While other provisions in the WTO Agreement may usefully be considered as part of the context which informs the meaning of a given provision, the scope of that provision should not be assumed *a priori* to vary depending on the mere presence of other provisions which may have some relevance to the situation: the contours of a provision should flow from its terms, as read in context alongside the other provisions of the agreement. The Panel is also mindful of the fact that different aspects of a particular measure may legitimately be covered by distinct provisions of the WTO Agreements."[292]

(ii) Internal taxes or other internal charges within the meaning of Article III:2 of the GATT 1994

Arguments of the parties

7.122 The **European Communities** argues that internal charges under Article III:2 of the GATT 1994 are not imposed on "products on their importation into the territory", but on products already "imported into the territory".[293]

7.123 The **United States** submits that an examination of the language used in Article III:2 involves a relationship between products that have been "imported into the territory" of a Member with "internal taxes or other internal charges". Thus, in contrast to ordinary customs duties under Article II, which are based on the product at the time of importation, an internal charge under Article III:2 may be associated with the product as it exists after it is imported into a Member's territory.[294] The United States submits that the applicability (or not) of Article III:2 follows from this provision's use of the terms "internal charges" and not from any notion (as China contends) that Article II provides "permission" for a violation of Article III.[295] For this reason, 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.[296]

7.124 **Canada** adds that the Appellate Body and GATT *acquis* have made it abundantly clear that Article III exists to prevent discrimination against imported products, by protecting expectations of an equal competitive relationship between imported and domestic products. The protection afforded by Article III does not work simply in respect of products once in the internal market, but also in respect of establishing the very point at which national treatment must apply. That point *must* be when a

[292] Panel Report on *India – Autos*, paragraphs 7.222 and 7.223. The complainants agreed with this approach in their respective responses to Panel question No. 203.
[293] European Communities' second written submission, para. 38.
[294] United States' response to Panel question No. 186.
[295] United States' second oral statement, para. 9.
[296] United States' second oral statement, para. 12.

product is physically presented at the border. Otherwise, how can the objective of Article III be realized when the very scope of the tariff concessions is uncertain, and the border itself can be set as a Member sees fit so as to deny national treatment?[297]

7.125 **China** submits that whether one examines the matter from the standpoint of Article II ("on their importation"), or from the standpoint of Article III ("imported"), it is evident that the delineation between Article II and Article III requires some understanding of what it means for products to have completed the *process of importation*. It is the completion of this process that marks the turning point between permissible discrimination under Article II and impermissible discrimination under Article III. In China's view, imports have been "cleared through customs" once *all* customs formalities are complete and the goods are in free circulation within the customs territory. In particular, China considers that imports have been "cleared through customs" once the national customs authorities have completed the administrative processes that are necessary for the imposition and assessment of the specific border charges that a Member is *allowed* to impose in respect of the imports at issue, and the imports are no longer subject to customs control. A Member may not impose any charge in connection with the customs clearance process and thereby evade the non-discrimination disciplines of Article III. Rather, it must be a charge of a type that the Member is allowed to impose under its Schedule of Concessions or in accordance with other WTO provisions.[298]

Consideration by the Panel

7.126 The first sentence of Article III:2 of the GATT 1994 provides:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, 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."

7.127 Neither Article III:2 of the GATT 1994 nor any other WTO covered agreement provides a definition of the term "internal taxes or charges". The *Dictionary of Trade Policy Terms* defines "internal taxes" as follows:

> "Government charges *applied to sale* of goods and services *inside a customs territory*. Article III of the GATT requires that such charges are levied at the same rate for domestic products as for imported products. In other words, *national treatment* is a fundamental obligation in this regard. ..."[299]

7.128 This definition of "internal taxes" above illustrates that the term "internal" seems to indicate that the element triggering the obligation to pay the charge – for example, the sale of the good – takes place inside the customs territory.

7.129 This also appears to be in line with the language of the first sentence of Article III:2 of the GATT 1994, which refers to "the products of the territory of any contracting party *imported into the territory* of any other contracting party".[300] In other words, products that have already been *imported* into the customs territory of a Member should not be subject to internal taxes and other internal

[297] Canada's second written submission, para. 13.
[298] China's response to Panel question No. 37.
[299] *Dictionary of Trade Policy Terms*, W. Goode, WTO Fourth Edition, 2003, page 184. Emphasis added.
[300] Emphasis added. Article III:1 also refers to *imported* products.

charges in excess of those applied to like domestic products. Thus, the imposition of an internal charge is not triggered by the act of *importing* a product into to the territory of any other contracting party.[301]

7.130 We also find useful guidance from previous GATT jurisprudence on the question of whether a charge is subject to the disciplines of Articles II or III of the GATT 1994. For example, in the GATT Panel *Belgium – Family Allowances*, the Panel considered that because a levy was "collected only on products purchased by public bodies for their own use and not on imports as such, and that the levy was charged, not at the time of importation, but when the purchase price was paid by the public body" as enough reason to characterize such a levy as an "internal charge" under Article III:2.[302] In *Canada – Gold Coins*, an unadopted GATT Panel Report, the panel, faced with the question of whether an Ontario provincial sales tax measure on gold coins was within the scope of Articles III or II of the GATT, noted, based on the language of *Belgium - Family Allowances*, that the tax was levied at the time of retail sale of goods within the province, not at the time of importation into Canadian territory and thus affected the internal retail sale of gold coins rather than the importation of *Krugerrands* as such. The panel therefore considered that the tax was an "internal tax" under Article III and not an "import charge" under Article II.[303]

7.131 Furthermore, in *Argentina – Hides and Leather*, the panel found that the pre-payment of the Value-Added Tax (VAT) established by the challenged measure was an internal measure under Article III:2, first sentence, because the measure applied to "definitive import transactions, but only if the products imported were subsequently re-sold in the internal Argentinean market."[304] In other words, the measure provided for the pre-payment of the VAT chargeable to an *internal* transaction. Furthermore, the panel, relying on *Ad* Note Article III of the GATT 1994, stated that the fact that the charge was "collected at the time and point of importation" did not preclude it from qualifying as an "internal tax measure".[305]

7.132 Consistent with those GATT and WTO panels, we also consider that an important element that would indicate that a charge constitutes an "internal tax or other internal charge" within the meaning of Article III:2 of the GATT 1994 is whether the obligation to pay such charge accrues because of an *internal* factor (e.g., because the product was *re-sold* internally or because the product was *used* internally), in the sense that such "internal factor" occurs *after the importation* of the product of one Member into the territory of another Member.

7.133 We find contextual support for this reading in *Ad* Note Article III of the GATT 1994, which clarifies that any internal tax or other internal charge which applies to an imported product and to the like domestic product and is collected in the case of the imported product at the time or point of importation is nevertheless to be regarded as an internal tax or other internal charge within the scope of Article III. The *Ad* Note Article III, therefore, appears to confirm that *when* or *where* the internal charge is *collected* is not necessarily the decisive criterion to indicate that it falls within the scope of Article III:2 of the GATT 1994.[306]

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[301] Obviously, importation is a necessary prerequisite to become an "imported product" and thus to be given national treatment on internal taxation. See also paragraph 7.133, below.

[302] GATT Panel Report on *Belgium - Family Allowances*, para. 2 (emphasis added).

[303] GATT Panel Report on *Canada – Gold Coins* (unadopted), para. 50. See also footnote 269.

[304] Panel Report on *Argentina – Hides and Leather*, para. 11.145 (emphasis added, original footnote omitted).

[305] Panel Report on *Argentina – Hides and Leather*, para. 11.145.

[306] See also Panel Report on *India – Autos*, para. 7.260. The Panel in *India – Autos* stated that "the fact that the measure applies only to imported products need not, in itself, be an obstacle to its falling within the

7.134 However, China submits that the charge under the measures is an ordinary customs duty, not an internal charge because it is imposed *as a condition of* – that is, *by reason of* – the importation of a product (auto parts) into China's customs territory and that this charge *objectively relates to a duty liability that arises by reason of the importation of the product*. In other words, China is of the view that the assessment of the charge based on the assembly of auto parts into motor vehicles is a condition of the importation of such auto parts.

7.135 Given China's arguments, we will next turn to the meaning of the term "ordinary customs duties" in Article II:1(b), first sentence, of the GATT 1994, before analysing whether the charge under the measures falls under either Article II:1(b), first sentence, or Article III:2 of the GATT 1994.

"Ordinary customs duties" within the meaning of Article II:1(b) of the GATT 1994

7.136 Article II:1(b) of the GATT 1994 provides:

> "The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, 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. Such products shall also be exempt 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." (emphasis added)

7.137 The **Panel** first recalls its statement at paragraph 7.121 above that it would follow the interpretative approach taken in *India – Autos* in dealing with the preliminary issue as to whether the charge under the measure falls within the scope of either Article II:1(b) or III:2 of the GATT 1994. We recall in particular our endorsement of that panel's statement that "[w]hile other provisions in the WTO Agreement may usefully be considered as part of the context which informs the meaning of a given provision, the scope of that provision should not be assumed *a priori* to vary depending on the mere presence of other provisions which may have some relevance to the situation: the contours of a provision *should flow from its terms*, as read in context alongside the other provisions of the agreement."[307]

7.138 With this statement in mind, we recall our conclusion above at paragraph 7.105 that the preliminary question before us is whether the *charge* under the measures is an "ordinary customs

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purview of Article III. For example, an internal tax ... conditioning the sale of the imported but not of the like domestic product, could nonetheless 'affect' the conditions of the imported product on the market and could be a source of less favourable treatment." It further observed that "Article III:1 refers to the application of measures 'to imported or domestic products', which suggests that application to both is not necessary." (Panel Report on *India – Autos*, para. 7.306 and footnote 437; original footnotes were omitted).

We concur with the Panel in *India – Autos*. We do not consider that the language of *Ad* Note Article III supports the interpretation that any charge not imposed on domestic products would fall *ipso facto* outside the scope of Article III:2 of the GATT 1994. Otherwise, Members could easily escape the application of Article III:2 of the GATT 1994 by simply exempting domestic products from a charge that would otherwise be internal.

See also China's response to Panel question No. 88 and the complainants' respective responses to Panel question No. 88.

[307] Panel Report on *India – Autos*, para. 7.223 (emphasis added).

duty" under the *first sentence* of Article II:1(b) of the GATT 1994 or an "internal charge"[308] under Article III:2 of the GATT 1994. We are of the view therefore that the ordinary meaning of the words "ordinary customs duties" in the first sentence of Article II:1(b), read in their context and in light of the object and purpose of the GATT 1994, is an important element in our preliminary task to determine which provision of the GATT 1994 the charge falls under.

Ordinary meaning of an "ordinary customs duty"

7.139 The term "ordinary customs duties" is not defined in the WTO covered agreements. Regarding the ordinary meaning of "customs duties", we do find some guidance in the following definitions:

> "Duties laid down in the Customs tariff to which goods are liable on entering or leaving the Customs territory";[309]
>
> "2. (*pl.*) Duties imposed on imports and exports. 3. (*pl.*) The agency or procedure for collecting such duties";[310]
>
> "charges levied at the border on goods entering or, much less often, leaving the country".[311]

7.140 The definitions of "customs duties" above seem to indicate that "customs duties" refer to "duties or charges" imposed *when* goods enter or leave the customs territory and *because* of importation or exportation.[312] "Customs territory" can be defined as follows:

> "The geographical territory upon which a sovereign nation imposes its import and export regulations and duties. Certain territorial possessions and special economic zones (such as foreign trade zones) are often considered outside the customs territory of a nation."[313]

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[308] We consider that the precise categorization of the charge as an "internal tax" or an "other internal charge" within the meaning of Article III:2 of the GATT 1994 is immaterial to the present case. Therefore, and without prejudice to the relevance of distinguishing these subsets of charges in other cases, in the present proceedings we will simply use "internal charge" in lieu of them.

[309] WCO, *Glossary of International Customs Terms*, 2006, page 8; *Revised Kyoto Convention*, General Annex, Chapter 2 and 4.

[310] *Black's Law Dictionary*, Seventh Edition, 1999, page 390.

[311] *Dictionary of Trade Policy Terms*, W. Goode, WTO Fourth edition, 2003, page 90.

[312] The Panel in *Chile – Price Bands System* elaborated on the dictionary meaning of "ordinary", including its French and Spanish versions. The Panel explained that:

> "the dictionary meaning of 'ordinary' is 'occurring in regular custom or practice', 'of common or everyday occurrence, frequent, abundant', 'of the usual kind, not singular or exceptional, commonplace, mundane' '*Propiamente dicho*' has been translated as 'true (something)' or '(something) in the strict sense'. '*Proprement dit*' has been explained as '*au sens exact et restreint, au sens propre*' and '*stricto sensu*'." (Panel Report on *Chile – Price Bands System*, para. 7.51. Footnotes omitted).

[313] *Handbook of the Global Trade Community, Dictionary of International Trade*, E. Hinkelman, Fourth Edition, 2000, page 59.

7.141 Although WTO/GATT jurisprudence does not provide guidance on the precise definition of the term "ordinary customs duties",[314] we nevertheless find useful the following statement of the Appellate Body in *Chile – Price Bands System* on the interpretation of "variable import levies" within the meaning of footnote 1 to Article 4.2 of the *Agreement on Agriculture*:

> "We begin with the interpretation of 'variable import levies'. In examining the ordinary meaning of the term 'variable import levies' as it appears in footnote 1, we note that a 'levy' is a duty, tax, charge, or other exaction usually imposed or raised by legal execution or process. An 'import' levy is, of course, *a duty assessed upon importation*. A levy is 'variable' when it is 'liable to vary'. This feature alone, however, is not conclusive as to what constitutes a 'variable import levy' within the meaning of footnote 1. *An 'ordinary customs duty' could also fit this description.* A Member *may, fully in accordance with Article II of the GATT 1994, exact a duty upon importation* and periodically change the rate at which it applies that duty (provided the changed rates remain below the tariff rates bound in the Member's Schedule)."[315] (original footnotes omitted; emphasis added)

7.142 Although the Appellate Body in *Chile – Price Band System* was not concerned with the delineation between "ordinary customs duties" and "internal charges", this reasoning indicates that the act of *importation* is an important element[316] for the analysis of whether a charge falls within the scope of Article II:1(b), first sentence, of the GATT 1994.

7.143 We will now move on to examine the scope of "ordinary customs duties" in its context, in particular, the first sentence of Article II:1(b) of the GATT 1994, which requires that the products of one Member shall, "on their importation" into the territory of another Member, be exempt from ordinary customs duties in excess of those set forth and provided in the Schedule of the importing Member. In the following section, we will therefore analyse whether the term "on their importation" provides further guidance on the meaning of "ordinary customs duties".

> "Ordinary customs duties" in the context of the first sentence of Article II:1(b) - "on their importation"
>
> *Arguments of the parties*

7.144 The **European Communities** disagrees with China's various formulations on the scope of Article II:1(b) of the GATT 1994. Under the first sentence of this provision ordinary customs duties can only be imposed *on* the importation of the product not *in connection with* the importation. These various formulations made by China are vague and simply used as an attempt to widen the scope of Article II to the detriment of that of Article III of the GATT 1994. There is nothing in law that supports China's position that Article II applies to charges that *relate* to a valid customs duty that a

[314] In the one occasion a panel has attempted to define "ordinary customs duties", albeit in the context of Article 4.2 of the *Agreement on Agriculture*, it was overruled by the Appellate Body. In *Chile – Price Bands System*, the panel defined an ordinary customs duty as "referring to a customs duty which is not applied on the basis of factors of an exogenous nature" (Panel Report on *Chile – Price Band System*, para. 7.52). The Appellate Body disagreed with such definition stating that it did not have any basis either on the ordinary meaning or the context of Article II:1(b), first sentence, of the GATT 1994 (Appellate Body Report on *Chile – Prince Bands*, paras. 271-278). The Appellate Body did not however present its own definition of ordinary customs duties in lieu of that of the panel.

[315] Appellate Body Report on *Chile – Prince Band Systems*, para. 232.

[316] As we will discuss below, importation is not the *only* element to the determination as to whether a charge falls within the scope of the first sentence of Article II:1(b) of the GATT 1994.

Member is *allowed* to impose, or to those that are imposed *as a condition of the importation* of the product into other Members.[317] Although not defined in the GATT 1994, an "ordinary customs duty", within the meaning of Article II:1(b), first sentence, of the GATT 1994 would be one set out in a country's tariff schedule and generally denotes a financial charge in the form of a tax imposed "on importation" and the liability to which is created by the importation. On the other hand, "other duties and charges" within the meaning of Article II:1(b), second sentence, of the GATT 1994 aims generally at preventing undermining the prohibition of Article II:1(b), first sentence, to impose ordinary customs duties in excess of the bindings.[318] This different language indicates that "ordinary customs duties" *cannot* be imposed "in connection with the importation".[319]

7.145 The European Communities further submits that the term "on importation" has both a *temporal* and *material* aspect. The *temporal* aspect means that "ordinary customs duties" are generally collected "at the time or point of importation", as suggested by the language of Interpretative Note *Ad* Article III:2 of the GATT 1994.[320] However, although the precise time and place of the *actual payment* or *collection* of a charge may happen *after* importation and is not determinative of the nature of the charge as a border charge, the determination of the amount due must be done "on importation", i.e. on the basis of the objective characteristics of the product when presented for classification at the border.[321] The European Communities asserts that China attempts to overstretch such *temporal* aspect by stating that "on importation" encompasses a "process of importation", the same process China contends the measures provide for, which is only over after *all* customs-related formalities are satisfied and there is no longer any customs control over the imported goods. The European Communities finds, therefore, not surprising that China asserts that the entire administrative procedure under Decree 125 and Announcement 4 is part of such customs-related formalities.[322] As to the *material* aspect of the term "on importation", the European Communities maintains that it means that a charge is levied "on the importation" if it is due because of the importation of the product, but not because of other events or criteria, e.g. the amount of local content in products into which the imported product is subsequently assembled. This is confirmed by the difference of scope between the first and second sentences of Article II:1(b) of the GATT 1994.[323] China attempts to extend such *material* aspect by suggesting that a charge is levied "on importation" when it "bears an objective relationship to the administration and enforcement of a valid customs

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[317] European Communities' responses to Panel question Nos. 84 and 246; second written submission, para. 45.

[318] European Communities' responses to Panel question Nos. 96(a) and 96(b); second written submission, para. 38.

[319] European Communities' response to Panel question No. 100. The European Communities also recalls that there is also no definition or jurisprudence defining the words "in connection with the importation" in Article II:1(b), second sentence, of the GATT 1994. It argues that the GATT Panel in *EEC – Parts and Components* simply cited certain factors (e.g. the policy purpose of a charge, the mere description or categorization of a charge under domestic law or the treatment of the goods "as not being in free circulation") that were not relevant to provide the required "connection with the importation." (European Communities' responses to Panel question Nos. 98 and 189).

[320] European Communities' second written submission, paras. 39-40.

[321] European Communities responses to Panel question Nos. 87, 180 and 186; observations on the letter of the WCO Secretariat of 30 July 2007 (WCO's response to question 18).

[322] European Communities' second written submission, para. 43; responses to Panel question Nos. 181 and 183.

[323] European Communities' second written submission, paras. 39 and 41. See a more detailed description of the parties' arguments on the relationship between the two paragraphs of Article II:1(b) of the GATT 1994, below at paragraphs 7.168 to 7.172.

liability", an overly broad, imprecise and unsuitable concept not found in the language of the first sentence of Article II:1(b).[324]

7.146 The **United States** equally disagrees with China's understanding that the term "on their importation" in Article II, first sentence, of the GATT 1994 includes measures that Members are *allowed* to impose "*conditional upon* the importation of a product" or those that are merely "*related*" to importation. There is no textual or contextual basis presented by China for such a broad interpretation. In fact, China's use of the expression "conditional upon" is so broad that it would seem to allow an internal sales tax to be different for domestic products and imported products simply because the higher tax on imported products would be "conditional" upon the fact that the product had been imported.[325] This demonstrates that China's analysis under this issue is essentially backwards: it starts with a purported interpretation of its Schedule, then moves to an analysis of Article II stating that if there is any "relation to importation," then Article II applies to the exclusion of Article III. This mode of argumentation is based on the false premise that Article II and China's Schedule give China the "right" to define a "customs duty" however China sees fit and to adopt measures inconsistent with Article III in order to collect such supposed "customs duties". To the contrary, Article II does not provide for any of these "rights" as it imposes obligations on Members that choose to impose customs duties. If China were correct that Article II provided such "rights" to WTO Members then Article III could be rendered a nullity through the ruse of defining internal charges as "customs duties".[326]

7.147 The United States further argues that it is mindful that the GATT 1994 does not define the term "ordinary customs duty" but it understands such term to mean a tax imposed on a good upon its importation, and calculated based on the quantity or value of the good at the time of importation. Ordinary customs duties can be specific, *ad valorem* or mixed. A specific customs duty on a good is an amount based on the weight, volume or quantity of that product upon importation. An *ad valorem* customs duty on a good is an amount based on the value of that good upon importation. A mixed duty is a combination of an *ad valorem* duty and a specific duty. "Other duties or charges" in Article II:1(b), second sentence, is intended as a catch-all phrase to prevent the avoidance of a Member's bindings on ordinary customs duties. According to paragraph 1 of the *Understanding on the Interpretation of Article II:1(b)* of the GATT 1994 "in order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of concessions annexed to GATT 1994 against the tariff item to which they apply. It is understood that such recording does not change the legal character of 'other duties or charges.'"[327]

7.148 For the above reasons, the United States submits that the imposition of ordinary customs duties occurs *at the time* of importation of goods into the territory to which a Member's Schedule relates.[328] The reference in Article II:1(b) of the GATT 1994 to "on their importation into the territory to which the Schedule relates" connects the imposition of the duties to the goods as they exist at the time of importation. Accordingly, a relationship between the charge and the condition of the goods at the border, at the time of importation, must be present in order for the charge to be an ordinary

[324] European Communities' second written submission, para. 44; response to Panel question No. 181.
[325] United States' response to Panel question No. 84.
[326] United States' comments on China's responses to Panel question Nos. 179(a), 187, 234 and 243; second written submission, paras. 7-8.
[327] United States' responses to Panel question Nos. 96 (a) and 96 (b). The European Communities and Canada also used a description similar to that used by the United States to describe ordinary customs duties and other duties and charges under Article II:1(b) of the GATT 1994 (see their respective responses to Panel question Nos. 96 (a) and 96 (b)).
[328] United States' responses to Panel question Nos. 181 and 183.

customs duty within the meaning of Article II:1(b). The United States relies on the findings of the Appellate Body in *EC – Chicken Cuts* to support its view on the existence of a necessary connection between the condition of the good as imported and the customs duty, in particular in the part of that finding that explained 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."[329] The United States does not however maintain, nor does it believe, that there is disagreement between the complainants on this point, that the *time and place* at which a charge is *collected* is *the* determinative consideration in evaluating whether the charge is an internal charge or a customs duty. Although it considers that the time and place of *assessment* or *calculation* of the charge would be relevant in evaluating whether the charge is an internal or a customs duty.[330]

7.149 **Canada** also disagrees with China on the proper interpretation of Article II:1(b), first sentence, of the GATT 1994 as this provision only provides for the imposition of ordinary customs duties to products "*on* their importation" not, as China proposes, "*by reason of* the importation", "*dependent upon* importation" or "*conditional upon* importation."[331] China's various propositions in this regard are just an attempt to infer, without any basis in the text of Article II or in the practice of WTO Members, that the application of an ordinary customs duty is somehow related to the ultimate justification for importation, independent of the proper classification of the good *as presented* at the border. This cannot be so as the "reason or event" under the first sentence of Article II:1(b) of the GATT 1994 is always the same: *the physical state of products when arriving at the border*. Liability for an ordinary customs duty can only arise from that single event at the very beginning of the importation process.[332] The ordinary meaning of "on their importation" in Article II:1(b), read in the context of Articles I, III and XI, and as evinced by Member practice, demonstrates such understanding.[333] For example, the reference to "on" in Article II:1(b) of the GATT 1994 emphasizes a single event and the ordinary meaning of "importation", supported in both the *Shorter Oxford English Dictionary* and the *WCO Glossary*, refers to the physical act of products being brought across the border into a country. Furthermore, the GATT 1994 generally, GATT *acquis*, the WTO Appellate Body and even the WCO support this interpretation of "on their importation", and confirm that ordinary customs duties may only be imposed on products based on their state as presented at the border.[334] Canada clarifies however that while ordinary customs duties must, as stated above, be

[329] United States' response to Panel question No. 186.

[330] United States' response to Panel question No. 180.

[331] Canada's responses to Panel question Nos. 84 and 180. Canada and the other co-complainants have also made the point that the use of the expression "conditional upon importation", that China borrowed from the GATT Panel Report on *EEC – Parts and Components*, does not have any legal value, because, besides the fact of not being supported by the text of Article II itself, this expression was not even used in that GATT panel in a legal sense in its findings on the proper interpretation of that Article. To them, the GATT panel's use of that expression was only a reference to an argument put forward by the then EEC, which, in any case, was made in the context of the *second sentence* of Article II:1(b). See also the responses of the European Communities and the United States to Panel question No. 84.

[332] Canada's responses to Panel question Nos. 13(a), 179(b), 181 and 183; first oral statement, para. 22; second written submission, paras. 15 and 39.

[333] Canada's second written submission, para. 17.

[334] Canada's second written submission, paras. 18-23. In support of this interpretation, Canada cites the GATT panel in *Canada – FIRA*, which emphasized that Article XI, which also contains the expression "on importation", shows the intention of the drafters of the GATT to define the concept of "importation" narrowly so as to prevent it from covering internal requirements on "imported products". Canada argues that this link to the state of products on physical entry is also supported by the drafting history of Article II and the language of the Interpretative *Ad* Note Article III. Canada recalls that in *EEC – Parts and Components*, the panel said that in characterizing a charge as subject to Article II or Article III:2 "[t]he relevant fact, according to the text of these

based on the state of goods as presented at the border, there is some flexibility for the application of "other border charges" until a product is available for internal use within a Member.[335] As China alleges that its measures impose "ordinary customs duties", that flexibility is not relevant to this dispute. Regardless, the measures apply well after the process of importation is complete and must be internal measures.[336] Finally, even if China had explicitly included in its Schedule a note allowing it to impose conditions on the importation of auto parts as an "ordinary customs duty", it could not rely on that condition to impose internal charges contrary to Article III of the GATT 1994 as Panels have consistently ruled that Members cannot use conditions reflected in a Schedule so as to justify measures otherwise inconsistent with their WTO obligations.[337]

7.150 Canada also clarifies however that the precise time and place of the *collection* of a charge is not determinative of whether it falls within the scope of Article III or Article II of the GATT 1994. The actual payment need not take place at the border, nor even must the amount owing be determined at that point (which could be characterized as the "calculation" or "assessment" of the charge), provided that the duty, as Canada explains above, is levied in respect of the good as presented at the border. Conversely, a clearly internal charge (for example, a value-added tax) may be *collected* at the exact moment that a product enters the country, in accordance with Article II:2(a) and *Ad* Article III. For a charge, what is significant is whether the charge relates to the product as presented at a Member's border. Any border charge, whether collected at the border or at some later time, may only relate to the product at that point in time. If it does not (i.e., a charge based on end-use), then it must be an internal charge.[338]

7.151 **China** believes that it is consistent with the context of Article II:1(b), as well as the object and purpose of the GATT 1994, to interpret the term "on their importation" to encompass charges that Members impose *as a condition of* – that is, *by reason of* – the importation of a product into its customs territory. Customs authorities may calculate, assess, and collect a particular charge *after* the products have physically entered the customs territory, so long as the charge *objectively relates to a duty liability that arises by reason of the importation of the product*. Such charges, and measures that Members adopt to collect such charges, are within the scope of Article II of the GATT 1994. Applying this understanding of the term "on their importation", the determination of whether a particular charge is within the scope of Article II will depend upon the *reason* or *event* that triggered the imposition of the charge. China does not perceive any substantial disagreement by the complainants and third parties on this point as they also support the conclusion that a measure or

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provisions, 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". According to Canada, this interpretation has been followed consistently. For example, in *EC – Chicken Cuts*, both the Appellate Body and the panel cited with approval the opinion of the WCO that a proper classification is done on the basis of the objective characteristics of the product at the time of importation, and may be based on a visual inspection and laboratory analysis. Canada claims that GIR 2(a), on which China places so much emphasis, supports a reading that classification (and thus assessment of duty which follows it) must occur based upon the time of physical entry by referring to the state of a product "as presented". Canada also recalls that the Customs Co-operation Council, the predecessor to the WCO, noted that the words "as presented" replaced the words "imported" in GIR 2(a) "to make it quite clear that the provisions of the Rules concerned applied to a given article *in the state in which it is presented for Customs clearance.*" (Canada's second written submission, paras. 18-23; emphasis in the original).

[335] Canada elaborates more on this point as set out below at paragraph 7.170.

[336] Canada's second written submission, para. 32.

[337] Canada's response to Panel question No. 84, citing the GATT Panel Reports on *EEC – Imports of Beef* and *US – Sugar*.

[338] Canada's responses to Panel question Nos. 11, 87, 90, 90(b) and 180.

charge is within the scope of Article II if it relates to what the United States refers to as "a valid customs liability."[339]

7.152 China adds that the characterization of the charges that China collects pursuant to Decree 125 requires an assessment of whether they are charges that China is *allowed to impose* by reason of the importation of auto parts and components into its customs territory, i.e., "on their importation" into China. If the measures fulfil a "valid customs liability", they are measures that are subject to the disciplines of Article II of the GATT. China believes that 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.[340]

7.153 China then submits that, for the above reasons, the *time* or *place* at which the charge is collected is not determinative; what matters is whether the charge fulfils a duty obligation that arises by reason of the importation of the product.[341] In fact WTO Members routinely assess border charges *after* such time or place. Examples of specific customs practices from some WTO Members support this point as they show that these countries allow, in certain general circumstances, duty (re)determinations and payments *after* the importation and entering into free circulation of the goods. For instance, in the United States final classification determinations and duty liability assessments can be made up until one year after the merchandise has entered the US customs territory and been in free circulation. Duties paid "at the time or point of importation" are merely estimated duties. Additionally, in many (if not most) cases, the merchandise has been sold, consumed, processed, or used in the manufacture of other products by the time that customs duties are actually imposed and collected.[342] Therefore, and consistent with Article 31(3)(b) of the *Vienna Convention*, the term "on their importation" must be interpreted in the light of the consistent and widespread practice among Members of imposing customs-related measures, and collecting customs duties, *after* goods have crossed the frontier.[343]

Consideration by the Panel

7.154 The **Panel** first notes China's argument[344] that the meaning of the word "importation" *alone* would suffice to the inquiry of whether the charge under the measures falls within the scope of Article II or III of the GATT 1994.[345] In the first sentence of Article II:1(b) of the GATT 1994, however, the

[339] China's second written submission, paras. 102-104; response to Panel question No. 54.
[340] China's second written submission, para. 105-106.
[341] China's second written submission, paras. 102-104; response to Panel question No. 54.
[342] China cites examples from customs laws of Australia, Canada, India, the European Communities and the United States. China also says that many countries also have "more specialized circumstances" in which duties can be assessed ***after*** the time or point of importation: (i) goods initially in transit but that subsequently enter free circulation; (ii) payment of imports that fail to adhere to conditions for temporary duty-free importation; or (iii) payment of imports that fail to adhere to inward processing and re-export requirements (China's first written submission, para. 66). See also China's first written submission, paras. 63-65 (including footnote 34 to para. 65) and 101.
[343] China's response to Panel question No. 179(a); China's second written submission, para. 101.
[344] China's responses to Panel question Nos. 87 and 89.
[345] We are mindful that other panels have identified the words "importation" and "imported" as important and relevant to the delineation between border and internal *measures* (encompassing fiscal and non-fiscal aspects). But the question before us is a narrower one: the categorization of a *charge*, which is the fiscal

word "importation" is preceded by the preposition "on" and the pronoun "their", and followed by the words "into the territory". Therefore, we will consider both terms "on their importation", in its entirety, and "into the territory" in examining the meaning of an "ordinary customs duty".

7.155 The word "importation" can be defined as: the "bringing of goods into a country from another country";[346] the "action of importing or bringing in something, *spec*. goods from another country";[347] and "the act of bringing or causing any goods to be brought into a customs territory".[348] The ordinary meaning of the word thus indicates that "importation" is an action with a locational element as it refers to "[t]he bringing of goods into a country from another country." This locational element is reinforced, in the context of Article II:1(b), first sentence, by the reading of "importation" together with the words "into the territory". We further note that the dictionary definitions of "importation" refer to it as *an* "action" or *an* "act" in the singular and not to *various* "actions" or "acts" in the plural.

7.156 The preposition "on" and the pronoun "their" further qualify the word "importation": "their" by indicating which products "importation" refers to (i.e., those "products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties ... "); and, "on" by potentially providing either a *temporal* or *relational* precision to the act it modifies. We therefore attach particular importance to the word "on", which, as a preposition, is defined in the *Shorter Oxford English Dictionary*, *inter alia* as follows:

> "**on** / *preposition.* … **II** *Of time, or action implying time.* **6** During, or at some time during (a specified day or part of a day); contemporaneously with (an occasion). Also (now chiefly *US & Austral.*) in or at (any period of time); *dial. & US* used redundantly with *tomorrow*, *yesterday*. **b** Within the space of; in (a length of time). **c** Exactly at or just coming up to (a specified time), just before or after in time. **7** On the occasion of (an action); immediately after (and because of or in reaction to), as a result of."[349]

7.157 The *Webster's New Encyclopedic Dictionary*, on the other hand, defines "on" *inter alia* as follows:

> "**on** / *prep* … **4:** with respect to <agreed *on* a price> **5a:** in connection, association, or activity with or with regard to <*on* a committee> <*on* a tour> **b** in a state or process of <on fire> <on the increase> **6:** during or at a specified time <every hour *on* the hour> <cash *on* delivery> …"[350]

7.158 We note that some of these meanings carry a *precise and strict temporal* connotation, as argued by the complainants, others, a more *flexible, relational* one, as argued by China. We are also mindful that those are not the only ordinary meanings of the word "on", but we believe they are the ones more closely related to the context of Article II:1(b), first sentence, of the GATT 1994.

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aspect of the Chinese measures. Thus, this circumstance requires a reading of the word "importation" in its proper proximate context, which is the *first sentence* of Article II:1(b) of the GATT 1994.

[346] *Black's Law Dictionary*, Seventh Edition, 1999, page 759.
[347] *The Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 1331.
[348] *WCO, Glossary of International Customs Terms*, 2006, page 16.
[349] *The Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 2, page 1996.
[350] *Webster's New Encyclopedic Dictionary*, 2003 ed., page 701.

7.159 We have also reviewed the French and Spanish texts of the first sentence of Article II:1(b) of the GATT 1994, which are equally authentic.[351]

7.160 The French text of the first sentence of Article II:1(b) reads:

> "Les produits repris dans la première partie de la liste d'une partie contractante et qui sont les produits du territoire d'autres parties contractantes ne seront pas soumis, ***à*** *leur importation* sur le territoire auquel se rapporte cette liste et compte tenu des conditions ou clauses spéciales qui y sont stipulées, à des droits de douane proprement dits plus élevés que ceux de cette liste." (emphasis added).

7.161 We note that, unlike the two alternative applicable meanings of "on" in *English* we have identified above at paragraph 7.158, the dictionary *Le Grand Robert de la langue française*[352], gives only the preposition "***à***" ("on" in English) a *temporal* meaning as follows:

> "**À**
> TEMPS.
> - 1. Indiquant la situation ponctuelle dans le temps, le moment.
> [a] Avec un verbe ou un nom d'action. Arriver, venir, rentrer... à l'aube, au soir, à la nuit. Ils sont venus à l'époque, au moment, à l'instant où..., au moment dit, prévu, à l'heure dite.
> [b] Mod. Avec un nom d'action (ci-dessus) ou un repère temporel. à l'annonce de... à ces mots, à ce signal, telle chose se passa."

7.162 The Spanish text of the first sentence of Article II:1(b) reads:

> "Los productos enumerados en la primera parte de la lista relativa a una de las partes contratantes, que son productos de los territorios de otras partes contratantes, no estarán sujetos -***al ser importados*** en el territorio a que se refiera esta lista y teniendo en cuenta las condiciones o cláusulas especiales establecidas en ella- a derechos de aduana propiamente dichos que excedan de los fijados en la lista." (emphasis added).

7.163 Similarly to the French text, we also conclude that the expression "on their importation" ("***-al ser importados***") in the Spanish text of the first sentence of Article II:1(b) points us more in the direction of a *temporal* meaning than a *relational* one. In reaching such a conclusion we first note that the *Real Academia Española* states that the construction "**al**" (which is the contraction of the preposition "**a**" and the article "**el**") when followed by an *infinitive verb*, usually amounts to a "temporal subordinate clause".[353] We further note that in another publication, the *Real Academia Española* states that the combination of <*Al* + infinitive> "indicates simultaneity between the time of the subordinate event and the time of the main event, and amounts to *when* with a finite verb."[354] We

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[351] See the final clause of the WTO Agreement. See also the Panel Report on *EC – Trademarks and Geographical Indications (United States)*, para. 7.607.

[352] *Le Grand Robert de la langue française* (deuxième édition, 1985, page 3)

[353] See *Esbozo de una Nueva Gramática de la Lengua Española* (Real Academia Española, 3.16.5, page 487).

[354] Unofficial translation. *Gramática Descriptiva de la Lengua Española* (Real Academia Española, Vol. II, 48.5.3, page 3187). The original reads: ".... indica simultaneidad entre el tiempo del evento subordinado y el tiempo del evento principal y equivale a *cuando* con verbo finito." *Ibid*. See also the *Diccionario de uso del Español* (by María Moliner, 1987, Vol. I, page 107), according to which the construction "**al**" is widely used before a verb in the infinitive to express the "momentaneous simultaneity" of the action expressed by this term with another action.

are mindful, on the other hand, that there are also particular exceptions to such grammatical rules, in which the combination of <*Al* + infinitive> does not have a temporal connotation. For such cases, in order to verify the temporal value of the construction "**al** + infinitive", the *Real Academia Española* indicates that this can be confirmed by posing the question "when?"[355]

7.164 Applying the above grammatical rules to the present case, we first note that the Spanish text of the first sentence of Article II:1(b) contains the phrase "**al ser importados**" (*on their importation*). We further note that this phrase contains the construction "**al**" (resulting from the contraction of the preposition "**a**" and the article "**el**") together with the infinitive verb "**ser**" and followed by the participle "**importado**", which indicates a verbal action in the passive voice. We therefore believe that the use of the phrase "**al ser importados**" in the Spanish text of the first sentence of Article II:1(b) was meant to have a *temporal* ordinary meaning. The "temporal value" of this phrase is further confirmed by the fact that it is possible to answer the question *when?* In the present case, this question should be: *when* shall the products described in the first sentence of Article II:1(b) be *exempt* from ordinary customs duties in excess of those set forth in the Part I of the Schedule? To which the answer is: "on their importation" ("**al ser importados**").

7.165 Under Article 33(3) of the *Vienna Convention* "[t]he terms of the treaty are presumed to have the same meaning in each authentic text."[356] As a consequence, in interpreting these terms we should "seek the meaning that gives effect, simultaneously, to all the terms of the treaty, as they are used in each authentic language."[357] Following the guidance provided by the Appellate Body in *EC – Bed Linen (Article 21.5 – India)*[358], we note that our analysis above reveals that the only "simultaneous" ordinary meaning of "on" as used in each authentic language version of the first sentence of

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[355] See *Gramática Descriptiva de la Lengua Española* (Real Academia Española, Vol. II, 48.5.3, page 3187).

[356] Appellate Body Report on *US – Countervailing Duty Investigation on DRAMs*, footnote 176 to para. 111.

[357] Appellate Body Report on *US – Softwood Lumber IV*, para. 59. The Appellate Body also noted in footnote 50 to para. 59 that:

> "[I]n discussing the draft article that was later adopted as Article 33(3) of the *Vienna Convention*, the International Law Commission observed that the 'presumption [that the terms of a treaty are intended to have the same meaning in each authentic text] requires that every effort should be made to find a common meaning for the texts before preferring one to another' (*Yearbook of the International Law Commission* (1966), Vol. II, page 225). With regard to the application of customary rules of interpretation in respect of treaties authenticated in more than one language, see also International Court of Justice, Merits, *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)* 1989, ICJ Reports, para. 132, where, in interpreting a provision of the Treaty of Friendship, Commerce and Navigation between the United States of America and the Italian Republic of 1948, the International Court of Justice noted that it was possible to interpret the English and Italian versions 'as meaning much the same thing', despite a potential divergence in scope. "

[358] Referring to Article 33(3) of the *Vienna Convention*, the Appellate Body in *EC – Bed Linen (Article 21.5 – India)* found confirmation for the temporal meaning of the English terms being scrutinized: "The Spanish terms ('se han cumplido' and 'hayan limitado'), in paragraphs 1 and 4 of Articles 9, have the same temporal meaning as the English terms ('have been fulfilled' and 'have limited'). The French terms ('sont remplies' and 'auront limité') *can* also accommodate this temporal meaning." (emphasis added). (Appellate Body Report on *EC – Bed Linen (Article 21.5 – India)*, footnote 153 to para. 123).

Article II:1(b) of the GATT 1994 is a *strict temporal* meaning. We therefore conclude that this is the proper ordinary meaning of the word "on".[359]

7.166 With the above conclusion in mind, we consider that, taken together, the terms "on their [products] importation" and "into the territory" in the first sentence of Article II:1(b) suggest that "ordinary customs duties" are charges which the obligation to pay accrues based on the products as they enter the customs territory of another Member. In particular, the strict temporal element of the word "on", which points to the precise moment of the action it modifies, indicates that an "ordinary customs duty" must be assessed on the basis of a good at the moment of importation.

7.167 We proceed to the second sentence of Article II:1(b) of the GATT 1994 to examine whether it provides any further assistance in understanding the meaning of "ordinary customs duties".

> "Ordinary customs duties" in the context of the second sentence of Article II:1(b) – "on or in connection with the importation"
>
> *Arguments of the parties*

7.168 The **complainants** and **China** disagree on the issue of the relationship between the first and second sentences of Article II:1(b) of the GATT 1994 and the importance of such relationship to the interpretation of what types of charges qualify as ordinary customs duties.

7.169 The **complainants** argue that the expression "in connection with", only present in the second sentence, provides important context for the interpretation of "on importation" in the first sentence, for it demonstrates the narrowness of the notion of "on importation". It shows that an ordinary customs duty can only be imposed "on" the importation of a product and never "in connection with" such importation, for the latter concept is only limited to the imposition of "all other charges and duties." There is therefore a tighter nexus between "ordinary customs duties" and importation than between "all other duties and charges" and importation. For this reason, in contrast to charges imposed "on importation", those imposed "in connection with importation" can take into account events other than the importation as such. WTO jurisprudence on the meaning of the expression "on importation" in Article XI:1 of the GATT 1994 is not automatically transferable to this issue because the contexts of Articles XI:1 and II:1(b) are different. For example, unlike Article II:1(b), Article XI:1 does not make an express distinction between "on importation" on the one hand and "on or in connection with importation" on the other. Additionally, Article XI:1 is a broad and comprehensive provision that

[359] We also note that had our analysis on the ordinary meaning of "on" focused only on the *English* text of the first sentence of Article II:1(b) of the GATT 1994, we would have been presented with the task of choosing one of the two different meanings claimed by the complainants and China, as described above in paragraph 7.158. In such case we would have similarly proceeded with our inquiry into which of those two meanings would be attributable to the word "on" by analysing it in its proper context. This was the approach taken by the Appellate Body in *US – Gambling*, in which it found that the panel erred by not taking due regard to the fact that, at least in some contexts, the word being interpreted, "sporting", was indicated in dictionaries as meaning "gambling" and "betting". To the Appellate Body the Panel's finding on the meaning of that word was premature because it "should have taken note that, in the abstract, the range of possible meanings of the word 'sporting' includes both the meaning claimed by Antigua and the meaning claimed by the United States, and then continued its inquiry into which of those meanings was to be attributed to the word as used in the United States' GATS Schedule." (Appellate Body Report on *US – Gambling*, paras. 166-167). We understand that in that case the choice was between different meanings of the word "sporting" given by different *dictionaries*, not, as in the present case, between different meanings coming from the three authentic language versions of an *Agreement* (the GATT 1994). Regardless, we believe that the same general approach would have applied *mutatis mutandis* here had we been faced with two choices of meaning instead of one, as stated above.

speaks in terms of "restrictions ... on importation." If anything, such precedents and the difference in context between Articles II:1(b) and XI:1 confirm the narrowness of the concept of "on importation" in Article II:1(b). Finally, even if *arguendo* the question were instead to whether the charges were "other duties and charges" within the meaning of the second sentence of Article II:1(b), the Chinese measures would not pass muster as they do not even provide for charges imposed "in connection with the importation." And even if they did, and the second sentence of Article II:1(b) was applicable, the measures would violate such provision because the charges would not have been provided for in China's Schedule.[360]

7.170 **Canada** further elaborates on this issue saying that China is "misapplying the logic" of the relevant jurisprudence on Article XI:1 of the GATT 1994 to the context of Article II:1(b) of the GATT 1994.[361] Article XI:1 applies to the *whole* of the importation phase, and to direct and indirect import and export restrictions. Accordingly, it may be appropriate to read into "on importation" the phrase "in connection with" in the context of Article XI, since the latter phrase connotes both a general phase of importation and the application of direct and indirect measures to that importation phase. The distinction between the *specific act of importation* and the *general importation phase* is also seen in the different language used in the first and second sentences of Article II:1(b) (i.e., "on or in connection with" in Article II:1(b), second sentence, refers to the *general importation phase*). As the Appellate Body confirmed in *Chile – Price Band System*, ordinary customs duties are assessed under the first sentence only, and other duties and charges under the second sentence. "In connection with" is used because it encompasses *both* direct charges and other, indirect "duties and charges" that can be applied throughout the process of importation[362] that begins when a product first arrives at the border. It encompasses a greater (although still temporally limited) period during the "importation" stage, and during this period these other charges can be assessed.[363] Therefore, given the contextual differences between Article XI and Article II:1(b), the expressions "on their importation" and "on the importation" cannot be read as synonymous by virtue of containing the word "on".[364]

7.171 **China** disagrees with the complainants on the usefulness of comparing the language of the first and second sentences of Article II:1(b) in order to define their respective scopes. China explains that while there is considerable ambiguity in this terminology, the most likely explanation for the use of the different formulation in Article II:1(b), second sentence, is that the *types* of charges at issue ("other duties or charges") are more varied in nature than "ordinary customs duties," the subject matter of Article II:1(b), first sentence. An "ordinary customs duty" is an *ad valorem* or specific duty that a Member is allowed to impose by reason of the importation of the product. There is a single event that triggers the Member's right to impose the ordinary customs duty, and the importer's obligation to pay it – the importation of the product into the customs territory. This does not mean however that the ordinary customs duty must be collected at the *time or place* of importation. An "other duty or charge," by contrast, may have other, more specific events or conditions that trigger the right to impose the charge and the obligation to pay it. These events or conditions would be spelled out in the Member's Schedule of Concessions. Because these events or conditions are more varied,

[360] European Communities' responses to Panel question Nos. 97, 189, 197 and 203; European Communities' comments on China's response to Panel question No. 197; European Communities' second written submission, para. 41; United States' responses to Panel question Nos. 84, 97-98, 100 and 203; United States' comments to China's response to Panel question No. 246; Canada's response to Panel question No. 203 and Canada's comments on China's response to Panel question No. 197.

[361] Canada's comments on China's response to Panel question No. 203.

[362] Canada's response to Panel question No. 197.

[363] Canada's second written submission, paras. 27-29.

[364] Canada's comments on China's response to Panel question No. 203.

the drafters may have used the "in connection with" language in Article II:1(b), second sentence, to reflect this fact.[365]

7.172 After noting the similarity between the expressions "on their importation" in Article II:1(b) of the GATT 1994 and "on the importation" in Article XI:1 of the GATT 1994, China also argues that the jurisprudence on the delineation between Article III:4 and XI:1 is highly relevant to the present case for two reasons. First, because it underscores the importance of the threshold issue in this dispute concerning the classification of the challenged measures in relation to Article II or Article III by showing that the scope of Article XI must be interpreted in relation to the scope of Article III so as to maintain the distinction between these separate articles of the GATT 1994, and to avoid reducing either article to superfluity or inutility. Moreover, these provisions must be interpreted to maintain what the Appellate Body has referred to as "the distinction normally made in the GATT between restrictions affecting the importation of products (i.e. border measures) and restrictions affecting imported products (i.e. internal measures)." This same rationale is applicable to the delineation between Articles II and III, and disregarding it would have the effect of rendering *inutile* a Member's right to impose customs duties in accordance with its Schedule of Concessions. Secondly, this jurisprudence establishes the interpretation of the term "on." The Panel report on *India – Autos* found that "[a]n ordinary meaning of the term '*on*', relevant to a description of the relationship which should exist between the measure and the importation of the product, includes 'with respect to', 'in connection, association or activity with or with regard to.'" This supports China's interpretation of the term "on their importation" to encompass charges that a Member collects by reason of (or "with respect to," or "in connection, association or activity with") the importation of a product, without regard to the exact point in time or space at which the charge is collected."[366]

Consideration by the Panel

7.173 The **Panel** first recalls its provisional finding above at paragraph 7.166 that the terms "on their [products] importation" and "into the territory" in the first sentence of Article II:1(b) of the GATT 1994 suggest that an "ordinary customs duty" is a charge which the obligation to pay accrues based on the product as it enters the customs territory of another Member. We further recall our emphasis on the strict temporal element of the word "on" in that sentence, which indicates that an "ordinary customs duty" must be assessed on the basis of a good at the moment of importation.

7.174 The *second sentence* of Article II:1(b) provides:

> "Such products shall also be exempt 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." (emphasis added)

7.175 We note that Article II:1(b) of the GATT 1994 refers to two sets of charges: "ordinary customs duties", referred to in its *first sentence*, and "all other duties and charges of any kind", referred to in its *second sentence*. This indicates that although contained in the same sub-paragraph of the same article, these charges are governed differently. This has been confirmed by the Appellate Body, which stated that "[o]rdinary customs duties are governed by the *first* sentence of

[365] China's response to Panel question No. 97. See also China's responses to Panel question Nos. 96(a), 96(b), 100 and 197.

[366] China's response to Panel question No. 203.

Article II:1(b); they are not relevant to the *second* sentence."[367] Likewise, we consider that the use of the expression "on their importation" in the first sentence and of the expression "on or in connection with the importation" in the second sentence also suggests a difference in the scope of "ordinary customs duties" and "other duties or charges". Consequently, any interpretation giving these two expressions the *same meaning* would risk reducing the intention of the drafters of the GATT 1994 to regulate "ordinary customs duties" and "all other duties and charges of any kind" differently.

7.176 China points out, albeit in the context of Article XI:1 of the GATT 1994, that previous panels interpreted that the preposition "on" as contained in Article XI:1 meant "with respect to," or "in connection, association or activity with".[368] The complainants argue that the conclusion reached in previous panels on the ordinary, contextual and purposive meanings of the expression "on ... importation" in Article XI:1 of the GATT 1994 cannot be automatically transferred to the interpretation of "on their importation" and "on or in connection with the importation" in Article II:1(b) of the GATT 1994.

7.177 We share the complainants' view. Unlike Article II:1(b) of the GATT 1994 in which "ordinary customs duties" and "other duties or charges" are addressed in two separate sentences – first and second sentences of Article II:1(b), Article XI:1 provides Members' obligations in respect of the various quantitative restrictions in the same sentence.[369] This confirms the need to make the intended difference between "ordinary customs duties" and "other duties or charges" in Article II:1(b) meaningful. We find further useful context for our understanding in this regard in Articles I:1 and

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[367] Appellate Body Report on *Chile – Price Band System*, para. 156.

[368] We note that in *Dominican Republic – Import and Sale of Cigarettes*, the panel said that it was "not persuaded that the bond requirement is a restriction 'on the importation' of cigarettes. Article XI:1 of the GATT does not cover any restriction, but only those restrictions that are instituted or maintained by any Member 'on the importation' (or exportation) of products" (para. 7.258). Referring to *The New Shorter Oxford English Dictionary*, the panel continued stating that:

> "In the expression 'on the importation' – read in the context of an Article [Article XI] that is entitled 'General Elimination of Quantitative Restrictions' –, the ordinary meaning of the word 'on' suggests that it is a preposition denoting a relation. In that sense, the expression 'on the importation' would be akin to 'with respect to the importation'." (*Ibid*.; footnote omitted)

The panel in *Dominican Republic – Import and Sale of Cigarettes* then found confirmation to such conclusion in the following statement of the Panel Report on *India – Autos*:

> "An ordinary meaning of the term 'on', relevant to a description of the relationship which should exist between the measure and the importation of the product, includes 'with respect to', 'in connection, association or activity with or with regard to'. In the context of Article XI:1, the expression 'restriction … on importation' may thus be appropriately read as meaning a restriction 'with regard to' or 'in connection with' the importation of the product." (*Ibid*; footnotes omitted, citing the Panel Report on *India – Autos*, para. 7.257)

We note however that in *India – Autos* the panel only used the definition of "on" contained in the *Webster's New Encyclopedic Dictionary* (see footnote 421 to para. 7.257 of the Panel Report on *India – Autos*). We also note that the Panel in *EC – Sugar* (paras. 7.274-7.275) used the same approach in *India – Autos* to interpret the meaning of "on the export" in Article 9.1(c) of the *Agreement on Agriculture* and concluded that "a payment 'on export' need not be 'contingent' on export but rather should be 'in connection' with exports." (para. 7.275).

[369] That is to say: prohibitions or restrictions, other than duties, taxes or other charges, made effective through quotas, import or export licences or other measures.

VIII:1(a) of the GATT 1994. We first note that these provisions, which also deal with fiscal matters, use the expression "on *or* in connection with importation"[370], not "on importation" alone. This seems to indicate the intended broad scope of these provisions and hence the choice of a broader language.[371] Had the framers of the GATT considered the term "on importation" as synonymous with the term "in connection with importation", irrespective of the context in which these terms are laid out, they would have simply used one or the other not both. The same, we believe, holds true in regard to Article II:1(b) of the GATT 1994.

7.178 Indeed, the language of the first sentence of Article II:1(b) of the GATT 1994 clearly indicates that "ordinary customs duties", within the meaning of that provision, apply *only* "on" the importation of a product, while "other duties and charges" are referred as those imposed "on or in connection with the importation." In the present context, interpreting "on" as also meaning "in connection with" (or any similar meaning) would eviscerate such difference. We are however bound by the general rules of interpretation of the *Vienna Convention* to "give meaning and effect to all terms of the treaty" and we therefore are not "free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[372] Hence, this contextual analysis confirms our conclusion above at paragraph 7.165 that the ordinary meaning of "on" in the first sentence of Article II:1(b) of the GATT 1994 contains a *strict temporal* connotation.[373]

Subsequent practice

7.179 **China** argues that there is widespread and consistent practice among WTO Members that demonstrates that a charge is "on … importation" of a product if the charge bears an objective relationship to the administration and enforcement of a valid customs liability.[374]

7.180 In this respect, China refers to the practice of the United States, indicating that customs authorities are not required to make a final classification determination and assessment of duty liability until one year after the merchandise has entered the customs territory of the United States. Furthermore, China describes practices of other WTO Members that have customs procedures that result in the collection of customs duties after the time of importation. China refers in particular to Australia, Canada, the European Communities, India and New Zealand.[375] Additionally, China points to many specialized circumstances in other Members in which duties can be assessed after the time or point of importation, including:

> "[t]he payment of duties on imports that enter in transit but that subsequently enter free circulation, the payment of duties on imports that fail to adhere to conditions for temporary duty-free importation, and the payment of duties on imports that fail to

[370] We also note that Article VIII:4 uses the expression "in connection with" alone, but this provision is a corollary of Article VIII:1(a).

[371] For example, Article I:1 of the GATT 1994 applies to "customs duties and charges *of any kind*" to "*all* rules and formalities" as well as "*all* matters referred to in paragraphs 2 and 4 of Article III". Article VIII:1(a) applies to "*all* fees and charges *of whatever character* (other than import and export duties and other taxes within the purview of Article III)."

[372] Appellate Body Report on *US – Gasoline*, DSR 1996:I, page 21. See also the Appellate Body Reports on: *Japan – Alcoholic Beverages II*, DSR 1997:I, page 106; *Canada – Dairy*, para. 133; and *US – Upland Cotton*, para. 549.

[373] Our conclusion would have been the same even if we were instead faced with the task of choosing which of the two alternative ordinary meanings of "on" we have identified above at paragraph 7.158 would give effect to this term as used in the context of Article II:1(b), first sentence, of the GATT 1994.

[374] China's first written submission, paras. 63-67.

[375] China's first written submission, para. 65.

> adhere to inward processing and re-export requirements. These are examples of goods that enter the customs territory subject to a condition, often secured by a bond, and that can become subject to a different customs treatment after "the time or point of importation" if the imported goods are not used in accordance with the stipulated condition."[376]

7.181 The **complainants**, on the other hand, disagree that there exists subsequent practice in support of China's interpretation of Article II:1(b), first sentence, of the GATT 1994. The **European Communities** argues that China's examples are based on the rules in force concerning the post-clearance recovery of the customs debt that have nothing to do with the ordinary tariff classification carried out at the border at the time of importation. In other words, the imposition and collection of customs duties is always made on the basis of the *status of goods at the time of importation* or in other words *as presented at the border*.[377] The **United States** disagrees with China's characterization of US practice because the imposition of customs duties in the United States occurs at the time of importation of goods that are entered into the United States. Duties and liability for their payment accrue upon imported merchandise on arrival of the importing vessel or other means of transport in the United States. Additional duty liability does not accrue based upon the usage of the goods after entering the United States.[378] Moreover, with respect to the other examples provided by China[379], the United States indicates these Members permit a final determination of duty liability after the goods have been imported[380], which is, however, fundamentally different from China's measure, which changes the level of a charge based on the local content thresholds of an internal manufacturing operation.[381] **Canada** also replies on the specific examples[382] provided by China and indicates that all of the cited customs authorities follow the practice of examining goods based upon their status at presentation at the border. Although the duty may be calculated and paid later, liability for customs duties is based on this assessment.[383]

7.182 **The Panel** starts by recalling that the Appellate Body has found that to establish "subsequent practice" within Article 31(3)(b) of the *Vienna Convention*, the following two elements must be shown: (i) there must be a common, consistent, discernible pattern of acts or pronouncements; and (ii) those acts or pronouncements must imply agreement among WTO Members.[384] Applying this standard, the Panel fails to observe subsequent practice establishing the agreement of the parties regarding China's interpretation of Article II:1(b), first sentence, of the GATT 1994. The practices of other Members described by China are not similar to the Chinese measure and do not support China's

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[376] China's first written submission, para. 66.

[377] The European Communities understands that the same applies for the customs systems of the United States and Canada. Moreover, the European Communities indicates that, even if there was, in the legal system of an individual WTO Member, a practice of classifying goods based on events after importation, such practice would not be "widespread and consistent" and would certainly not fulfil the test of Article 31(3)(b) of the *Vienna Convention*. European Communities' response to Panel question No. 32.

[378] The United States also indicates that the one-year time frame within which the United States will verify the accuracy of the amount of the estimated duties is not a time frame within which the United States may impose additional customs duties, unless such duties are based upon the condition of the goods at the time of their importation. United States' response to Panel question No. 32

[379] In particular, those from Australia, India and the European Communities.

[380] Such as retaining the right to verify the accuracy of origin, classification, valuation, and other facts that may affect the dutiability of goods.

[381] United States' response to Panel question No. 32

[382] Relating to Canada's own practice as well as to the practice in Australia, New Zealand, India and the European Communities.

[383] Canada's response to Panel question No. 32

[384] Appellate Body Report on *US – Gambling*, para. 192.

interpretation of Article II:1(b), first sentence, of the GATT 1994. We have reviewed the examples of customs practices from the complainants and other Members submitted by China on this issue and consider, as the United States and Canada correctly argue[385], that these practices, in fact, reinforce the evidence that WTO Members impose ordinary customs duties based on the state of the products as they are presented at the border and that they routinely *collect or assess* these duties after the products have entered the customs territory of the importing country. This supports our conclusion above that the ordinary meaning of "on their importation" in the first sentence of Article II:1(b) of the GATT 1994 indicates a *strict temporal element*.

7.183 With respect to the "specialized circumstances" mentioned by China, these typically apply to goods that have *not* entered and are not intended to enter the internal market of a Member. Duties are applied if the goods eventually enter into the internal market of the Member in question, not if the goods are not "used" in accordance with a stipulated condition. Typically in these situations products are not re-classified and new tariff rates do not apply based on anything that occurs inside the territory of the importing Member. The words China itself uses to describe these circumstances are prescient: China refers to goods "in transit"; goods imported on a "temporary" basis; and goods imported for "processing and re-export". None of these concepts imply that the goods are intended for sale or use in the internal market. In our opinion, the circumstances described by China are therefore not analogous to the charge under the Chinese measures. This is even supported by Article 30 of the Decree 125[386], which, in contrast with the rest of this measure and similarly to the "specialized circumstances" cited by China, indicates that Decree 125 does *not* apply to auto manufacturers located in a bonded zone, in an export-processing zone, or in other special zones supervised by the customs, *unless* they use imported auto parts to assemble motor vehicles that are sold into the domestic market.

Conclusion

7.184 We therefore conclude that the ordinary meaning of "on their importation" in Article II:1(b), first sentence, of the GATT 1994, considered in its context and in light of the object and purpose of the GATT 1994, contains a *strict and precise temporal element* which cannot be ignored. This means that the obligation to pay ordinary customs duties is linked to the product at the moment it enters the territory of another Member.[387] If the right to impose ordinary customs duties – and the importer's obligation to pay it – accrues because of the importation of the product at the very moment it enters the territory of another Member, ordinary customs duties should necessarily be related to the status of the product at that single moment.[388] It is at this moment, and this moment only, that the obligation to pay such charge accrues. As stated by the Appellate Body in *EC – Poultry*, "it is *upon entry* of a product into the customs territory, but *before* the product enters the domestic market, that the obligation to pay customs duties ... accrues."[389] And it is based on the condition of the good at this

[385] Canada's responses to Panel question Nos. 32, 116; United States' response to Panel question No. 32.

[386] See footnote 213 to paragraph 7.40 above.

[387] As China acknowledges, "there is a single event that triggers the Member's right to impose the ordinary customs duty, and the importer's obligation to pay it – the importation of the product into the customs territory." (China's response to Panel question No. 97).

[388] In this regard, we recall our finding above at paragraph 7.155 that the dictionary definitions of "importation" refer to it as *an* "action" or *an* "act" in the singular and not to *various* "actions" or "acts" in the plural.

[389] Appellate Body Report on *EC – Poultry*, para. 145 (emphasis added). We note that in this sentence the Appellate Body also included "internal charges." Without evaluating the merits of including "internal charges" within the meaning of this sentence, we consider that such inclusion does not diminish the importance that we attach to this statement as applied to "customs duties".

moment that any contemporaneous or subsequent act by the importing country to enforce, assess or reassess, impose or collect ordinary custom duties should be carried out.

7.185 This conclusion is in line with our findings above in paragraphs 7.126 to 7.133 on the scope of "internal tax or charge" under Article III:2 of the GATT 1994. In contrast to ordinary customs duties, the obligation to pay internal charges does not accrue because of the importation of the product at the very moment it enters the territory of another Member but because of internal factors (e.g., because the product was re-sold internally or because the product was used internally), which occurs once the product has been *imported* into the territory of another Member. The status of the *imported* good, which does not necessarily correspond to its status at the moment of *importation*, seems to be the relevant basis to assess this internal charge. The distinction between ordinary customs duties and internal charges, which is of "fundamental importance"[390], would be blurred if the obligation to pay an ordinary customs duty could accrue based on the status of the product *after* importation, rather than on its status at the moment of *importation* (i.e., "on ... importation").[391]

7.186 In this respect, this interpretation serves to guarantee the "security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade", which is a recognized object and purpose of the WTO Agreement.[392] Indeed, such predictability and security of tariff concessions would be undermined if ordinary customs duties were not based on the product at the time of importation but on factors that occur internally.

7.187 In addition, we find support for our view in the Appellate Body's holding in *EC – Chicken Cuts* 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".[393] We are well aware that this statement relates to the issue of classification, not the scope of "ordinary customs duty" *per se*. However, we consider that the same statement provides some contextual support to the question before us. The complainants referred to this statement of the Appellate Body in the context of the discussion of whether the charge falls within the meaning of Article II or III of the GATT[394] and China itself emphasized the link between tariff classification and this discussion.[395]

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[390] See the GATT Panel Report on *EEC – Parts and Components*, paras. 5.4 and 5.7.

[391] For this reason we disagree with China's arguments that it is "the completion of the [process of importation] that marks the turning point between permissible discrimination under Article II and impermissible discrimination under Article III", and that "imports have been 'cleared through customs' once all customs formalities are complete and the goods are in free circulation within the customs territory." (China's response to Panel question No. 37). In our analysis above we did not find any basis in Article II:1(b), first sentence, nor in Article III:2 of the GATT 1994 to support the argument that it is the completion of the process of importation that marks such turning point. In fact, China's argument seems to be in contradiction with its own explanation that the charge collected pursuant to Article 29 of Decree 125 on parts imported by third-party suppliers, which it considers to be in free circulation in China, free of customs formalities and not subject to customs control, nevertheless falls within the scope of II:1(b), first sentence, of the GATT 1994 in that it objectively relates to the proper classification of the imported parts and components. See paragraph 7.114 above.

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

[393] Appellate Body Report on *EC – Chicken Cuts*, para. 246.

[394] European Communities' response to Panel question No. 186; Canada's response to Panel question No. 187; United States' response to Panel question No. 186.

[395] See, for example, China's response to Panel question No. 37: "This brings China to the tariff classification issue at the heart of the present dispute" and "[t]he critical issue in relation to China's obligations under Article II and its Schedule of Concessions is whether China is allowed to interpret the term 'motor vehicles' in this way, and to establish a customs process to give effect to this interpretation."

7.188 This does not mean, however, that we accept China's argument that the HS, including its interpretative rules, justify the imposition of the alleged "ordinary customs duties" on auto parts on the basis of their final internal assembly into motor vehicles. In our view, China has not explained why the interpretative rules of another international agreement – the HS – are the determining factor for the scope of the treaty term at issue under the WTO Agreements. More importantly, even if we were to base our ruling in the present section of these Reports on the alleged rights under the HS, which we are not, we would be guided by our duty not to "add to or diminish the rights and obligations provided in the covered agreements."[396]

7.189 We find support and confirmation in the findings of the GATT Panel *EEC – Parts and Components*, which rejected the argument by the EEC that the anti-circumvention duties at issue were customs duties within the scope of Article II:1(b) and not internal taxes or charges falling under Article III:2. The GATT Panel stated:

> "The Panel noted that the anti-circumvention duties are levied, according to Article 13:10(a), 'on products that are introduced into the commerce of the Community after having been assembled or produced in the Community'. The duties are thus imposed, as the EEC explained before the Panel, not on imported parts or materials but on the finished products assembled or produced in the EEC. They are not imposed conditional upon the importation of a product or at the time or point of importation. ... *The relevant fact*, according to the text of these provisions, 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."[397] (emphasis added)

7.190 We also agree with the Panel in *EEC – Parts and Components* that the mere fact that a charge is *described under domestic law* as an "ordinary customs duty", or that the good is considered by the importing country as not being in *free circulation* (and consequently under *customs control*), or even the *policy purpose of the charge*, are all not decisive factors to its characterization as a "border charge" under Article II:1(b) of the GATT 1994 because otherwise Members could determine by themselves which of the provisions would apply to their charges. We also consider, for the same reason, that the fact that a charge is administered by a *customs authority* is not determinative of its nature.[398]

7.191 Furthermore, China submits that for a charge to be considered an ordinary customs duty under Article II:1(b), first sentence, of the GATT 1994 it does not need to be necessarily *imposed, collected or assessed* at the border nor at the time goods cross the border into the territory of the importing country. We see no controversy on this point among the parties to this dispute. Indeed, as the

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[396] Article 3.2 of the DSU. Further, even if we were to consider China's arguments based on the classification rules under the HS, as elaborated under part VII.D.2 of these reports, the tariff term "motor vehicles" is not to be interpreted to include auto parts imported in multiple shipments. China's arguments in this connection therefore would not change our interpretation, based on the principles of the *Vienna Convention*, of the scope of the first sentence of Article II:1(b) of the GATT 1994. In fact, we note that our finding here on the meaning of "on their importation" in the first sentence of Article II:1(b) of the GATT 1994 and our finding in Section VII.D.2(a)(ii) on the meaning of "as presented" in GIR 2(a) seem not to be in contradiction with each other.

[397] GATT Panel Report on *EEC – Parts and Components*, para. 5.5.

[398] See GATT Panel Report on *EEC – Parts and Components*, paras. 5.6-5.7. See also the Panel Report on *US – 1916 (Japan)*, paras. 6.53 (and its footnote 464), 6.58 (and its footnote 461), 6.134 (and its footnote 504) and 6.152(a) (and its footnote 518).

complainants themselves agree, albeit in varying degrees,[399] we note that in practice, WTO Members' customs authorities routinely *collect or assess* customs duties after the goods have physically crossed the border. We are mindful that customs practice in general, and importation in particular, can frequently be a complex process "during which a number of steps must be completed."[400] The increasing sheer volume of goods that cross the borders of WTO Member countries every day undoubtedly adds to such complexity. This reality, as the complainants themselves recognize, can make it in certain cases very difficult for a customs authority to execute and finalize all customs acts, including the final assessment, calculation and collection of customs duties at the very time and point when and where the goods cross the border into the territory of a WTO Member.[401] However, we do not agree with the proposition that these typical customs practices mean that goods cannot be considered "imported", and therefore are outside the protection of the national treatment obligation in Article III:2 of the GATT 1994, simply because there has been a delay in the final assessment, calculation and/or collection of customs duties. In our view, what is decisive for determining whether a charge is an ordinary customs duty is whether the charge is imposed on products "on their importation into the territory", as we have established above at paragraphs 7.184 and 7.185.

7.192 In sum, based on its ordinary meaning and its context, we conclude that "ordinary customs duties" within the meaning of the first sentence of Article II:1(b) refer to duties imposed on goods at the moment of their "importation" into the customs territory of an importing Member and must be interpreted more narrowly than "other charges and duties" under the second sentence of Article II:1(b), which are imposed on goods "on or in connection with importation".

7.193 We will now examine the terms "internal charges" and "ordinary customs duties" in the light of the object and purpose of the WTO Agreement as well as the GATT 1994, in general and that of Articles II and III of the GATT 1994, in particular.

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[399] European Communities' first written submission, para. 139; European Communities' first oral statement, paras. 25-26; United States' response to Panel question No. 87; Canada's response to Panel question No. 87.

[400] Panel Report on *Turkey – Rice*, para. 7.127. Additionally, "UNCTAD estimates that the average customs transaction involves 20–30 different parties, 40 documents, 200 data elements (30 of which are repeated at least 30 times) and the re-keying of 60–70% of all data at least once." (http://www.wto.org/english/thewto_e/minist_e/min99_e/english/about_e/15facil_e.htm).

[401] Finalizing customs acts in a single moment is not necessarily an issue restricted to the question presented to us under Article II:1(b) of the GATT 1994. We note that other covered agreements seem to recognize that finalization of certain customs acts is not necessarily contemporaneous with the reason that triggered that act. For example, the Agreement on Implementation of Article VII of the GATT 1994 (*Customs Valuation Agreement*), refers to possible necessary delays in the "final determination" of the customs value of imported goods (Article 13) or the right of customs administrations "to satisfy themselves as to the truth or accuracy of any statement, document or declaration presented for customs valuation purposes" (Article 17). Likewise, the SCM Agreement refers to the obligation to "maintain judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review of administrative actions relating to final determinations and reviews of determinations" on countervailing duties (Article 23). Finally, the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (*Anti-Dumping Agreement*), states *inter alia* that the determination of the final liability for payment of anti-dumping duties, when they are assessed on a retrospective basis, shall take place as soon as possible, normally within 12 months, and in no case more than 18 months, after the date on which a request for a final assessment of the amount of the anti-dumping duty has been made (Article 9.3.1).

Object and purpose of the WTO Agreement and the GATT 1994

Arguments of the parties

7.194 The **complainants** express systemic concerns that if the processing and manufacturing of products after importation into the territory of a Member could be generally accepted as an intermediate step before tariff classification, the GATT 1994's core national treatment obligations under Article III would be rendered a nullity.[402]

7.195 The **United States** further argues that 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.[403]

7.196 **Canada** submits that by using (selectively and out of context) Members' conducts and the HS to classify products inappropriately, China would see the scope of the GATT 1994's national treatment provisions systematically reduced.[404] The Appellate Body has clearly said that the broad purpose of Article III is to avoid protectionism in the application of internal taxes and regulatory measures. 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.

7.197 **China** argues that customs authorities are permitted under Article II of the GATT 1994 to deal with the complex relationship between complete articles and parts of those articles in a manner that is consistent with the HS, and in a manner that allows customs authorities to give effect to the substance of a series of import transactions over their form.[405] In China's view, the only loophole that needs closing is the complainants' position that importers can evade higher duties that apply to complete articles merely through the manner in which they structure their imports. This arbitrary, form-over-substance position is the only argument in this proceeding that poses a systemic risk to the GATT – that is, to the security and predictability of tariff concessions under Article II. The concerns of Article II and the concerns of Article III are of equal dignity and importance within the GATT system. Just as Article II does not allow Members to take actions that would be inconsistent with its obligations under Article III, Article III does not prohibit Members from taking actions that are consistent with its rights under Article II.[406] Article II countenances a particular type of discrimination against imported products – the application of ordinary customs duties to which domestic products are not subject. Members may apply such duties to products from other Members "on their importation" into the customs territory, and in accordance with the limits bound in their Schedules of Concessions. Once the products are "imported" however, they become subject to the basic principles of non-discrimination set forth in Article III.[407]

[402] See. e.g., the European Communities' first written submission, para. 140; responses to Panel question Nos. 78 and 109.
[403] United States' first written submission, para. 3.
[404] Canada's second written submission, para. 6.
[405] China's response to Panel question No. 38.
[406] China's response to Panel question No. 37.
[407] China's response to Panel question No. 37.

Consideration by the Panel

7.198 The **Panel** now examines the terms "internal charges" and "ordinary customs duties" in light of the object and purpose of the WTO Agreement and the GATT 1994 in general.[408] As the Appellate Body in *EC – Chicken Cuts* observed, one of the objects and purpose of the GATT 1994 and the WTO Agreement in general is "the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade."[409] We also recall the Appellate Body's finding that Article 31(1) of the *Vienna Convention* does not necessarily exclude taking into account the object and purpose of a particular treaty term, if doing so assists the interpreter in determining the treaty's object and purpose on the whole.[410]

7.199 In addressing the issue before us, namely what are the elements that distinguish "internal charges" under Article III:2 from "ordinary customs duties" under Article II:1(b), we also find useful the following statement by the GATT Panel in *EEC – Parts and Components*:

> "The distinction between import duties and internal charges is of fundamental importance because the General Agreement regulates ordinary customs duties, other import charges and internal taxes differently: the imposition of 'ordinary customs duties' for the purpose of protection is allowed unless they exceed tariff bindings; all other duties or charges of any kind imposed on or in connection with importation are in principle prohibited in respect of bound items (Article II:1(b)). By contrast, internal taxes that discriminate against imported products are prohibited, whether or not the items concerned are bound (Article III:2)."[411]

7.200 That GATT Panel concluded that one of the basic objectives underlying Articles II and III was that "discrimination against products from other contracting parties should only take the form of ordinary customs duties ... and not the form of internal taxes ... ."[412] We agree with the GATT Panel in *EEC – Parts and Components*.

7.201 As the Appellate Body clarified, a basic object and purpose of the GATT 1994, as reflected in Article II of the GATT, is "to preserve the value of tariff concessions negotiated by a Member with its trading partners and bound in that Member's Schedule".[413] At the same time, the broad purpose of Article III is "to avoid protectionism in the application of internal tax and regulatory measures".[414] While serving their own objects and purposes, these two provisions are also interrelated such that the disciplines contained in these two provisions aim to ensure "the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and

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[408] Appellate Body Report on *EC – Chicken Cuts*, para. 238.
[409] Appellate Body Report on *EC – Chicken Cuts*, para. 243.
[410] Appellate Body Report on *EC – Chicken Cuts*, para. 238.
[411] GATT Panel Report on *EEC – Parts and Components*, paras. 5.4 and 5.7.
[412] GATT Panel Report on *EEC – Parts and Components*, para. 5.7.
[413] Appellate Body Report on *Argentina – Textiles and Apparel*, para. 47.
[414] Appellate Body Report on *Japan – Alcoholic Beverages II*, DSR 1996:I, pages 16-17; 109-110 (original footnotes omitted). See also Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 204. The GATT Panel in *Italy – Agricultural Machinery* also provides insight in the object and purpose of Article III, stating that "... the intention of the drafters of the Agreement was clearly 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." GATT Panel Report on *Italy – Agricultural Machinery*, para. 11).

other barriers to trade."[415] To achieve this overall object and purpose of the WTO Agreement, Members are obliged to respect the boundaries between Article III and Article II of the GATT 1994.

7.202 Therefore, the Panel will be guided by this objective in applying the elements we considered above as distinguishing "ordinary customs duties" from "internal charge" to the charge under the measures to determine whether it is an "internal charge" or "ordinary customs duty".

> Is the charge under the measures an "ordinary customs duty" within the scope of Article II:1(b), first sentence, or an "internal charge" within the meaning of Article III:2?

7.203 The **Panel** recalls the complainants' argument that the charge on imported auto parts resulting from the measures is an internal charge subject to the first sentence of Article III:2 of the GATT 1994 because it is triggered by the actual use of these parts in the assembling of motor vehicles inside China after importation. We further recall China's response that this charge is instead an ordinary customs duty because it is imposed as a condition of – that is, by reason of – the importation of a product (auto part) into China's customs territory and that this charge objectively relates to a duty liability that arises by reason of the importation of the product. China argues that the charge is a valid ordinary customs duty because it implements and enforces China's Schedule of Concessions by giving effect to the provisions of China's Schedule relating to "motor vehicles."

7.204 We have established above, however, if the obligation to pay a charge does not accrue based on the product at the moment of its importation, it cannot be an "ordinary customs duty" within the meaning of Article II:1(b), first sentence of the GATT 1994: it is, instead, an "internal charge" under Article III:2 of the GATT 1994, which obligation to pay accrues based on internal factors.

7.205 Under the measures, the obligation to pay the charge[416] accrues internally after auto parts enter into the customs territory of China and are assembled/produced into motor vehicles. In this connection, Article 5 of Decree 125 provides:

> "Article 5 The reference to 'automobile parts characterized as complete vehicles' in these Rules shall mean that the imported automobile parts should be characterized as complete vehicles *at the stage when complete vehicles are assembled*. The reference to 'automobile parts characterized as assemblies (systems)' shall mean that the imported automobile parts should be characterized as assemblies (systems) at the stage when the assemblies (systems) are assembled" (emphasis added).

7.206 Furthermore, Article 28 of Decree 125 states that "*after* the imported automobile parts have been assembled into complete vehicles, the automobile manufacturer shall make a declaration of duty payable to Customs and Customs shall ... proceed with classification and duty collection."[417]

7.207 Also relevant to the question before us are (i) the fact that the charge is imposed on automobile manufacturers, not importers in general (be it manufacturers or suppliers); (ii) the fact that the charge is determined not based on auto parts as they enter the customs territory of China, but

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

[416] The charge under the measures refer to both that imposed under Article 29 of Decree 125 and that imposed in general under the measures. As we concluded at paragraph 7.115 above, these charges are no different from each other.

[417] Emphasis added. See paragraph 2.4 in the Descriptive Part of these reports for background information on the translation of Article 28 of Decree 125. See also, more generally on Article 28, parties' responses to Panel question No. 304.

instead based on what other parts from other countries and/or other importers are used together with the goods concerned in assembling a vehicle model; and (iii) the fact that identical imported parts included in the same shipment can be subject to different charge rates depending on which vehicle model they are assembled into.[418]

7.208 Furthermore, we recall China's own explanation of the charge imposed under Article 29 of Decree 125 in respect of parts imported by a third-party supplier, which is, as we have concluded above at paragraph 7.115, not different from the charge imposed in general under the measures. As we have stated above at paragraph 7.108, China has explained that imported auto parts that the auto manufacturer purchases from a third-party supplier in China will have completed the necessary customs formalities and are no longer subject to customs control and are in free circulation in China. China also explained that the rules for bonded goods do not apply to auto parts imported by a third-party supplier. We recall our conclusion above at paragraph 7.190 that factors such as "customs control" and "free circulation" are not decisive to the characterization of a charge as ordinary customs duty.[419] We note that China submits that an Article 29 charge is nevertheless an ordinary customs duty because it "objectively relates to the administration and enforcement of China's tariff provisions for motor vehicles."[420] However, we have already established above that this is not the correct standard to determine whether a charge falls under Article II:1(b), first sentence, of the GATT 1994. As we have stated above at paragraph 7.108, the charge under Article 29 is subject to the same set of rules as charges in general under the measures in the sense that the applicability of the Article 29 charge is determined based on the same criteria for the essential character determination as set out in Articles 21 and 22 of Decree 125.

7.209 Finally, we do not believe that our conclusion on the internal elements of the charge is affected by the fact that, under the measures, auto manufacturers are required to make a declaration at the moment imported auto parts enter China.[421] This is because such declaration is not based on the status of these parts at that moment but, instead, on their *predicted* use internally in the assembly of motor vehicles.[422] Moreover, the information in the declaration is not decisive to the determination of the rate of the charge because such determination is only made, as explained above, internally after assembly.[423] In this respect, China itself acknowledges that this declaration as well as the bonding requirement are simply elements of the customs procedure and are not decisive on the question whether this is an internal charge or an ordinary customs duty.[424] With respect to the bonding

[418] See paragraph 7.117 above for the United States' arguments in this regard.

[419] However, even if *arguendo* these factors would be relevant to render the charge in general under the measures as an ordinary customs duty, using China's own logic, such factors would not be present in the case of the charge under Article 29 of Decree 125.

[420] China's response to Panel question No. 83.

[421] Article 13 Decree 125. See paragraph 7.53.

[422] A *prediction* is made through the self-evaluation and vehicle model registration procedures, as examined above in Section VII.A.1(b)(ii). China seems to agree that indeed such a declaration is made on the basis of the intention of the manufacturer at the moment of importation (See China's first written submission, para. 7). See also the European Communities' first oral submission, para. 28; European Communities' second written submission, para. 52; the United States' second oral statement, para. 18; and Canada's second written submission, paras. 33-36. See also Japan's third party oral statement, para. 14.

[423] See China's response to Panel question No. 5, footnote 2.

[424] China's response to Panel question No. 79. However, the Panel observes that in other statements, China seems to attach considerable relevance to the declaration at the moment of importation to support its argumentation on the nature of the measures. For example, China argues that it "will demonstrate that, contrary to complainants' assertions, the challenged measures impose ordinary customs duties that are conditioned upon the entry of goods into China. *The measures give effect to a declaration that is made at the time of importation*, based on the demonstrated intention of the auto manufacturer to import and assemble parts and components that

requirement on auto parts characterized as complete vehicles, China indicates that these are required to ensure that the auto manufacturer abides by all relevant customs rules and can satisfy the customs liability and that these auto parts remain under customs control.[425] However, the Panel observes that there is no restriction on the use in the internal market of these auto parts in bonded status[426] and the bond requirement thus seems, as indicated by the complainants, merely a financial guarantee.[427] In contrast, as the European Communities and Canada correctly argue[428], the auto parts which can effectively be considered under customs supervision are those described under the situations elaborated in Article 30 of Decree 125 (e.g. in a bonded zone and export processing zones), which are exempt from the measure *unless* they are eventually entered into the internal market of China.[429]

7.210 In sum, based on the above elements considered as a whole, in particular the fact that the charge under the measures relates to the internal assembly of auto parts into motor vehicles, we conclude that the charge is an internal charge within the meaning of Article III:2 of the GATT 1994.

7.211 Moreover, as mentioned above, the "security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade ", which is a recognized object and purpose of the WTO Agreement,[430] would be undermined if a charge were to be considered as an ordinary customs duty even when the obligation to pay the charge accrues after goods have already entered into the customs territory of China and been assembled into complete goods of the corresponding kind. We therefore share the systemic concerns expressed by the complainants that if the assembly of the products after their importation into the customs territory of a Member could provide a basis for tariff classification, the tariff classification system would undermine the national treatment obligation under Article III of the GATT 1994, which is one of the core principles of the WTO Agreements. Such an interpretation would blur the fundamental distinction between measures falling within the scope of Article III:2 and those falling within the scope of Article II:1(b), first sentence, of the GATT 1994.

(iii) Conclusion

7.212 We therefore find that the complainants have satisfactorily demonstrated that the *charge* under the measures[431] is an *internal charge* under Article III:2 of the GATT 1994.

7.213 We now turn to the complainants' specific claims that the charge is inconsistent with Article III:2 of the GATT 1994. In this respect, we recall our statement above at paragraph 7.104 that the Appellate Body in *Canada – Periodicals* clarified that the analysis of whether a measure is inconsistent with this provision of the GATT 1994 involves a two-step test: first, whether imported and domestic products are *like products* and, second, whether the imported products are *taxed in*

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have the essential character of a complete motor vehicle." (China's first written submission, para. 7, emphasis added).

[425] China's response to Panel question No. 18.

[426] See China's second written submission, para. 116: "... Decree 125 permits *the release of* auto parts..." (emphasis added).

[427] European Communities' response to Panel question No. 201; United States' response to Panel question No. 201; Canada's second written submission, para. 38; Canada's response to Panel question No. 201.

[428] European Communities' response to Panel question No. 201; Canada's second written submission, para. 38; Canada's response to Panel question No. 201. See also China's response to Panel question No. 16.

[429] See China's response to Panel question No. 16. See also the last sentence of paragraph 7.183 above.

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

[431] With exception of the charge levied on the importation of CKD and SKD kits under the optional provision of Article 2(2) of Decree 125. See paragraphs 7.101 and 7.636-7.638.

excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence, of the GATT 1994.[432] We will now analyse these two questions.

(c) Are imported auto parts like domestic auto parts?

(i) Arguments of the parties

7.214 The **complainants**[433] argue that, where a WTO Member draws an origin-based distinction in respect of internal charges, the imported and domestic products must be like products and a case-by-case determination of "likeness" between the foreign and domestic products is unnecessary.[434] As the measures do not distinguish between auto parts based on any other criteria than their origin, it therefore follows that all imported and domestic parts are like products.[435]

7.215 **China**'s only response is that as the charge under the measures is an ordinary customs duty under Article II:1(b) of the GATT 1994, this claim should fail as Article III:2 of the GATT 1994 is inapplicable.

(ii) Consideration by the Panel

7.216 We recall our conclusion above in the section of these reports dealing with the description of the measures that the products at issue in this case are *all imported auto parts* that are potentially subject to the measure.[436] Hence, as under the measures *origin* is the sole criterion distinguishing the imported and domestic parts, it is correct to treat such products as like products within the meaning of Article III:2 of the GATT 1994.[437] Similarly to the panel in *US – FSC (Article 21.5 – EC II)*, "we do not believe that the mere fact that a good has [Chinese] origin renders it 'unlike' an imported good."[438]

7.217 The Panel therefore concludes that the complainants have satisfactorily met their burden of proof[439] that auto parts of domestic and foreign origin are like products within the meaning of Article III:2 of GATT 1994.

(d) Are imported auto parts subject to internal taxes and charges in excess of those applied to domestic products?

(i) Arguments of the parties

7.218 The **complainants**[440] claim that under the measures imported auto parts are taxed in excess of those applied to domestic auto parts because imported auto parts, if they are assembled into vehicles and characterized as complete vehicles, are subject to an internal charge that like domestic products

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[432] Appellate Body Report on *Canada – Periodicals*, DSR 1997:I, page 468.

[433] Supported by Argentina (see Argentina's third party submission, para. 42).

[434] European Communities' first written submission, paras. 164-165; United States' first written submission, para. 85; Canada's first written submission, para. 90.

[435] European Communities' first written submission, para. 166; Canada's first written submission, paras. 90-91. See also Argentina's third party submission, para. 43.

[436] See paragraph 7.86 above.

[437] Panel Report on *Canada – Autos*, para. 10.74; Panel Report on *India – Autos*, paras. 7.174-7.176.

[438] Panel Report on *US – FSC (Article 21.5 – EC II)*, para. 8.133.

[439] In *Japan – Alcoholic Beverages II*, in a finding subsequently not addressed by the Appellate Body, the Panel stated that "complainants have the burden of proof to show first that products are like and second, that foreign products are taxed in excess of domestic ones." (para. 6.14).

[440] Supported by Argentina (see Argentina's third party submission, para. 44).

are not subject to.[441] In this respect, the **European Communities** and **Canada** refer to the holding of the Appellate Body in *Japan – Alcoholic Beverages II* clarifying that "even the smallest of 'excess' is too much."[442]

7.219 As stated above, **China** responds that, because the measures are border measures, they do not result in the imposition of internal taxes or other internal charges within the meaning of Article III:2, first sentence, GATT 1994.[443]

(ii) Consideration by the Panel

7.220 We start our analysis by recalling that in *Japan – Alcoholic Beverages II*, the Appellate Body established a strict standard for the term "in excess of" under Article III:2, first sentence:

> "The only remaining issue under Article III:2, first sentence, is whether the taxes on imported products are 'in excess of' those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. Even the smallest amount of 'excess' is too much. 'The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard.'"[444]

7.221 With this standard in mind, we recall our conclusion above at paragraph 7.212 that the measures impose an internal charge under Article III:2 of the GATT 1994. We do not believe that the question of whether the precise amount of this internal charge is equivalent to an *ad valorem* rate of 25 per cent or only 15 per cent over the imported part is essential to our findings under this claim as any one of these values would undoubtedly be "in excess of those applied to domestic products". In fact, as domestic products are not subject to the measures they are also not therefore subject to any charge under the measures at all.

7.222 The Panel therefore concludes that the complainants have satisfactorily met their burden of proving that imported auto parts are subject to an internal charge in excess of those applied to domestic products within the meaning of Article III:2 of GATT 1994.

(e) Conclusion

7.223 We therefore find that the charge under the measures[445] is inconsistent with the first sentence of Article III:2 of the GATT 1994.

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[441] European Communities' first written submission, para. 163; United States' first written submission, para. 84; Canada's first written submission, para. 92.

[442] European Communities' first written submission, para. 168; Canada's first written submission, para. 92, footnote 125.

[443] See China's first written submission, para. 170.

[444] Appellate Body Report on *Japan – Alcoholic Beverages II*, page 23. This finding was followed by the Panel on *Argentina – Hides and Leather* (See Panel Report on *Argentina – Hides and Leather*, para. 11.243).

[445] With the exception of the "ordinary customs duties" levied under Article 2(2) of Decree 125, which are addressed under Article II:1 (a) and (b), first sentence, of the GATT 1994 in Part VII.F of these reports, below.

2. Are the measures consistent with Article III:2, second sentence, of the GATT 1994?

(a) Arguments of the parties

7.224 Should the Panel not find a violation of the first sentence of Article III:2, the **European Communities** claims, in the alternative, that the measures would nevertheless be inconsistent with Article III:2, second sentence, of the GATT 1994.[446]

7.225 **China** responds that the measures are border not internal measures. In any case, they do not otherwise apply internal taxes or charges in a manner contrary to the principles set forth in Article III:1 of the GATT 1994, as provided in Article III:2, second sentence, of the GATT 1994.[447]

(b) Consideration by the Panel

7.226 We recall our finding above at paragraph 7.223 that the charge under the measures, with the exception of those levied under Article 2(2) of Decree 125, is an internal charge that is inconsistent with the first sentence of Article III:2 of the GATT 1994. As the European Communities only makes its claim under the second sentence of Article III:2 in case we do not find a violation in respect of the first sentence of this provision, we do not need to make a finding on this claim.

3. Are the measures consistent with Article III:4 of the GATT 1994?

7.227 The **complainants** argue that the measures are inconsistent with Article III:4 of the GATT 1994.[448] In response, **China** again submits that, as border measures, they do not fall within the scope of Article III:4 GATT 1994.[449]

7.228 Article III:4 of the GATT 1994 reads as follows in the relevant part:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded 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. ..."

7.229 The Appellate Body has clarified that three elements must be satisfied to establish a violation of Article III:4: (1) the imported and domestic products at issue are "like" products"; (2) the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and (3) the imported products are accorded "less favourable" treatment than that accorded to like domestic products.[450]

7.230 For Article III:4 to apply two things are first required. First the domestic and imported products must be "like". Second, the law, regulation, or requirement must "affect" the internal sale, offering for sale, purchase, transportation, distribution, or use of the like products. Only once those

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[446] European Communities' first written submission, paras. 172-185.
[447] China's first written submission, para. 170.
[448] Supported by Japan and Mexico (See Japan's third party written submission, paras. 13-14 and Mexico's third party written submission, paras. 5-6).
[449] China's first written submission, para. 171.
[450] Appellate Body Report on *Korea – Various Measures on Beef*, para. 133.

two elements are established does the obligation to afford no less favourable treatment apply.[451] In this connection, we note China's argument that the measures do not fall within the scope of Article III:4 because they are "border measures". Therefore, we will address the question of whether Article III:4 applies to the contested measures by analysing whether the domestic and imported auto parts are "like" and whether the Chinese measures are "laws, regulations, and requirements affecting the internal sale, offer for sale, purchase, transportation, distribution or use" of the imported auto parts. If found so, we will proceed to determine whether the contested measures accord "less favourable" treatment to imported auto parts than to like domestic auto parts inconsistently with China's obligation under Article III:4 of the GATT 1994.

(a) Are imported auto parts like domestic auto parts?

(i) Arguments of the parties

7.231 Similar to their claim under Article III:2, first sentence, of the GATT 1994, the **complainants**[452] hold the view that domestic and imported auto parts are like products because origin is the only basis for their distinction under the measures at issue.[453] The **United States** relies upon the finding of the panel in *Canada – Wheat Exports*, which stated that:

> "Where a difference in treatment between domestic and imported products is based exclusively on the products' origin, the complaining party need not necessarily identify specific domestic and imported products and establish their likeness in terms of the traditional criteria – that is, the physical properties, end-uses and consumers' taste and habits. Instead, it is sufficient for the purposes of satisfying the 'like product' requirement, to demonstrate that there can or will be domestic and imported products that are like."[454]

7.232 The United States goes on to argue that, because China's measures at issue apply an internal charge as well as burdensome administrative requirements on vehicle manufacturers solely on an origin-based distinction, it follows therefore that foreign and domestic auto parts are "like products" within the meaning of Article III:4.[455]

7.233 **China** responds that as the measures are border measures under Article II:1(b) of the GATT 1994, this claim should fail as Article III:4 of the GATT 1994 is inapplicable.

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[451] We find support for this conclusion in the Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 208, where the Appellate Body stated that "it is, therefore, not *any* 'laws, regulations and requirements' which are covered by Article III:4, but only those which '*affect*' the specific transactions, activities, and uses mentioned in that provision. Thus the word 'affecting' assist in defining the types of measures that must conform to the obligation not to accord 'less favourable treatment' to like imported products, which is set out in Article III:4."

[452] Argentina, a third party in this case, supports the complainants' view (see Argentina's third party submission, para. 47).

[453] European Communities' first written submission, paras. 145-146; United States' first written submission, paras. 91-92; Canada's first written submission, para. 96.

[454] United States' first written submission, para. 91, citing Panel Report on *Canada – Wheat Exports and Grain Imports*, para. 6.164.

[455] United States' first written submission, para. 92.

(ii) Consideration by the Panel

7.234 We recall our conclusion above at paragraph 7.217 that, under the measures, auto parts of domestic and foreign origin are like products within the meaning of Article III:2 of GATT 1994. We also note that the Appellate Body has found that the scope of "like" in Article III:4 is broader than the scope of "like" in Article III:2, first sentence, of the GATT 1994.[456]

7.235 Because we have found that, under the measures, imported auto parts and domestic auto parts are "like" within the meaning of Article III:2, first sentence, which has a narrower scope of application than the term "like" in Article III:4, we also conclude that auto parts of domestic and foreign origin are like within the meaning of Article III:4 of GATT 1994.

(b) Are the measures a "law, regulation, or requirement" within the meaning of Article III:4?

(i) Arguments of the parties

7.236 The **European Communities** argues that the measures impose very strict procedural and administrative rules which apply to all automobile manufacturers unless a vehicle and all its parts are 100 per cent of Chinese origin.[457] The European Communities also maintains that many aspects of the measures apply after the parts are already used in production and complete vehicles have been made out of them.[458]

7.237 **Canada** claims that case law shows that this phrase has broad application, including 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. Canada observes that the measures are legally binding and, applying the case law, remarks that compliance with them is necessary to obtain the advantage of avoiding the additional internal charge and, therefore, constitute "laws, regulations or requirements".[459]

7.238 **China** responds that as the measures are border measures under Article II:1(b) of the GATT 1994, this claim should therefore fail as Article III:4 of the GATT 1994 is inapplicable.[460]

(ii) Consideration by the Panel

7.239 We note that China does not dispute that the contested measures are "laws, regulations, or requirements" within the meaning of Article III:4; it argues, however, that the measures are "border measures". Previous panels have found that the term "regulations" is equivalent to "mandatory rules applying across-the-board."[461]

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[456] Appellate Body Report on *EC – Asbestos*, para. 99; see also Appellate Body Report on *Japan – Alcoholic Beverages II* (finding that the term "like product" evoked the image of an accordion whose width would vary depending on the provision under which the term was being interpreted).

[457] European Communities' first written submission, para. 149.

[458] European Communities' first written submission, para. 151.

[459] Canada's first written submission, paras. 97-98.

[460] The Panel specifically asked China to address the complainants' arguments in the event the Panel were to consider the measures to be subject to Article III of the GATT 1994. Instead of answering these questions, China maintained that it did not consider that the measures at issue were subject to the disciplines of Article III of the GATT 1994 (See China's responses to Panel question Nos. 146, 148).

[461] GATT Panel Report on *Canada – FIRA*, para. 5.5, which was followed by Panel Report on *India – Autos*, para. 7.181.

7.240 However, a measure needs not to be mandatory and apply across-the-board to be subject to the obligations contained in Article III:4.[462] Article III:4 also applies to "requirements", a term which has been interpreted by previous panels to encompass commitments entered into on a voluntary basis by individual firms as a condition to obtaining an advantage.[463] Examining the term "requirement" in the context of Article III:4 of the GATT 1994, the panel in *India – Autos* found that this term encompasses two distinct situations, (1) obligations which an enterprise is legally bound to carry out; and (2) those which an enterprise voluntarily accepts in order to obtain an advantage from the government.[464] We find further support for this interpretation in the Panel Report on *Canada – Autos*, where the panel explained:

> "Article III:4 applies not only to mandatory measures but also to conditions that an enterprise accepts in order to receive an advantage,[465] including in cases where the advantage is in the form of a benefit with respect to the conditions of importation of a product.[466,467]

7.241 The measures at issue impose various administrative procedures on any automobile manufacturers who intend to use imported auto parts. These administrative requirements involve *inter alia* several obligations before, during and after the importation of the auto parts affected by the measures, such as self-evaluation, registration of vehicle models with the CGA, placement of duty bonds and verifications after assembly and re-verifications in case of changes in the combinations or value of parts *vis-à-vis* domestic parts. Therefore, Policy Order 8, Decree 125 and Announcement 4 are "laws or regulations" within the meaning of the Article III:4 of the GATT 1994.

7.242 In this connection, although the measures are mandatory for all vehicle manufacturers using imported parts to assemble motor vehicles, an automobile manufacturer can avoid the application of the administrative procedures if it chooses not to use imported parts at all. Therefore, if these measures were to be considered "voluntary" they would nevertheless be "requirements" within the meaning of Article III:4 of the GATT 1994.

7.243 Therefore the panel concludes that the measures are "laws, regulations" in that they are mandatory for all vehicle manufacturers using imported parts and, to the extent that they might be considered "voluntary", they also constitute requirements within the meaning of Article III:4 of the GATT 1994.[468]

(c) Are the measures a law, regulation, or requirement "affecting the internal sale, offering for sale, purchase, transportation, distribution, or use" of imported auto parts?

(i) Arguments of the parties

7.244 The **complainants** observe that the term "affecting" is interpreted broadly in GATT and WTO case law, going beyond measures which "directly" govern the conditions of sale or purchase, so

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[462] GATT Panel Report on *Canada – FIRA*, para. 5.5.
[463] GATT Panel Report on *Canada – FIRA*, para. 5.4; Panel Report on *India - Autos*, para. 7.174.
[464] Panel Report on *India – Autos*, paras. 7.189-7.191.
[465] (footnote original) See e.g. GATT Panel Report on *EEC – Parts and Components*, para. 5.21.
[466] (footnote original) See, e.g., Appellate Body Report on *EC – Bananas III*, para. 211.
[467] Panel Report on *Canada – Autos*, para. 10.73.
[468] See Panel Report on *Canada – Autos*, para. 10.73, citing GATT Panel Report on *EEC – Parts and Components*, para. 5.21.

as to cover measures which might "adversely modify the conditions of competition between domestic and imported products".[469]

7.245 The **European Communities** relies upon the GATT panel report in *Italy – Agricultural Machinery* for the proposition that Article III:4 covers "not only laws and regulations, which directly govern the conditions of sale and purchase but also any laws or regulations which *might adversely modify the conditions of competition between the domestic and imported products on the internal market*".[470]

7.246 The **United States** notes that the Appellate Body has explained that the term "affecting" in Article III:4 of the GATT 1994 should be interpreted as having a "broad scope of application."[471] In addition, the panels in *EC – Bananas III*[472] and *India – Autos*[473] 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."[474] 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.[475] 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.[476]

7.247 With respect to the contested measure, the **complainants** argue that Policy Order 8, Decree 125 and Announcement 4 work together to create an incentive to purchase domestic auto parts. The **United States** argues that through the combination of internal charges and burdensome administrative recording requirements "China has established a disincentive to purchase, use and distribute imported auto parts."[477] According to the **European Communities**, the measures influence the decision-making of automobile manufacturers and are "bound to adversely modify the conditions of competition between the domestic and imported products on the internal market."[478] **Canada** also argues that the measures affect the sale, purchase or use of imported auto parts because they impose obligations adversely modifying the conditions of competition as they impose an internal charge when imported parts are used over a specified threshold and an administrative burden when *any* imported

[469] The following GATT/WTO cases are cited: Appellate Body Report on *US – FSC (Article 21.5)*, para. 210; Panel Report on *Canada - Autos*, para. 10.73; Panel Report on *EC – Bananas III*, para. 7.175; Panel Report on *India – Autos*, para. 7.196; GATT Panel Report on *EEC – Parts and Components*, para. 5.21; GATT Panel Report on *Italy – Agricultural Machinery*, para. 12; and GATT Panel Report on *US – Section 337*, para. 5.10.

[470] European Communities' first written submission, para. 148, citing GATT Panel Report, *Italy – Agricultural Machinery*, para. 12.

[471] Appellate Body Report on *US – FSC (Article 21.5)*, para. 210. See also Panel Report on *Canada – Autos*, para. 10.80; and Panel Report on *India – Autos*, para. 7.196.

[472] Panel Report on *EC – Bananas III*, para. 7.175.

[473] Panel Report on *India – Autos*, para. 7.196.

[474] Panel Report on *India – Autos*, para. 7.196.

[475] Panel Report on *India – Autos*, para. 7.197.

[476] Panel Report on *Canada – Wheat Exports and Grain Imports*, para. 6.267.

[477] United States' first written submission, para. 95.

[478] European Communities' first written submission, paras. 147-151.

parts are used.[479] Thus, according to the complainants, the measures at issue "affect" the internal sale, offering for sale, purchase, distribution, or use of imported auto parts.[480]

7.248 In response, **China** submits that "as border measures, the challenged measures do not constitute laws, regulations and requirements affecting the internal sale, offering for sale, purchase, distribution or use of imported products within the meaning of Article III:4."[481]

(ii) Consideration by the Panel

7.249 In order for a measure to fall within the scope of Article III:4 of the GATT 1994 it must not only be a "law, regulation, and requirement" but it must also *affect* the internal sale, offer for sale, purchase, transportation, distribution or use of the imported products.

7.250 As the Appellate Body in *US – FSC (Article 21.5 – EC)* clarified, the phrase "affecting the internal sale, offering for sale, purchase, transportation, distribution or use" defines, and thus limits, the types of "laws, regulations, and requirements" that fall within the scope of Article III:4 of the GATT 1994. In the words of the Appellate Body:

> "the clause in which the word 'affecting' appears – 'in respect of all laws, regulations and requirements *affecting* their internal sale, offering for sale, purchase, transportation, distribution or use' – serves to define the scope of application of Article III:4. (emphasis added) Within this phrase, the word 'affecting' operates as a link between identified types of government action ('laws, regulations and requirements') and specific transactions, activities and uses relating to products in the marketplace ('internal sale, offering for sale, purchase, transportation, distribution or use'). It is, therefore, not *any* 'laws, regulations and requirements' which are covered by Article III:4, but only those which '*affect*' the specific transactions, activities and uses mentioned in that provision. Thus, the word 'affecting' assists in defining the types of measure that must conform to the obligation not to accord 'less favourable treatment' to like imported products, which is set out in Article III:4."[482]

7.251 Therefore, only "laws, regulations and requirements" which *affect* "the internal sale offering for sale, purchase, transportation, distribution or use" are subject to the disciplines under Article III:4 of the GATT. The Appellate Body has further explained that the ordinary meaning of the word "affecting" implies that a measure also has "an effect on" and thus indicates a broad scope of application,[483] which is wider in scope than such terms as "regulating" or "governing".[484] Furthermore, the word "affecting" in Article III:4 of the GATT has been interpreted to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products.

7.252 In this respect, we concur with the findings of the panel in *India – Autos* that:

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[479] Canada's first written submission, para. 99.

[480] See e.g., European Communities' first written submission, paras. 149-150; and Canada's first written submission, para. 99.

[481] China's first written submission, para. 171.

[482] Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 208.

[483] Appellate Body Report on *EC – Bananas III*, para. 220.

[484] Appellate Body Report on *EC – Bananas III*, footnote 47, para. 220. See also the Appellate Body Report on *Canada – Autos*, footnote 56, para. 150 (interpreting the word "affecting" in Article I:1 of the GATS).

> "[T]he fact that the measure applies only to imported products need not [be], in itself, an obstacle to its falling within the purview of Article III.[485] For example, an internal tax, or a product standard conditioning the sale of the imported but not of the like domestic product, could nonetheless 'affect' the conditions of the imported product on the market and could be a source of less favourable treatment. Similarly, *the fact that a requirement is imposed as a condition on importation* is not necessarily in itself an obstacle to its falling within the scope of Article III:4.[486],[487] (emphasis added)

7.253 Article III:4 thus covers all laws, regulations and requirements, including those which only apply to imported products, that have an effect on "specific transactions, activities and uses relating to products *in the marketplace* ('internal sale, offering for sale, purchase, transportation, distribution or use')."[488] In this regard, we also find the Appellate Body's reasoning in *EC – Bananas III* relevant, whereby it rejected the claim that the measure in that case fell outside the scope of Article III:4 of the GATT 1994. The Appellate Body held in the relevant parts that:

> "At issue in this appeal is not whether *any* import licensing requirement, as such, is within the scope of Article III:4, but whether the EC procedures and requirements for the *distribution* of import licences for imported bananas among eligible operators *within* the European Communities are within the scope of this provision. ... These rules go far beyond the mere import licence requirements needed to administer the tariff quota for third-country and non-traditional ACP bananas or Lomé Convention requirements for the importation of bananas. These rules are intended, among other things, to cross-subsidize distributors of EC (and ACP) bananas and to ensure that EC banana ripeners obtain a share of the quota rents. As such, these rules affect "the internal sale, offering for sale, purchase, ..." within the meaning of Article III:4, and therefore fall within the scope of this provision."[489]

7.254 China holds the view that this reasoning of the Appellate Body in *EC – Bananas III* confirms that what matters is whether the aspect of the measures under scrutiny is an element of administrating a valid border measure, which is therefore within the scope of Article II, or whether this aspect of the measure serves instead to affect the internal sale, distribution or use of the product.[490] Given our

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[485] *(footnote original)* Article III:1 refers to the application of measures "to imported *or* domestic products", which suggests that application to both is not necessary.

[486] *(footnote original)* Thus, the "advantage" to be obtained could consist in a right to import a product. See for instance, the Report of the second GATT panel on *EC – Bananas II* as cited and endorsed in *EC – Bananas III*, WT/DS27/R/USA, adopted on 25 September 1997, as modified by the Appellate Body Report, para. 4.385 (DSR 1997:II, 943):

> "The Panel further noted that previous panels had found consistently that this obligation applies to any requirement imposed by a contracting party, including requirements 'which an enterprise voluntarily accepts to obtain an advantage from the government.' In the view of the Panel, a requirement to purchase a domestic product in order to obtain the right to import a product at a lower rate of duty under a tariff quota is therefore a requirement affecting the purchase of a product within the meaning of Article III:4."

[487] Panel Report on *India – Autos*, para. 7.306.

[488] Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 208 (emphasis added). The word "internal" qualifies all the transactions spelled out in Article III:4. See Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 213.

[489] Appellate Body Report on *EC – Bananas III*, para. 211 (emphasis in the original; footnotes omitted)

[490] China's response to Panel question No. 85.

finding above that the charge under the measures is an "internal charge" within the meaning of Article III:2 of the GATT 1994,[491] the procedures under the measures do not serve, as China argues, to administer a valid border measure. Our finding that the charge applies to imported products therefore supports a conclusion that the administrative procedures related to the application of the charge likewise "affect" imported products.[492]

7.255 Moreover, the complainants argue that the criteria for the determination of the essential character of a motor vehicle create an incentive to purchase domestic auto parts instead of imported auto parts and therefore affect the "internal sale, offering for sale, purchase, transportation, distribution or use."[493] China, on the other hand, holds that the incentive to import auto parts instead of motor vehicles (because of the higher tariff rate for motor vehicles) is a characteristic inherent to the Schedule of Concessions that China negotiated.[494]

7.256 However, in the view of the Panel, China seems to misunderstand the claim of the complainants. The complainants do not challenge the fact that China's tariff structure creates an incentive to *import auto parts* instead of *motor vehicles* but, instead, they challenge the alleged incentive created by the criteria under the measures to use *domestic auto parts* instead of *imported auto parts*.[495] Applying the reasoning developed by the Appellate Body in *US – FSC (Article 21.5 - EC)* to the present dispute[496], any auto manufacturer/importer that seeks to avoid the charge at issue must ensure that imported auto parts used in the assembly of a given vehicle model do not meet any of the criteria set out in the measures.[497] Under the measures, whether imported auto parts meet any of the criteria set out in the measures is assessed based on the final assembly of auto parts in China, which consequently requires the examination of auto parts imported in "multiple shipments". In our view, this aspect of the measures inevitably influences an automobile manufacturer's choice between domestic and imported auto parts and thus affects the internal use of imported auto parts.[498]

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[491] See paragraph 7.212 above.

[492] Panel Report on *Mexico – Taxes on Soft Drinks*, para. 8.109.

[493] European Communities' first written submission, para. 150; United States' first written submission, para. 95; Canada's first written submission, para. 99.

[494] China's response to Panel question No. 275. China states that "whatever incentives or disincentives arise from the difference in duty rates in China's Schedule of Concessions are characteristics that are inherent to the Schedule of Concessions that China negotiated. One function of ordinary customs duties is to regulate access to markets. They do so, in part, through the incentives and disincentives that are created by the establishment of duty rates at different levels. No party disputes that the higher tariff rate for motor vehicles in China's Schedule of Concessions creates some degree of incentive to assemble motor vehicles in China from auto parts and components, as compared to importing finished motor vehicles."

[495] It is, thus, also not the incentive to use domestic auto parts instead of imported auto parts that results from the customs duty inscribed in China's Schedule which is at issue here. In this respect, we do agree with China's statement that "the discrimination inherent in a customs duty that a Member validly imposes is not a form of discrimination that is prohibited under Article III" (China's response to Panel question No. 85). See also footnote 498, below.

[496] Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 212.

[497] See paragraphs 7.32 and 7.33 above, for the relevant criteria under the measures.

[498] If the same criteria were applied to imported auto parts at the moment of importation only, however, it would not necessarily influence the automobile manufacturer's choice between domestic and imported auto parts in the same way. In that case, the relevant question would be whether auto parts considered at the time of their importation satisfy any of the criteria. In the Panel's understanding, this is what the United States explained in its second oral statement concerning the difference between China's measures and the discrimination inherent in a customs duty: "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." (United States' second oral statement, para. 12,

7.257 The Panel thus concludes that the administrative procedures imposed on any auto manufacturer using imported auto parts as well as the criteria set out in the measures, combined with the assessment of the charge which is based on the final assembly internally, create an incentive for auto manufacturers to use domestic auto parts instead of imported auto parts. The Panel, therefore, finds that the measures affect "the internal sale, offering for sale, purchase, transportation, distribution or use" of imported auto parts, within the meaning of Article III:4 of the GATT 1994.

7.258 In conclusion, because the measures apply to imported auto parts which are "like" domestic auto parts and are laws, regulations, and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of the imported auto parts, we find that Article III:4 of the GATT 1994 is applicable to the measures.

(d) Do the measures accord less favourable treatment to imported auto parts than to domestic auto parts?

7.259 As noted above, we have found that the domestic and imported products are "like" and that the measures are laws, regulations, or requirements which "affect" the internal sale, offering for sale, purchase, transportation, distribution, or use, of the relevant products. The question which remains to be answered under this claim is therefore whether the measures afford imported products "less favourable" treatment than the like domestic products.

(i) Arguments of the parties

7.260 The **European Communities** and **Canada**[499] cite the Appellate Body report in *Korea – Various Measures on Beef* to contend that a finding on whether there is "less favourable treatment" requires an examination of "whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products."[500] They claim that, as GATT case law also has clarified, a Member must provide effective equality of opportunities for imported products.[501]

7.261 Moreover, **Canada** and the **United States** recall the observation of the Appellate Body in *US – FSC (Article 21.5)* that a measure could still be inconsistent with Article III:4 even if unfavourable treatment did not arise in every instance.[502]

7.262 The **complainants** then submit that the measures fundamentally modify the conditions of competition in the Chinese market to the detriment of imported auto parts in two ways.[503] First, only imported parts may become subject to an *internal charge* in case their input exceeds the level

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emphasis in the original). Our reasoning in the context of Article III:4 does not rule on the question of whether the criteria, if assessed solely on the basis of auto parts imported in a single shipment, would be in violation with Article II of the GATT 1994. We address this question in Section VII.D.3 of these reports.

[499] European Communities' first written submission, para. 152; Canada's first written submission, para. 100.

[500] Emphasis in the original. Moreover, "(a) formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4." Appellate Body Report on *Korea – Various Measures on Beef*, para. 137.

[501] GATT Panel Report on *US – Section 337*, para. 5.11, as cited by the European Communities in its first written submission, para. 152 and by Canada in its first written submission, para. 100.

[502] Appellate Body Report on *US – FSC (Article 21.5 - EC)*, para. 221. United States' first written submission, para. 96; Canada's first written submission, para. 95.

[503] European Communities' first written submission, paras. 153-157; United States' first written submission, paras. 97-102; Canada's first written submission, paras. 101-102. Argentina, a third party participant, supports the complainants' view (see Argentina's third party submission, paras. 49-51).

specified in the measures. Consequently, this creates an incentive for manufacturers to use domestic parts rather than imported parts. Second, only imported parts are subject to *administrative procedures*. In the words of Canada, "a vehicle manufacturer using *any* imported auto parts is subjected to a burdensome administrative regime."[504] The only way to avoid the administrative requirements spelled out in the measures[505] is for a vehicle manufacturer to use *solely* domestic auto parts.[506] Moreover, Canada indicates that auto parts manufacturers, while not directly subject to the measures, are also affected by their application.[507]

7.263 **China** responds that what the complainants have characterized as a "burdensome administrative regime" is the customs process that China has established to determine whether an auto manufacturer imports and assembles a collection of auto parts that, in its entirety, has the essential character of a motor vehicle. China does not consider that the process it has established for this purpose is any more "burdensome" than the customs processes that Members have adopted to deal with other complex issues of customs administration, such as inward processing and duty drawback regimes. Article VIII:1(c) of the GATT 1994 explicitly recognizes that customs processes can be complex. The mere fact that these processes can be complex does not mean that they are subject to the disciplines of Article III.[508]

(ii) Consideration by the Panel

7.264 Before we can examine whether the Chinese measures afford "less favourable" treatment to imported auto parts, we must first recall the standard of what qualifies as "less favourable" treatment within the meaning of Article III:4 of the GATT 1994.

7.265 In this regard, the Appellate Body in *Korea – Various Measures on Beef* states:

> "A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated 'less favourably' than like domestic products should be assessed instead by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products."[509]

7.266 Following the Appellate Body's guidance, we will examine whether the measures at issue modify the conditions of competition in China's market to the detriment of imported auto parts.

7.267 First, as described in Section VII.A.1 above, the measures impose certain administrative procedures on automobile manufacturers who use imported auto parts in the assembly of motor

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[504] Canada's first written submission, para. 102.

[505] These include, *inter alia*, performing self-verifications of domestic content; applying for an import licence; registering a vehicle model with Customs; and being subject to additional review and verification procedures. See Canada's first written submission, para. 102. Further details as well as an example are provided by the United States (See United States' first written submission, paras. 100-102).

[506] Canada's first written submission, para. 102.

[507] Canada submits that "[i]n using imported parts, [auto part manufacturers] risk financial penalties through contractual terms with downstream manufacturers that wish to avoid the brunt of the additional internal charge" and they have "the risk of being found to violate the Measures or general Customs law if their record-keeping concerning the use of imported parts is not satisfactory." (citing Article 36 of Decree 125). See Canada's first written submission, para. 102.

[508] China's response to Panel question 104.

[509] Appellate Body Report on *Korea – Various Measures on Beef*, para. 137.

vehicles before, during and after imported auto parts enter China.[510] The complainants submit that these administrative procedures are burdensome and add costs to the assembly operations of automobile manufacturers.[511]

7.268 In particular, the European Communities argues that the considerable complexity of the measures in itself delays the launching of a new model in the Chinese market by two to three years. Further, according to the European Communities, establishing the self-verification report required under Article 7 of Decree 125 may take an additional six months for a team of 10-15 highly skilled experts and afterwards, it can take over one year before all the procedures are finalized. The United States also explains that to perform a 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. Furthermore, as the United States submits, if an automobile manufacturer uses imported parts imported by a third party supplier, the manufacturer is required to maintain records regarding the actual importer of record, and any evidence of duties and value-added taxes paid.[512] China has not provided any response to these specific arguments by the European Communities and the United States. We also recall our observation above in paragraphs 7.65 and 7.66 that the sample of pending applications for review and verification, submitted by the European Communities, shows that the period for review and verification by the Verification Centre can take from 30 days to a couple of years.

7.269 Therefore, in our view, by subjecting imported auto parts to the administrative procedures not faced by like domestic products, which could cause a substantial delay throughout the entire assembly operations from the launching of a new model to the verification by the Verification Centre, the measures modify the conditions of competition in China's market to the detriment of imported auto parts.

7.270 Furthermore, we found above that whether imported auto parts meet the criteria for the essential character determination under the measures is assessed based on the final assembly of auto parts, and it inevitably influences an automobile manufacturer's choice between domestic and imported auto parts if it wishes to avoid the administrative procedures at issue.[513] In other words, auto manufacturers must ensure that imported auto parts used in the assembly of motor vehicles do not meet any of the criteria under the measures to avoid being subject to the administrative procedures imposed under the measures.[514] In sum, the criteria for the essential character determination set out in the measures and the application of the criteria after the final assembly of motor vehicles not only draw a formal distinction between imported auto parts and like domestic auto parts, but this formal difference also has a substantive importance in that it creates a disincentive for auto manufacturers to use imported auto parts.[515]

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[510] The measure thus creates a formal distinction between imported auto parts and domestic auto parts. The administrative procedures do not apply if an auto manufacturer uses only domestic auto parts. Auto manufacturers using at least one imported auto part are however subject to the administrative procedures under the measures.

[511] European Communities' response to Panel question No. 8; United States' first written submission, paras. 44-66, 99-104; Canada's first written submission, para. 102; Canada's response to Panel question No. 8. See also paragraph 7.65 above.

[512] See Articles 9 and 29 of Decree 125.

[513] In this respect, we refer to the elaboration of the specific thresholds in paras. 7.31-7.33.

[514] This applies to both auto parts imported by auto manufacturers themselves and those purchased from a third-party supplier.

[515] Appellate Body Report on *US – FSC (Article 21.5 - EC)*, paras. 217 and 218.

7.271 This "careful analysis of the contested measures and of its implications in the marketplace"[516], shows that the administrative procedures as well as the application of the criteria for the essential character determination as defined by China based on the final assembly, accord less favourable treatment to imported auto parts than to domestic auto parts.

(e) Conclusion

7.272 In light of the foregoing, the **Panel** finds that China's measures, which fall within the scope of Article III:4, are inconsistent with its obligations under Article III:4 of the GATT 1994 to afford no less favourable treatment to like imported products.

4. Are the measures consistent with Article III:5 of the GATT 1994?

(a) Arguments of the parties

7.273 The **complainants** submit that the measures violate Article III:5, first sentence, of the GATT 1994. In the alternative, the **European Communities** and the **United States** argue that the measures violate Article III:5, second sentence, of the GATT 1994.[517]

7.274 **China** argues in response that the challenged measures constitute border measures subject to Article II of the GATT 1994 and, therefore, do not fall within the scope of Article III:5, first and second sentences, of the GATT 1994. China does not advance any further arguments in response to this claim.[518]

(b) Consideration by the Panel

7.275 We note that the complainants have slightly different positions on the necessity of proceeding with their claims under Article III:5 of the GATT 1994 in case the Panel finds the measures are inconsistent with Article III:2 and III:4 of the GATT 1994. At least one of the co-complainants left to the discretion of the Panel the decision to exercise judicial economy with respect of its claim under Article III:5 of the GATT 1994.[519] Indeed, we do not believe that making a finding on the claims

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[516] Appellate Body Report on *US – FSC (Article 21.5 - EC)*, para. 215.

[517] European Communities' first written submission, paras. 186-187; United States' first written submission, paras. 3, 110-111, footnote 141; United States' first oral statement, paras. 4, 18-19; United States' second written submission, para. 3; United States' second oral statement, para. 5; Canada's first written submission, paras. 87, 104-115. Canada's second oral statement, paras. 2, 23.

[518] China's first written submission, paras. 42-48, 169-171, 174. See also China's first oral statement, paras. 16-19, 40; China's second written submission, paras. 123-124, 127; China's response to Panel question No. 85.

[519] The **United States** indicates that insofar as the findings of the Panel are sufficient to resolve the dispute, it views the exercise of judicial economy in respect of the other claims as a matter to be left to the discretion of the Panel. More specifically, it says that "a breach of Article III:4 would also indicate a breach of Article III:5". The United States made the following statement, stating that it considers:

> "the most essential claims in this dispute as the breach of Article III:4 and/or the TRIMs Agreement, because China's measures impose a local content requirement that discriminates against all imported parts as well as administrative burdens that discourage the use of imported auto parts, and Article III:2, because China imposes an internal charge on certain imported parts in excess of any charges with no comparable charge on like domestic parts. With respect to other claims, the United States understands that questions of judicial economy are to be decided at the discretion of the panel, so long as the all [sic] findings are made that

under Article III:5 would "enhance the ability of the DSB to make sufficiently precise recommendations and rulings in this dispute."[520] In reaching this conclusion we are guided by the following statement of the Appellate Body:

> "Nothing in this provision or in previous GATT practice requires a panel to examine all legal claims made by the complaining party. Previous GATT 1947 and WTO panels have frequently addressed only those issues that such panels considered necessary for the resolution of the matter between the parties, and have declined to decide other issues. Thus, if a panel found that a measure was inconsistent with a particular provision of the GATT 1947, it generally did not go on to examine whether the measure was also inconsistent with other GATT provisions that a complaining party may have argued were violated. In recent WTO practice, panels likewise have refrained from examining each and every claim made by the complaining party and have made findings only on those claims that such panels concluded were necessary to resolve the particular matter.
>
> Although a few GATT 1947 and WTO panels did make broader rulings, by considering and deciding issues that were not absolutely necessary to dispose of the particular dispute, there is nothing anywhere in the *DSU* that requires panels to do so."[521]

7.276 Therefore, in view of our findings above that China has acted inconsistently with Articles III:2 and III:4 of the GATT 1994, and guided by the above statement of the Appellate Body, we consider that we have made the findings that are necessary for the resolution of the dispute raised by the complainants. We therefore exercise judicial economy in respect of the complainants' respective claims under Article III:5 of the GATT 1994.

5. Are the measures justified under Article XX(d) of the GATT 1994?

7.277 As set forth above, the Panel found that the internal charge imposed on imported auto parts under the measures was inconsistent with Article III:2 of the GATT 1994 and that the measures were also inconsistent with III:4 of the GATT 1994.

7.278 **China** submits that the challenged measures as a whole, or particular aspects of the measures, are justified under Article XX(d) of the GATT 1994 if the measures are found inconsistent with one or more provisions of the GATT 1994.[522] The **complainants** argue that the measures are not justified under Article XX(d).[523]

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are necessary for the resolution of the dispute." (United States' response to Panel question 151. See also United States' response to Panel question No. 152).

On the other hand, the other two co-complainants, the **European Communities** and **Canada**, are of the view that a finding on Article III:4 of the GATT 1994 would not render a finding on Article III:5 unnecessary (see their respective responses to the Panel question No. 152).

[520] Appellate Body Report on *US – Lamb*, para. 194.

[521] Appellate Body Report on *US – Wool Shirts and Blouses*, pages 18-19 (original footnotes omitted).

[522] China's first written submission, para. 202.

[523] European Communities' second written submission, paras. 136-148; European Communities' second oral statement, paras. 33-38, United States' second oral statement, paras. 29-36; Canada's second written submission, paras. 75-103; Canada's second oral statement, paras. 34-52.

7.279 Because a Member invoking Article XX(d) as a justification of its measure – China in this case – has the initial burden of proof for its affirmative defence[524], the **Panel** will examine whether China has discharged its burden of proving that the measures satisfy the requirements of, and thus are justified under, Article XX(d).

7.280 For a measure, otherwise inconsistent with GATT 1994, to be justified under Article XX, two elements must be proved: first, the measure falls under one or more of the exceptions provided in Article XX; and, second, the measure satisfies the requirements under the chapeau of Article XX.[525] As China claims that the measures are justified under Article XX(d), we will commence our analysis with the first element – whether the measures fall under Article XX(d).

7.281 Article XX(d) provides:

> "Nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices."

7.282 The Appellate Body clarified in *Korea – Various Measures on Beef* that two elements must be shown in order for a measure to be justified provisionally under paragraph (d) of Article XX:

> "First, the measure must be one designed to 'secure compliance' with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Second, the measure must be 'necessary' to secure such compliance."[526]

7.283 Before commencing our analysis of whether the measures at issue are designed to 'secure compliance' with laws or regulations that are not themselves inconsistent with the GATT 1994, the **Panel** observes that, initially, China did not distinguish its justification of the measures under Article XX(d) in respect of the Panel's possible finding of the measures' inconsistency with Article III of the GATT 1994 from that with Article II. In its written submissions, China provided a general defence under Article XX(d) against the Panel's possible findings against the measures "under one or more provisions of the GATT 1994".[527] The relevant heading (Section IV.G) in China's first submission in this regard reads "*Any* Inconsistency with the GATT 1994 Is Subject to the General Exception Under Article XX(d)", and the relevant heading (Section VI) in China's second written submission reads "The Challenged Measures Would Be Justified Under Article XX(d) If The Panel Were To Identify *Any* Violation of the Covered Agreements" (emphasis added).

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[524] Appellate Body Report on *Korea – Various Measures on Beef*, para. 157, also citing Appellate Body Reports on *US – Gasoline*, footnote 98, at 21 and *US – Wool Shirts and Blouses*, at 335-337 and GATT Panel Report on *US – Section 337*, footnote 69, para. 5.27.

[525] Appellate Body Report on *US – Gasoline*, page 21. The Appellate Body also found that the proper sequence of steps is to first assess whether a measure can be provisionally justified as one of the categories under paragraphs (a)-(j), and then, to further appraise the same measure under the chapeau of Article XX. According to the Appellate Body, this sequence of steps in the analysis of a claim of justification under Article XX reflects, not inadvertence or random choice, but rather than fundamental structure and logic of Article XX (Appellate Body Report on *US – Shrimp*, paras. 119-120).

[526] Appellate Body Report on *Korea – Various Measures on Beef*, para. 157.

[527] China's first written submission, para. 202; China's second written submission, para. 164.

7.284 In a written response to a question from the Panel after the second substantive meeting, however, China indicated a change in its position and clarified that the Article XX(d) analysis would be different depending on whether a violation is found under Article III or Article II.[528] China submits that if the challenged measures were to be found inconsistent with Article III, the measures could be justified under Article XX(d) on the grounds that the charge and measures are necessary to secure compliance with "a valid interpretation of China's tariff provisions for motor vehicles".[529]

7.285 Specifically, **China** submits as follows:

> "[T]he Article XX(d) analysis would be different in respect of a finding of a violation of Article III. … In these circumstances, the charges and measures could be justified under Article XX(d) as charges and measures that are necessary to secure compliance with a valid interpretation of China's tariff provisions for motor vehicles, i.e. an interpretation that encompasses parts and components in multiple shipments that have the essential character of a motor vehicle. That is, the Panel could find that China's interpretation of its tariff provisions is not inconsistent with the interpretive rules of the Harmonized System, and is not otherwise inconsistent with the meaning of the relevant terms of China's tariff schedule, but that China has adopted impermissible 'internal' charges and measures as a means of securing compliance with that interpretation.
>
> While China would not agree with the finding of violation of Article III, it would seem to be exactly the circumstance in which Article XX(d) would apply. The reference to customs enforcement in Article XX(d) presupposes that Members may need to take actions that are inconsistent with its GATT obligations (and thus requiring the invocation of a general exception), but that are otherwise necessary to secure compliance with its customs law. The adoption of charges and measures that violate the disciplines of Article III, but that are necessary to secure compliance with a customs measure that the Member is allowed to impose in accordance with its Article II commitments, would seem to be the paradigmatic case in which Article XX(d) would apply. If Article XX(d) did not apply in this circumstance, it is hard to see when it would ever apply.
>
> ... For the reasons that China has explained, China believes that Decree 125 falls within the scope of China's rights and obligations under Article II. However, if the Panel were to find that one or more aspect of the measure constitutes an impermissible measure or charge within the scope of Article III, China considers that any such internal measure or charge is justified under Article XX(d) to secure compliance with duties that China is allowed to collect by reason of the importation of parts and components that have the essential character of a motor vehicle."[530]

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[528] China's response to Panel question No. 282.

[529] China's response to Panel question No. 282.

[530] China's response to Panel question No. 282. China's statement quoted above in paragraph 7.285 was in response to the Panel question whether, and if so, how the Panel's analysis of China's defence under Article XX(d) in respect of an Article II violation should be different from that in respect of an Article III violation.

In respect of a possible finding of a violation of Article II, China submits that the measures could still be justified under Article XX(d) since Article XX(d) provides an authority for China to give effect to China's tariff provisions for motor vehicles to the extent that the rules of the HS, when reviewed in the context of Article II, do not provide an unambiguous legal basis for China (China's response to Panel question No. 282).

7.286 In its comments on China's response above, the **European Communities** submits that since China's explicit arguments relating to Article XX(d) are very cursory in both its first and second submissions and fall short of satisfying China's obligations on the burden of proof, the Panel's analysis should stop there.[531] The European Communities further submits that China has not demonstrated that the measures are necessary to secure compliance with its tariff schedule provisions for motor vehicles, and instead, China formulates its *hope* that "it would seem to be exactly the circumstance in which Article XX(d) would apply", or "[i]f Article XX(d) did not apply in this circumstance, it is hard to see when it would ever apply".[532] The European Communities argues that such wishful thinking, however, cannot replace a proper defence under Article XX(d).

7.287 As noted by the **Panel** above in paragraph 7.279, China, as the party putting forward an affirmative defence under Article XX(d), bears the burden to prove, based on factual and legal arguments supported by specific evidence, how its measures are justified under Article XX(d). The fact that China has not distinguished its Article XX(d) arguments from the possible violation of one provision of the GATT 1994 (i.e. Article III) from that of an entirely different provision of the GATT 1994 (i.e. Article II) until specifically asked by the Panel, makes us question from the outset the validity of China's defence under Article XX(d). It is not for the Panel to advance or presume specific arguments or analysis for a claim made by a party to the dispute.[533] The burden to prove an affirmative claim based on supporting arguments and evidence rests on the party asserting the claim. Having said that, we will move on to examine whether China has proved that the measures satisfy the first element necessary to justify a measure under Article XX(d).

(a) What is the law or regulation that the measures at issue secure compliance with within the meaning of Article XX(d)?

(i) China's interpretation of the tariff provisions for motor vehicles

7.288 The Appellate Body stated in *Mexico – Soft Drinks* that the term "laws or regulations" within the meaning of Article XX(d) refers to rules that form part of the domestic legal system of a WTO Member invoking the provision, including rules deriving from international agreements that have been incorporated into the domestic legal system of a WTO Member or have a direct effect according to that WTO Member's legal system.[534]

7.289 To determine whether the measures at issue are justified under Article XX(d), the Panel first needs to examine whether China has identified a domestic law or regulation that is not itself inconsistent with the GATT 1994.

7.290 In the course of this dispute, China has interchangeably referred to various items as the law or regulation the measures are securing compliance with. For example, **China** has made references to

[531] European Communities' second oral statement, para. 34.
[532] European Communities' comments on China's response to Panel question No. 282.
[533] The Appellate Body states in *US – Gambling:* "In the context of affirmative defences, then, a responding party must invoke a defence and put forward evidence and arguments in support of its assertion that the challenged measure satisfies the requirements of the defence. When a responding party fulfils this obligation, a panel may rule on whether the challenged measure is justified under the relevant defence, relying on arguments advanced by the parties or developing its own reasoning. The same applies to rebuttals. *A panel may not take upon itself to rebut the claim (or defence) where the responding party (or complaining party) itself has not done so*" (emphasis added) (Appellate Body Report on *US – Gambling*, para. 282).
[534] Appellate Body Report on *Mexico – Taxes on Soft Drinks*, paras. 69, 79.

China's customs laws and regulations[535]; China's customs laws, including its tariff provisions for motor vehicles[536]; China's tariff schedule[537]; the tariff provisions for motor vehicles provided in China's tariff schedule[538]; an allegedly valid interpretation[539] of the tariff provisions for motor vehicles on the relationship between motor vehicles and parts of motor vehicles as advocated by China; and duties[540] that China is allowed to collect by reason of the importation of parts and components that have the essential character of a motor vehicle.[541] In this regard, China was of the view that it did not perceive a distinction between its tariff provisions for motor vehicles "as such" and its tariff provisions for motor vehicles as interpreted in accordance with the rules of the HS.[542]

7.291 As noted above in paragraph 7.285, however, China clarified its Article XX(d) arguments specifically with respect to the Panel's possible finding against the measures under Article III only in response to a question from the Panel.

7.292 In that response, as cited above in paragraph 7.285, China indicated that the law or regulation that the measures at issue secure compliance with is China's alleged "valid interpretation of its tariff provisions for motor vehicles". According to China, this valid interpretation encompasses parts and components in multiple shipments that have the essential character of a motor vehicle. China argues that the charge and the administrative requirements under the measures are thus a customs measure that the Member is allowed to impose in accordance with its Article II commitments.

7.293 The **European Communities** and **Canada** consider that the alleged GATT consistent law or regulation in this case is China's Schedule as such, as implemented under China's domestic law.[543]

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[535] China's first written submission, paras. 203-204; China's second written submission, paras. 7, 164; China's response to Panel question No. 13.

[536] China's first written submission, para. 205; China's response to Panel question No. 84.

[537] China's response to Panel question No. 287.

[538] China's first written submission, paras. 202-204, 207, 212, China's second written submission, paras. 168-169, 172, 176, 182-183, 186, 187; China's responses to Panel question Nos. 13, 281, 282, 283, 286.

[539] China's responses to Panel question Nos. 9, 282.

[540] China's response to Panel question No. 282; China's first written submission, para. 205.

[541] China argues that measures are necessary to 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 (China's first written submission, paras. 203-204). China explains that Article 3 of China's Import/Export Tariff Regulation (Exhibit CHI-32) incorporates China's Schedule of Concessions into Chinese law (China's first written submission, footnote 140). China also submits that the measures secure compliance with China's tariff provisions for motor vehicles by ensuring the effective enforcement of China's tariff provisions for motor vehicles since the measures define and enforce the boundary between a motor vehicle and parts of a motor vehicle, without regard to the manner in which the importer structures or documents its import transactions (China's second written submission, paras. 168, 169). At the same time, China also argues that the measures are necessary to secure compliance with *a valid interpretation* of China's tariff provisions for motor vehicles, i.e. an interpretation that encompasses parts and components in multiple shipments that have the essential character of a motor vehicle (China's responses to Panel question Nos. 9, 282). In China's view, the measures should be justified under Article XX(d) to secure compliance with duties that China is allowed to collect by reason of the importation of parts and components that have the essential character of a motor vehicle (China's response to Panel question No. 282; China's first written submission, para. 205). According to China, China must be able to interpret its tariff provisions for motor vehicles in a manner that gives them meaningful effect, and to adopt measures to secure compliance with this interpretation (China's second written submission, para. 169).

[542] China's response to Panel question No. 281.

[543] Parties' responses to Panel question No. 281.

7.294 The **Panel** thus notes that the law or regulation that China claims the measures secure compliance with is its interpretation of the tariff provisions for motor vehicles in China's domestic tariff schedule. While not conceding that the law or regulation that is "not inconsistent" within the meaning of Article XX(d) includes an interpretation of certain tariff provisions of a Members' Schedule, the complainants submit that even if China's interpretation of its tariff provisions for motor vehicles were to be considered as the law or regulation under Article XX(d), China has not proved that the measures meet the requirements under Article XX(d) because China's interpretation of the tariff provisions for motor vehicles is in fact inconsistent with the GATT 1994.[544]

7.295 China's tariff provisions, including those for motor vehicles, are contained in and are thus part of China's domestic tariff schedule, which reproduces China's commitments in China's Schedule of Concessions with respect to goods from other Member countries. In turn, China's Schedule of Concessions is part of China's Accession Protocol and thus an integral part of the WTO Agreement.[545] In this connection, we recall the Appellate Body's reasoning in *EC – Computer Equipment* that *common* intentions cannot be ascertained on the basis of the subjective and unilaterally determined 'expectations' of one of the parties to a treaty.[546] We thus do not consider that China's interpretation of its concessions with respect to motor vehicles can form part of China's tariff schedule itself.[547] Finding otherwise would lead to an absurd situation where a WTO Member's own interpretation of a treaty term is considered as constituting part of such a treaty itself. This is particularly so in the present case where China's interpretation of its tariff provisions for motor vehicles is contested by the complainants in their alternative claim under Article II of the GATT 1994.

7.296 In any event, as set out below in Section VII.D with respect to the complainants' alternative claim under Article II of the GATT 1994, we find that China's interpretation of the tariff provisions for motor vehicles is *inconsistent* with China's commitment under its Schedule of Concessions and, consequently, with China's obligations under Article II:1(a) and (b) of the GATT 1994. Accordingly, if we were to accept China's position that the law or regulation that the measures secure compliance with is China's interpretation of its tariff provisions for motor vehicles, we conclude that China has failed to prove that the measures are justified under Article XX(d) because the measures do not secure compliance with the law or regulation that is "not inconsistent" with the GATT 1994 within the meaning of Article XX(d).

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[544] European Communities' comments on China's response to Panel question No. 281; United States' second oral statement, paras. 31-32; United States' response to Panel question No. 280; Canada's second written submission, para. 79.

[545] See paragraph 7.740 below.

[546] See paragraph 7.740 below.

[547] Appellate Body Report on *EC – Computer Equipment*, para. 84, also referred to by the Appellate Body Report on *EC – Chicken Cuts*, para. 250.

Furthermore, we note that under Article IX:1 of the WTO Agreement, the exclusive authority to adopt interpretations of the WTO Agreement and the Multilateral Trade Agreements is granted to the Ministerial Conference and the General Council. Specifically, Article IX:1 of the WTO Agreement provides:

> "The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements. In the case of an interpretation of a Multilateral Trade Agreement in Annex 1, they shall exercise their authority on the basis of a recommendation by the Council overseeing the functioning of that Agreement. The decision to adopt an interpretation shall be taken by a three-fourths majority of the Members..."

(ii) China's tariff schedule

7.297 Having found that China failed to prove that the law or regulation China's measures seek to secure compliance with is not itself inconsistent with the GATT 1994, the Panel does not need to proceed with its examination of the rest of the requirements under Article XX(d). However, if the Panel were to consider, *arguendo*, that China's "tariff schedule" is the law or regulation the measures secure compliance with, such a law or regulation would be "not inconsistent" with the GATT 1994 to the extent China's tariff schedule reproduces China's concessions contained in its Schedule as such, which is an integral part of the WTO Agreement.[548] Therefore, for the purpose of completeness of our analysis, we will proceed to examine whether, if the law or regulation that the measures secure compliance with is China's domestic tariff schedule, China's measures are justified under Article XX(d).

(b) Are the measures designed to secure compliance with the law or regulation?

7.298 The Panel recalls the Appellate Body's statement in *Mexico – Taxes on Soft Drinks* concerning the terms "to secure compliance with" under Article XX(d):

> "[T]he terms 'to secure compliance' speak to the *types* of measures that a WTO Member can seek to justify under Article XX(d). They relate to the *design* of the measures sought to be justified. There is no justification under Article XX(d) for a measure that is not designed 'to secure compliance' with a Member's laws or regulations. Thus, the terms 'to secure compliance' do not expand the scope of the terms 'laws or regulations' to encompass the international obligations of another WTO Member. Rather, the terms 'to secure compliance' circumscribe the scope of Article XX(d)."[549] (original footnote omitted and emphasis added)

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[548] See paragraph 7.295 above. China's Schedule of Concessions is incorporated into China's domestic law in the form of a tariff schedule pursuant to Article 3 of China's Import/Export Tariff Regulation (China's first written submission, footnote 140 (Exhibit CHI-32)). Article 3 provides:

> "Article 3 The State Council formulates the Import/Export Tariff Code of the People's Republic of China (hereinafter referred to as the 'Tariff Code') and the Code of Import Tariff on Entrance of Articles of the People's Republic of China (hereinafter referred to as the 'Tariff Code for Entrance of Articles') as integral parts of this Regulation, which set forth dutiable items, tariff numbers, and tariff rates" (Exhibit CHI-32) (emphasis in original).

See also Panel Report on *EC – Chicken Cuts*, paras. 7.5-7.8; GATT Panel Report on *EEC – Parts and Components*, para. 5.13. The complainants do not dispute that China's tariff schedule is a reproduction of China's Schedule of Concessions, and thus, to that extent, not itself inconsistent with the GATT 1994.

In this regard, we note China's statement that China's tariff provisions for motor vehicles are incorporated into the GATT, and are therefore not inconsistent with the GATT (China's second written submission, para. 169). We do not consider this is a legally and factually correct statement. China's Schedule of Concessions is an integral part of the WTO Agreement, and China's Schedule is incorporated into China's tariff schedule (domestic nomenclature), not the other way around. In any event, a Member's tariff schedule can be assumed to be consistent with the WTO Agreement to the extent the domestic nomenclature is a reproduction of that Member's Schedule of Concessions. Based on such understanding, we are assuming for the purpose of the present proceeding that China's tariff schedule is "not inconsistent" with the GATT 1994.

[549] Appellate Body Report on *Mexico – Taxes on Soft Drinks*, para. 72, also citing its Report on *Korea – Various Measures on Beef*, para. 157. See also Panel Report on *Korea – Various Measures on Beef*, paras. 655-658. In particular, the Panel stated:

7.299 The Panel considers that the Appellate Body's analysis in the statement above shows that the requirement "to secure compliance" with the concerned law or regulation under Article XX(d) can be examined in two parts: (i) whether the challenged measure is "designed" to secure compliance with the law or regulation concerned; and (ii) whether the measure in fact "secures compliance with" the law or regulation. In this connection, we find further support for our understanding of the terms "to secure compliance" in the analysis of the Panel in *EC – Tariff Preferences* where the Panel determined that, to examine whether the measure in that dispute was designed to achieve the stated health objectives under Article XX(b), it needed to consider not only the express provisions of the measure, but also the design, architecture and structure of the measure.[550] Although the Panel's analysis in *EC – Tariff Preferences* was made in the context of paragraph (b) ("necessary to protect human...life or health") of Article XX, not paragraph (d) ("necessary to secure compliance..."), we consider that the same type of analysis is also relevant to the question before us, i.e. whether China's measures are designed to secure compliance with China's tariff schedule.

7.300 We will, therefore, first examine whether the measures concerned in this case are "designed" to secure compliance with the laws or regulations, which are "not inconsistent" with the GATT 1994. If so found, we will then turn to the question of whether the measures in fact "secure compliance" with the GATT-consistent laws or regulations.

(i) Whether the measures are "designed" to secure compliance with the law or regulation

7.301 **China** argues that the measures implement and enforce the provisions of China's tariff schedule (incorporating China's Schedule of Concessions) relating to imports of "motor vehicles" by preventing the importation and assembly of auto parts as a means of circumventing China's tariff provisions relating to motor vehicles.[551] According to China, the measures achieve this objective by establishing an administrative process to ensure that auto parts having the essential character of a complete vehicle are classified for customs purposes as the importation of a motor vehicle, regardless of whether the parts enter China in one shipment or in multiple shipments. China submits that Chapter XI of Policy Order 8, the chapter concerning the administration and enforcement of China's

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> "However, despite the troublesome aspects, the Panel accepts that the dual retail system was put in place, at least in part, in order to secure compliance with the Korean legislation against deceptive practices to the extent that it serves to prevent acts inconsistent with the *Unfair Competition Act*. First, the system was established at the time when, ..., acts of misrepresentation were widespread in the beef sector. Second, it must be conceded that the dual retail system does appear to reduce the opportunities and thus the temptations for butchers to misrepresent foreign beef for domestic beef, ... The Panel notes that its interpretation of the words "measure ... to secure compliance with laws or regulations" is not inconsistent with the approach taken by the panel on *EEC – Parts and Components* and later followed by the panel on *Canada - Periodicals*". (Panel Report on *Korea – Various Measures on Beef*, para. 658) (original footnote (footnote 363) omitted).

[550] Panel Report on *EC – Tariff Preferences*, para. 7.200, citing the Appellate Body Report on *Japan – Alcoholic Beverages II*: the Appellate Body stated that "the aim of a measure may not be easily ascertained, nevertheless, its protective application can most often be discerned from the design, the architecture and the revealing structure of a measure" (Appellate Body Reports on *Japan – Alcoholic Beverages II*, page 29 and *Argentina – Textiles and Apparel*, para. 55). The Panel also cited the Appellate Body Report on *US – Shrimp*. In *US – Shrimp*, the Appellate Body stated, "we must examine the relationship between the general structure and design of the measure here at stake, …, and the policy goal it purports to serve, that is, the conservation of sea turtles" (Appellate Body Report on *US – Shrimp*, para. 137).

[551] China's first written submission, paras. 203-204.

tariff provisions for motor vehicles and vehicle parts, gave rise to the customs enforcement procedures embodied in Decree 125 and Announcement 4.[552]

7.302 The **European Communities** argues that nothing in the measures indicates that they are intended to secure compliance with China's tariff schedule, but rather the actual purpose of the measures is "to develop the Chinese automotive industry into a pillar industry of the national economy by 2010" as indicated in the preamble of Policy Order 8.[553] According to the European Communities, China's allegation that the measures are designed to secure compliance with its tariff schedule is an *ex post facto* rationalization by China which is not supported by any evidence. The European Communities points to the fact 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" as stated in Article 4 of Policy Order 8.[554] Furthermore, there is not a single reference, let alone more detailed justification in the measures that would even remotely point to GIR 2(a) or its language.[555] The European Communities considers that the silence in the measures about GIR 2(a) is because the objective of the measures is to nurture the domestic automotive industry, which is not related to GIR 2(a).[556] The measures, in particular Chapter XI of Policy Order 8, which even China admits as motivating Decree 125 and Announcement 4, explicitly refer to the objective of nurturing the domestic automobile industry.

7.303 The **United States** submits that although statements of intent contained in legislation may not be determinative because laws are often adopted for more than one reason, the statements of intent contained in China's laws are relevant and should be considered by the Panel.[557] The United States refers the Panel to the statement in China's measures that they are intended to promote the development of China's domestic auto parts industry, and the fact that China's measures make no mention of any goal of preventing "tariff evasion" or "tariff circumvention".

7.304 **Canada** also submits that when read collectively, particularly in the light of Policy Order 8, the measures are not designed to enforce customs obligations by preventing so-called tariff evasion, but to promote China's domestic auto parts industry.[558] In Canada's view, the measures do not secure compliance with China's tariff provisions for motor vehicles since, first, the purpose of the measures is to provide protection and support to the domestic auto parts industry, and, second, the measures are not designed to enforce China's tariff schedule because, on their face, they conflict with it by imposing an additional 15 per cent charge on foreign auto parts, which is not listed in China's tariff schedule and therefore cannot be applied.[559]

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[552] China's response to Panel question No. 49.

[553] European Communities' second written submission, paras. 99, 144. The European Communities also refers to Articles 3 and 4 of Policy Order 8 and the corresponding provisions in Decree 125 and Announcement 4.

[554] European Communities' second written submission, para. 99.

[555] European Communities' second written submission, para. 121.

[556] European Communities' second written submission, para. 122.

[557] United States' response to Panel question No. 292.

[558] Canada's second written submission, paras. 87, 88, also citing its first written submission, Part D.2 of the factual background section submitted jointly by the complainants. Specifically, to show that the measures are designed to promote the Chinese domestic auto parts industry, Canada refers to the preamble and the policy objectives of Policy Order 8, Article 52 (Chapter XI) of Policy Order 8, the preamble and Article 1 of Decree 125 and Article 1 of Announcement 4.

[559] Canada's response to Panel question No. 280.

7.305 Following the approach adopted by previous panels as well as the Appellate Body as noted above, the **Panel** will examine the express provisions as well as the design, structure and architecture of the measures (i.e. Policy Order 8[560], Decree 125, and Announcement 4) to determine whether the measures are designed to enforce China's tariff schedule. With respect to Policy Order 8, which is a legal instrument that provides the legal basis for the introduction of Decree 125 and Announcement 4, the complainants argue that its preamble, policy objectives (in particular, Articles 3 and 4) and Article 52 show that the measures are designed to protect and promote China's domestic auto parts industry. China, on the other hand, submits that Chapter XI of the Policy, as the only chapter in the Policy relevant to the measures at issue, reveals the rationale behind the measures, which is to enforce China's tariff schedule.

7.306 First, we note that the title of Policy Order 8 – "the Policy on Development of the Automotive Industry" – refers to the development of China's automotive industry, not enforcement of China's tariff provisions for motor vehicles or vehicle parts. Further, as submitted by the complainants, the text of the preamble of Policy Order 8 also shows that the main reason for introducing the Policy is to further develop China's automotive industry. The preamble of Policy Order 8 provides:

> "The Policy on Development of the Automotive Industry is formulated in order to meet the need to continuously improve the socialist market economy system as well as the new circumstances *for the development of the automotive industry* at home and abroad following accession to the World Trade Organization; in order *to promote the structural adjustment and upgrading of the automotive industry*, and *comprehensively improve the international competitiveness of the automotive industry*; and *in order to satisfy the ever-increasing demand from consumers for automotive products, and foster the healthy development of the automotive industry*. Through the implementation of this Policy, *our country's automotive industry is to develop into a pillar industry of the national economy by 2010*, and to make greater contributions toward realizing the objective to comprehensively build a fundamentally prosperous society." (emphasis added)

7.307 The preamble thus makes no reference to the need to enforce China's tariff provisions as claimed by China.

7.308 We further observe similar language in the Policy objectives[561] as well as other provisions of the Policy, including those of Chapter VIII[562] addressing China's auto parts industry. We also recall

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[560] The Panel recalls its statement above in paragraph 7.9 that it would refer back to the provisions contained in Policy Order 8 as necessary in its legal analysis.

[561] "Article 2. ...By 2010, our country is to become a major global automotive manufacturing country, with automotive products that are able to satisfy most of the domestic market's demand and that have entered the international market in large volumes.

Article 3. ...In 2010, vehicle manufacturers shall have forged a number of well-known brands in automobile, motorcycle and parts products.

Article 4. Promote structural adjustments and restructuring in the automotive industry, ... Through market competition, form several internationally competitive large vehicle manufacturers, and strive to make them into the list of the world's top 500 enterprises by 2010. ... 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."

that Article 52 of Chapter XI, which is the chapter on import management and gives rise to the implementation of Decree 125 and Announcement 4, mentions the development of automobile manufacturers and vehicle manufacturers giving impetus to the technological progress of auto parts manufacturers.

7.309 In response to a request from the Panel to explain the specific situation leading up to China's decision to introduce the measures at issue in 2004, China submits that there was a significant issue concerning the evasion of higher tariff rates that apply to motor vehicles, including parts and components that have the essential character of a motor vehicle.[563] China argues that the dramatic increase in the value of imported parts and components between 2001 and 2004, greatly outstripping the rate of motor vehicle production in China[564], proves the existence of the alleged problems relating to circumvention of ordinary customs duties for motor vehicles, particularly since this increase occurred at a time when automobile manufacturers were introducing a large number of new vehicle models into the Chinese market. According to China, these figures strongly suggest that there were issues of tariff classification concerning motor vehicles and parts of motor vehicles that warranted examination.

7.310 We are not convinced, however, that these particular statistics showing an increase in auto parts imports between 2001-2004 alone can prove that the alleged problem relating to evasion of higher tariff rates applicable to motor vehicles existed prior to the introduction of the measures.[565] As pointed out by the European Communities and Canada, numerous factors could explain this increase

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[562] For example, Chapter VIII of Policy 8 provides:

> "Article 30. Auto parts manufacturers should adapt to international industrial development trends and actively participate in product development word done by the manufacturers of complete vehicles and assembles. In the field of key auto parts, systematic development capabilities should progressively be formed, while in the field of general autoparts, capabilities for the development and manufacturing of advanced products should be formed, so as to meet domestic and foreign market demand and to strive to enter the international purchasing system for auto parts.
>
> Article 31. Formulate specific development plans for parts, give different guidance and support depending on the category of auto parts, bring it about that capital in society is invested in the filed of auto parts production, impel auto parts manufacturers that have comparative advantages to form the capability to specialize, mass-produce and modularize supply. Auto parts manufacturers capable of supplying several independent manufacturers that undertake the production of whole vehicles and of entering the international purchasing system for auto parts shall be given priority support by the State with respect to introduction of technology, technological upgrading, financing and merging and restructuring. Manufacturers that undertake the production of whole vehicles should progressively procure parts from the open market by adopting e-commerce and online purchasing methods. ..."

[563] China's response to Panel question No. 12(a).

[564] China's response to Panel question No. 12(a), referring to its first written submission, para. 21. China submits that between 2001 and 2004, the value of imported parts and components increased by 300 per cent, which is nearly three times the rate of total motor vehicle production in China (China's first written submission, para. 21, citing Exhibit CHI-1). China also refers to the fact that approximately 120 of the 500 or so vehicle models that have completed the evaluation process are assembled from imported parts and components having the essential character of a motor vehicle. According to China, these indicators confirm that auto manufacturers were importing motor vehicles in parts and assembling them domestically, thereby evading tariff rates applicable to motor vehicles.

[565] Parties' responses to Panel question No. 14(a).

in auto parts imports, including factors such as foreign supply, trade regulations, currency rates, investment flows, tax policies, and the increased demand for automobiles produced in China, which consequently could have increased the demand for auto parts imports. We share the complainants' view that China has not explained why and how the import data for complete vehicles submitted by China, which shows a slowing rate of increase for imported motor vehicles in 2003 and 2004, reflects China's notion of circumvention, namely that this data reflects auto manufacturers' decision to change their business practices to avoid the higher duty rates on motor vehicles.[566]

7.311 Nor has China explained why the increased value of auto parts imports cannot simply be a direct consequence of China's commitment to the lower tariff rates for auto parts.[567] In fact, China itself acknowledges that the incentive to import auto parts instead of motor vehicles (because of the higher tariff rate for motor vehicles) is a characteristic that is inherent to China's Schedule of Concessions that China negotiated.[568]

7.312 Therefore, the language of Policy Order 8, which is a legal authority giving rise to the implementing measures at issue (Decree 125 and Announcement 4), as well as the circumstances leading up to the introduction of the measures as explained by China cast doubt on China's claim that the measures are "designed" to address the evasion or circumvention of higher tariff rates that apply to motor vehicles under China's tariff schedule.

7.313 Nonetheless, we note that the remaining provisions in Chapter XI of Policy Order 8 refer to issues relevant to the importation of auto parts, including Articles 55, 56 and 57[569], which are also

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[566] United States' comments on China's response to Panel question No. 14(b). The United States submits that rather, the data reflects China's own concerted efforts to discourage imports of motor vehicles by manufacturing an already restrictive quota regime, while promoting imports of CKD/SKD kits and parts. In its comments on China's argument that a slowing rate of increase for imported motor vehicles in 2003 and 2004 was abnormal considering that China's import quotas on motor vehicles were being "substantially loosened" during this period, the Untied States contends that China's response is not convincing because China was doing everything in its power to limit imports of motor vehicles during the years 2001, 2002 and 2003. The United States submits that only in 2004 did China begin to lift the barriers that it had put in place to limit vehicle imports, and these barriers were only lifted in full by the end of 2004 (with the exception of the high tariff rates that are still applicable to motor vehicles).

[567] European Communities' response to Panel question No. 14(a). The European Communities argues that China's Schedule of Concessions or the HS under Chapters 84 and 87 do not provide for the anti-circumvention measures argued by China, and hence, there is no need to consider trade statistics provided by China. However, in the European Communities' view, such statistics could at most demonstrate that after WTO accession, trade has increased in imported parts and components as a direct consequence of China's commitment to reduce the tariff rate for parts and components to a bound level of 10 per cent or less. According to the European Communities, if the expected effect of a commitment could serve as a justification for not respecting this commitment any longer, this would entirely undermine the legal value of WTO commitments.

[568] China's response to Panel question No. 275.

[569] For example, Articles 55 and 56 of Chapter XI of Policy Order 8 provide:

> "Article 55. The following parts are characterized as complete vehicles: the body (including driver's cabin) assembly, the engine assembly, the transmission assembly, the drive axle assembly, the non-drive axle assembly, the frame assembly, the steering system and the brake system.
>
> Article 56. Auto parts shall be determined to have the character of a complete assembly in the following cases: complete assemblies imported in their constituent parts (completely knocked-down), or assemblies and/or systems imported dismantled into several key parts

reflected in Decree 125 and Announcement 4. Also, Article 54 of Chapter XI states, *inter alia*, that "[c]ustoms duties will be levied strictly in accordance with the tariff rates for imported whole vehicles and parts, *to prevent any loss of customs duties*. ..." Furthermore, Decree 125 and Announcement 4, introduced pursuant to Policy Order 8, provide specific rules relating to the importation of auto parts.[570] Setting aside whether these rules do secure compliance with China's tariff schedule, an issue the Panel will address next, Decree 125 and Announcement 4, except for a general remark in Article 1 of Decree 125[571], do not make any reference to the development or promotion of automobile or auto parts industries in China.

7.314 Taken together, the elements comprising the structure of the measures reveal the drafters' mixed intentions as regards the purpose of the introduction of the measures. This is particularly so in light of the tone of the language prevalent throughout Policy Order 8. Nevertheless, we do not have sufficient evidence to conclude that the measures are not *per se* designed to secure compliance with China's tariff schedule, namely to prevent the problems relating to circumvention of the tariff provisions for motor vehicles, as advanced by China. Therefore, we will now turn to the question of whether the measures do in fact "secure compliance with" China's tariff schedule within the meaning of Article XX(d).

(ii) Whether the measures "secure compliance" with the law or regulation

7.315 In examining whether the measures at issue secure compliance with China's tariff schedule within the meaning of Article XX(d), we find an approach adopted by the Panel in *Korea – Various Measures on Beef* useful. The Panel in that case, having first identified the law or regulation within the meaning of Article XX(d), proceeded to determine the inconsistent actions under that regulation the measure at issue aimed to prevent to analyse whether the subject measure secured compliance with that regulation.[572] Following the same approach, we first recall our finding above that the law or

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(semi-knocked down). Whenever imported key parts attain or exceed the stipulated quantity they shall be characterized as Imported Assemblies."

[570] Concerning the legal relationship among the measures, China submits that there is no legal hierarchy between Policy Order 8 and Decree 125 and that Policy Order 8 is a broad policy instrument that sets forth general goals across a wide array of issues relating to motor vehicles and the automobile industry (China's response to Panel question No. 48). See also Section VII.A.1(a). China further submits that Chapter XI of Policy Order 8 addresses the administration and enforcement of China's tariff rates for motor vehicles and vehicles parts. Article 60 of Policy Order 8 directed the CGA jointly with other relevant departments to promulgate the specific administrative rules to give effect to the general principles set forth in Chapter XI, and that the CGA did so through the promulgation of Decree 125. Afterwards, in order to detail the procedures for the verification of evaluation by automobile manufacturers, the CGA formulated Announcement 4 to provide further details concerning the verification process.

[571] Article 1 of Decree 125 provides:

"These Rules are formulated in accordance with relevant laws and regulations with a view to formalizing and strengthening the administration of the importation of automobile parts, and *promoting the healthy development of the automobile industry*." (emphasis added)

[572] Panel Report on *Korea – Various Measures on Beef*, paras. 655, 658. Specifically, the Panel identified that the practices that Korea considered deceptive and aimed to prevent through the measure at issue in that case were the misrepresentation of the origin of beef, i.e. selling imported beef as domestic beef. Whatever is the cause of such fraudulent practices, the Panel acknowledged that selling imported beef as domestic beef constitutes misrepresentation as to the origin of beef contrary to the specific provisions of the Unfair Competition Act (i.e. the alleged GATT-consistent law).

regulation with which China's measures allegedly secure compliance is China's tariff schedule. Accordingly, to show that the measures do in fact "secure compliance with" China's tariff schedule, China must first demonstrate specific obligations that the measures at issue try to enforce and/or actions considered inconsistent under China's tariff schedule that the measures at issue aim to prevent.

7.316 **China** submits that the challenged measures secure compliance with China's tariff schedule by preventing the importation and assembly of auto parts as a means of circumventing China's tariff provisions relating to motor vehicles.[573] Specifically, China alleges that this so-called "circumvention" occurs when manufacturers evade the higher duty rate for motor vehicles by structuring their imports of auto parts and components in multiple shipments so that no single shipment has the essential character of a motor vehicle, even if those parts and components would have been classified as a motor vehicle had they entered China in a single shipment.[574] By structuring the importation of auto parts and components in this manner, auto manufacturers deprive China of the revenue and market access benefits that it negotiated when it obtained a higher bound duty rate for motor vehicles as compared to parts and components of motor vehicles. According to China, therefore, the question is whether importers should be able to evade the line that customs authorities have drawn by importing parts and components in multiple shipments.[575] China considers that such an action by auto parts importers is contrary to the interpretation of its tariff schedule based on the interpretative rules of the HS. China submits that a Member's ability to adopt measures to interpret its tariff schedule in accordance with the rules of HS is co-extensive with those rules since any such measure must comport with the requirements of the HS.[576]

7.317 On the contrary, the **complainants** do not even acknowledge the existence of "circumvention of customs duties" as a concept. The complainants submit that notions of "tariff arbitrage", "tariff evasion" or "tariff circumvention", mentioned during the course of this Panel's proceeding to describe the "circumvention" of tariff duties as defined by China, do not exist in the WTO Agreement.

7.318 The **European Communities** submits that China has not even shown that there is in reality a problem of tariff evasion that needs to be addressed.[577] The European Communities submits that in its customs law, the concept of "circumventing a customs duty" does not exist, although there are situations in which operators try to avoid paying the ordinary customs duties, for example, by falsely declaring that the goods they are importing come from a country that has a preferential trade

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The GATT Panel in *EEC – Parts and Components* also considered that the term "to secure compliance with laws or regulations" under Article XX(d) cover measures preventing actions inconsistent with the obligations set out in laws or regulations. In sum, the Panel in that case concluded that Article XX(d) covers only measures related to the enforcement of obligations under laws or obligations consistent with the GATT (GATT Panel Report on *EEC – Parts and Components*, paras. 5.14, 5.18).

We also note a similar analytical element in the context of Article XX(b). In *EC – Asbestos*, the Panel considered it necessary first to determine the existence of a health risk to address the question of whether the policy in respect of the measures for which Article XX(b) was invoked fell within the range of policies designed to protect human, animal or plant life or health. The Panel stated that "the use of the word 'protection' implies the existence of a risk". (Panel Report on *EC – Asbestos*, paras. 8.170, 8.184, also cited in *Brazil – Retreaded Tyres*, para. 7.42). Likewise, we also consider the terms "to secure compliance" implies the existence of obligations under the law or regulation.

[573] China's first written submission, para. 204.

[574] China's response to Panel question No. 13. China argues that the measures exist as an anti-circumvention measure for China's tariff schedule (China's first written submission, paras. 207, 210).

[575] China's second written submission, para. 32.

[576] China's response to Panel question No. 9.

[577] European Communities' second written submission, para. 146; response to Panel question No. 280.

agreement with the European Communities and therefore such goods are subject to zero per cent customs duty.[578]

7.319 The **United States** submits that it cannot accept the assumption advocated by China that it amounts to "circumvention" when automobile manufacturers use normal channels of trade to source bulk shipments of parts for assembly purposes. There is no legislation or regulation in which the United States sets forth specific criteria and procedures for determining whether an importer is avoiding payment of the correct amount of ordinary customs duty.[579] Nor does the United States investigate whether a manufacturer may be arranging multiple shipments in order to obtain lower tariff duties, and does not consider such practice to constitute "circumvention".[580] In the United States, an importer is not entitled to misrepresent the condition of the goods when imported in order to obtain a lower rate of duty. In this context, the United States submits that an importer would be entitled to obtain the rate of duty applicable to the parts (and not complete motor vehicles) if auto parts that were previously imported together on the same conveyance are now shipped in multiple conveyances on multiple dates to multiple ports, presuming that none of the parts so imported separately has the essential character of a complete motor vehicle.

7.320 **Canada** submits that China does not explain why the so-called tariff evasion (avoiding paying one tariff rate in favour of another, by splitting shipments that otherwise would have arrived at the border together and properly be classified as motor vehicles into multiple shipments), which is the "problem" alleged by China, is a problem and why importers cannot take advantage of tariff rates that are mutually agreed to by Members.[581] Canada argues that there is no legal foundation for the claim that tariff arbitrage is improper. Moreover, China has not even presented any evidence that tariff evasion actually occurs with any frequency, let alone with any intent. The measures simply presume that there is tariff avoidance in all instances where imported parts meet the thresholds under the measures.[582]

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[578] European Communities' response to Panel question No. 142.

[579] United States' response to Panel question No. 142.

[580] United States' response to Panel question No. 216(d). The United States' statement was provided in response to a Panel question whether the United States believes that it would be proper for customs authorities to *investigate* whether a manufacturer is splitting a CKD shipment into two or more separate boxes, thereby evading the higher tariff rate that would apply to the complete article. The United States emphasizes again that under both the WTO Agreement and the HS, a good should be classified in its condition as imported. Therefore, assuming that an imported CKD is a complete vehicle unassembled, it would be classified differently than the auto parts included in such kits if such auto parts were to be imported separately. Therefore, when an imported auto part is specifically described by a heading of the tariff schedule, it is classifiable under that heading notwithstanding that, post importation, the auto part may be used in the assembly of a complete motor vehicle, in accordance with GIR 1. Any measures that compel an auto manufacturer to provide proof of the post-importation assembly of many different imported parts, in their entirety, into a complete vehicle do not retroactively confer to those parts at the time of importation the "essential character" of a motor vehicle.

[581] Canada's second written submission, paras. 93-97; Canada's response to Panel question No. 237. The Panel notes that Canada's argument in this regard is made in the context of the "necessity" test (specifically, the contribution element of the test). In this respect, the Appellate Body in *EC – Hormones* stated, "...Panels are inhibited from addressing legal claims falling outside their terms of reference. However, nothing in the DSU limits the faculty of a panel freely to use arguments submitted by any of the parties – or to develop its own legal reasoning – to support its own findings and conclusions on the matter under its consideration" (Appellate Body Report on *EC – Hormones*, para. 156). See also, Appellate Body Report on *US – Certain EC Products*, para. 123.

[582] Canada emphasizes that there is no evidence that evasion of the tariff commitments is occurring, or even that such evasion is improper (Canada's second written submission, paras. 87, 88, also citing its first written submission, Part D.2 of the factual background section submitted jointly by the complainants).

7.321 In light of the above, the **Panel** understands that the action alleged by China to be inconsistent with China's tariff schedule that the measures aim to prevent is "circumvention" of the tariff provisions for motor vehicles. China has referred to the following as examples of actions considered to be "circumventing" China's tariff provisions for motor vehicles: (i) removing parts of the vehicle, such as tyres and wiper blades, and *declaring* them as auto parts; (ii) importing parts and components that have the essential character of a motor vehicle, and *documenting* them as "separate" shipments even if they arrive on the same ship, at the same port, on the same day; or (iii) importing parts and components that have the essential character of a motor vehicle in multiple shipments and *arranging* imports so that they arrive on different ships, at different ports, or on different days.[583] China argues that if China has no means of looking past the above described ploys, importers would never have to pay the tariff rates applicable to motor vehicles.[584]

7.322 Given these examples of actions and China's position that this circumvention takes place by importing auto parts above the thresholds set out in the measures, with or without an intention to avoid higher tariff rates for motor vehicles, and assembling them into motor vehicles in China, we consider that the actions allegedly circumventing China's tariff schedule encompass the following three types of actions: (i) importing auto parts for domestic assembly without any intent to avoid or evade higher duty rates applicable to motor vehicles; (ii) importing auto parts for domestic assembly with the intent to avoid or evade higher tariff rates applicable to motor vehicles; and (iii) importing "motor vehicles", but breaking them into parts so as not to be subject to higher tariff rates applicable to motor vehicles when presented to the customs, and declaring and/or documenting their imports as auto parts inconsistently with the actual content of what is being imported.

7.323 As noted above, the complainants contest that the so-called "circumvention" of China's tariff provisions for motor vehicles through the above-mentioned types of actions is inconsistent with China's tariff schedule. To establish its claim, therefore, China must explain why the "circumvention" of the tariff provisions for motor vehicles is inconsistent with the obligations under its tariff schedule, and thus needs to be prevented through the measures.

7.324 First, according to China, the concept of "circumvention of customs duties" is broad in that the intention of an auto parts importer to evade the higher duty rates on motor vehicles is not required to constitute the circumvention of tariff duties.[585] China considers that the importation and assembly

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[583] China's second written submission, para. 166 (emphasis added).

[584] In this connection, the United States submits that China presents two scenarios in which China believes that importers are not entitled to obtain the lower tariff rates for auto parts instead of paying the high tariff rates for complete motor vehicles: *first*, the scenario where importers restructure their importations of parts and components, in the sense that parts previously imported together on the same conveyance are now shipped in multiple conveyances on multiple dates to multiple ports, with none of the parts having the essential character of a complete motor vehicle; and *second*, the scenario where an importer submits paperwork claiming that parts imported together are separate shipments, although the contents of the paperwork itself do not turn such a collection of auto parts into multiple importations (United States' response to Panel question No. 237).

[585] In this regard, we note China's argument in the context of tariff classification under Article II that the charge imposed under the measures relates back to the condition attached at the time of importation; when the auto manufacturer *fulfils its stated intention to import and assemble* parts and components that have the essential character of a motor vehicle, it will be obliged to pay the applicable duty rate for motor vehicles. At the same time, China argues that the intention of importers to assemble parts and components into the finished article is irrelevant to the classification determination under GIR 2(a) (China's response to Panel question No. 108(d)). Thus, if an importer imports a completely unassembled motor vehicle in a single container with the intention of selling the various parts and components as replacement parts, this intention is irrelevant to the classification determination and the customs authorities should classify the entry as a complete motor vehicle in accordance with GIR 2(a). We do not consider that China's arguments are coherent: if intention is in principle

of auto parts and components through multiple shipments undermines the value of the tariff concessions that China negotiated, whether the auto manufacturer has an intention to evade the higher duty rates on motor vehicles or not.

7.325 If one were to follow China's logic, therefore, an automobile manufacturer who imports auto parts in the normal course of its business operation, without any specific intent to avoid the higher tariff rates applicable to motor vehicles, and uses imported auto parts in the assembly of motor vehicles in China would be regarded as circumventing China's tariff provisions for motor vehicles. China has not demonstrated any legal basis for such a position.

7.326 The term "circumvention" can be defined as "the action or an act of circumventing someone".[586] The word "circumvent" is in turn defined as "1. *verb trans.* Deceive, outwit, overreach; find a way around, evade (a difficulty); .. 3 *verb trans* Go round; enclose; make the circuit of"".[587] As the European Communities submits, the dictionary definitions of the term "circumvention" appear to contemplate both situations where criminal or fraudulent intent behind the action exists and situations where such intent is not necessarily present and where actions amounting to circumvention would not be per se illegal. Although not necessarily requiring criminal or fraudulent intent, the ordinary meaning of the term "circumvent" (i.e. "find a way around" or "go around ") implies the presence of a will or intent necessary to avoid a certain thing or situation. Thus, to circumvent one tariff duty for another as claimed by China, an importer at least needs to have the intent to do so. In light of this, to the extent the action China submits as inconsistent under its tariff schedule includes the importation and assembly of auto parts without any intention to avoid the higher tariff duties imposed on motor vehicles, China has not explained why and how such an action is inconsistent with its tariff schedule.

7.327 Second, assuming then, *arguendo*, that some importers do intentionally structure their imports so as to avoid the higher tariff rates applicable to motor vehicles, China has to demonstrate why such an action is inconsistent with China's tariff schedule.

7.328 The **United States** argues that an importer would be entitled to obtain the tariff rate applicable to parts (and not complete motor vehicles) in such a situation, given that the identity of the imported good must be demonstrable by the good in its condition "as presented" for entry into the customs territory, that is, at the time of importation.[588]

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irrelevant for the purpose of tariff classification under GIR 2(a), the importers' intention to import and assemble parts and components into motor vehicles should also be considered irrelevant under the measures, which China argues is related to the correct classification of certain tariff provisions. China's position is puzzling in that the same intention (to import and assemble auto parts) is irrelevant to tariff classification under GIR 2(a), but relevant under the measures, which allegedly give effect to China's tariff provisions for motor vehicles, as the condition of imposing the tariff rates applicable to motor vehicles. See also the United States' comments on China's response to Panel question No. 108(d).

[586] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 414.

[587] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 414. The term "circumvent" is also defined as "2. To go around; bypass. 3, To avoid or get around by artful manoeuvring" (*The American Heritage College Dictionary*, Third Edition (1993), page 255). See also the European Communities' response to Panel question No. 13(a).

[588] The United States submits that separate importations of other parts and components with which the good will be assembled in the importing country's internal market cannot be considered in the classification of the good because there is no assembly of the good and the other parts and components at the time that the good is imported. Activities occurring after the imported goods have entered the country's customs territory are not a basis for classification under the HS (United States' response to Panel question No. 237).

7.329 The **European Communities** also submits that in the absence of any conditions in the applicable tariff schedules, importers are entitled to structure their imports according to their preferences and the priorities of their manufacturing plans and the goods so imported must be classified in accordance with the objective characteristics of the product in question when presented for classification at the border.[589] The United States and Canada also agree with the European Communities: they would not find circumvention of the customs classification rules if a manufacturer were to order all of individual auto parts from one company and then separate them into different containers and make separate entry of each shipment in order to obtain a lower tariff duty.[590]

7.330 **Canada** further submits that if vehicle manufacturers shipped all the parts necessary to assemble a vehicle in two or more shipments to avoid paying the tariff rates applicable to motor vehicles as asserted by China, it could be characterized neutrally as "tariff arbitrage", or "tariff avoidance", or more negatively as "tariff evasion" or "tariff circumvention".[591] According to Canada, if there were evidence that this were happening, and if the measures were targeted to address this practice, then the legal issue for the present dispute would be whether Article XX(d) is available to counter such a practice.

7.331 **China** argues that the complainants' position allows form to prevail over substance in the classification of parts and components. If an importer had complete discretion to structure and document its imports as it saw fit, there would be no purpose in defining the circumstances under which customs authorities may classify unassembled or disassembled parts and components as equivalent to the complete article. Any set of tariff provisions that established different tariff rates for a complete article and the parts and components of that article would be inherently unenforceable, because any rational importer would simply organize its containers so as to benefit from whichever tariff rate was lower. The tariff provision with the higher rate of duty would be automatically *inutile*.[592]

7.332 The **Panel** will first examine whether there is any reference in the WTO Agreements to the notion of "circumvention" in relation to the situation where importers intentionally structure their auto parts imports so as to use lower tariff rates applicable under a Member's schedule. The term "circumvention"[593] is defined in the *Dictionary of Trade Policy Terms* as follows:

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[589] European Communities' response to Panel question No. 237, also referring to the Appellate Body's statement in *EC – Chicken Cuts* 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" (Appellate Body Report on *EC – Chicken Cuts*, para. 246).

[590] Complainants' responses to Panel question Nos. 216(b) and (c).

[591] Canada's response to Panel question No. 229.

[592] Further, China submits that the complainants' position is antithetical to the function that GIR 2(a) serves within the HS to distinguish between complete articles and parts of those articles. Such a form-over-substance position sharply highlights the complainants' failure to articulate and substantiate an interpretation of GIR 2(a) and the term "as presented".

[593] The European Communities submits that the EC law defines "circumvention" in the context of anti-dumping duties as follows: "Circumvention shall be defined as a change in the pattern of trade between third countries and the Community or between individual companies in the country subject to measures and the Community, which stems from a practice, process or work for which there is insufficient due cause or economic justification other than the imposition of the duty, and where there is evidence of injury or that the remedial effects of the duty are being undermined in terms of the prices and/or quantities of the like product, and where there is evidence of dumping in relation to the normal values previously established for the like product, if necessary in accordance with the provisions of Article 2." (European Communities' response to Panel question No. 13(a), referring to Article 13(1) of Regulation 384/96 as amended by Regulation 461/2004). See the

> "Measures taken by exporters to evade *anti-dumping measures or countervailing duties*. It can refer also to the evasion of *rules of origin*, etc. Circumvention consists of disguising the true origin of the product, sometimes through manufacturing operations whose sole purpose is to provide sufficient evidence to meet the requirements of an agreement. These sometimes fall into the category of screwdriver operations. The *Agreement on Agriculture* seeks to prevent circumvention of commitments to rein in export subsidies. Circumvention in the *textile trade* refers to avoiding quotas and other restrictions by altering the country of origin of a product. [See also anti-circumvention.]"[594] (emphasis added)

> "The avoidance of trade restrains in export markets, by, for instance, transhipments through other states subject to more advantageous terms of entry. In the WTO the issue of 'anti-circumvention' figures in negotiations and agreements related to *textiles and clothing, anti-dumping and agriculture*."[595] (emphasis added)

7.333 Further, "anti-circumvention" is defined in the *Dictionary of Trade Policy Terms* as follows:

> "[m]easures by governments to prevent circumvention of measures they have imposed, such as *definitive anti-dumping duties*. Sometimes firms seek to avoid such duties through, for example, assembly of parts and components either in the importing country or in a third country, or by shifting the source of manufacture and export to a third country. *The term as used in the WTO does not refer to cases of fraud.* These would be dealt with under normal legal procedures of the countries concerned. The *Agreement on Agriculture* contains an anti-circumvention provision. It stipulates that export subsidies not listed in the Agreement must not be used to circumvent export subsidy commitments. Nor must non-commercial transactions be used in this way. [See also *anti-dumping measures*, carousel effect, dumping and screwdriver operations.]"[596] (emphasis added)

7.334 The definitions of the word "circumvent" in the context of international trade, as observed above, show that the notions of "circumvention" and "anti-circumvention" are not contemplated in the relation to ordinary customs duties. In the context of the WTO Agreement, "circumvention" is recognized concerning anti-dumping duties, rules of origin, the *Agreement on Agriculture* and the textile trade.[597] Further, it is only in the *Agreement on Agriculture* that the notion of "anti-

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complainants' responses to Panel question No. 141 for the description of their domestic procedures determining circumvention by importers of anti-dumping duties.

[594] WTO, W. Goode, *Dictionary of Trade Policy Terms*, Fourth Edition, 2003, pages 61-62. The Dictionary defines "screwdriver operations" as follows: "a pejorative term for manufacturing operations concerned mainly with the assembly of components. This often involves little or no transfer of technology. Screwdriver operations are more likely to be found where there is an adequate supply of comparatively inexpensive labour. They are partly a cause and a result of globalization driven by the need to find the most efficient production arrangement. They can also be due to preferential rules of origin which encourages firms to establish operations inside free-trade areas to get around market access impediments. …" (*Dictionary of Trade Policy Terms*, page 303).

[595] Agency for International Trade Information and Cooperation (AITIC), *Glossary of Commonly Used International Trade Terminology with Particular Reference to the WTO*, 2003, Part International Trade and WTO Terms, page 15.

[596] *Dictionary of Trade Policy Terms*, W. Goode, WTO Fourth edition, 2003, pages 19-20.

[597] The European Communities notes that under WTO law, anti-circumvention measures are explicitly contemplated in Article 10 of the *Agreement on Agriculture*. In the context of anti-dumping duties, the

circumvention" is explicitly recognized: Article 10 of the *Agreement on Agriculture*, entitled "prevention of circumvention of export subsidy commitments", stipulates that export subsidies not listed in the Agreement must not be used to circumvent export subsidy commitments. The WTO Members are also in the process of negotiating anti-circumvention issues in the context of anti-dumping duties.[598]

7.335 Moreover, the concepts such as "evasion" and "avoidance" do not appear to exist in relation to customs duties, at least not in a legal context. In comparison, we observe that such concepts are relatively well defined in the context of domestic tax law. For example, *Black's Law Dictionary* provides the following definitions: "tax avoidance" is defined as "the act of taking advantage of *legally available* tax-planning opportunities in order to minimize one's tax liability"; and "tax evasion" is defined as "the wilful attempt to defeat or *circumvent the tax law* in order to *illegally reduce* one's tax liability; tax evasion is *punishable by both civil and criminal penalties* – also termed as *tax fraud*".[599]

7.336 Furthermore, in fact, China's tariff schedule explicitly provides different tariff rates for motor vehicles and auto parts, the first with the higher tariff rate of 25 per cent on average and the latter with the lower tariff rate of 10 per cent on average. Under this circumstance, any importer, automobile manufacturers in this case, would, in the normal operation of their business, decide to import auto parts and assemble them into motor vehicles, to the extent allowed under their business requirements. As noted earlier, China itself has also acknowledged that the incentive to import auto parts instead of motor vehicles (because of the higher tariff rate for motor vehicles) is a characteristic that is inherent to China's Schedule of Concessions that China negotiated.[600]

7.337 Therefore, to the extent that by the notion of "circumvention", China is referring to importers' decision to import auto parts for domestic assembly rather than importing complete motor vehicles, which are subject to higher tariff rates, China has neither provided evidence showing such practices by importers[601], nor proved to our satisfaction why such actions are inconsistent with importers' obligations under China's tariff schedule. In this regard, we are not saying that specific evidence of any steady pattern of import practices accused by China as circumventing its tariff schedule must be shown to prove that such practices are inconsistent under China's tariff schedule, because, in our view, there is nothing that prevents WTO Members from having a "preventive" measure, as opposed to a "responsive" measure, against actions considered inconsistent under their domestic laws or regulations. In our view, such evidence would be useful in proving that a certain measure is "designed" to secure compliance with the concerned domestic law or regulation. However, to show that the measures at issue "do in fact secure compliance with" its tariff schedule, which is contested by the complainants in this case, China must at least demonstrate why the types of actions as described by China are inconsistent under China's tariff schedule and thus need to be prevented through the measures.

European Communities refers to the Ministerial Decision on Anti-Circumvention adopted by the *Trade Negotiations Committee* on 15 December 1993 (European Communities' response to Panel question No. 13(b)).

[598] See paragraphs 7.498-7.499 for an explanation on the WTO Members' negotiations on circumvention of anti-dumping duty measures.

[599] *Black's Law Dictionary*, Seventh Edition, 1999, pages 1473 and 1474, respectively (emphasis added).

[600] China's response to Panel question No. 271. See also paragraph 7.310 above.

[601] See paragraphs 7.309-7.310 above for the discussion on China's arguments relating to the existence of the alleged problems relating to circumvention of ordinary customs duties.

Also see footnote 572 above for the relevant finding by the Panel on *Korea – Various Measures on Beef*, paras. 655, 658.

7.338 Finally, we now turn to the situation where automobile manufacturers import "motor vehicles", but break them into parts before importation so as not to be subject to the higher tariff rates applicable to motor vehicles when presented to the customs, and declare and/or document their imports as auto parts inconsistently with the actual content of what is being imported.[602]

7.339 According to the **European Communities**, such false declarations can give rise to sanctions and penalties, applied at the national level in the European Communities, and are more related to fraud than to circumvention.

7.340 The **United States** submits that an importer is not entitled to *misrepresent* the condition of the goods when imported in order to obtain a lower tariff rate.[603] Where there is a suspicion that an importer is attempting to avoid the payment of the proper amount of ordinary customs duties owing on imported merchandise by, for example, undervaluing the goods, providing fraudulent certification of eligibility for duty-free treatment under a free trade agreement, or misclassifying goods under an incorrect tariff heading with a lower tariff rate, the United States may initiate an audit of its records or initiate a criminal investigation.[604] The United States submits that depending on the outcome of such an investigation, penalties can be imposed or criminal charges can be filed against the importer.

7.341 **Canada** submits that there is no evidence to suggest that any companies are or ever have sought to obtain a lower tariff rate merely by documenting their imports as "separate" shipments.[605] Furthermore, customs authorities determine appropriate classification of goods based upon their state as they arrive at the border, which includes (but is not limited to) the declaration. Canada has no procedures for determining whether an ordinary customs duty is being circumvented.[606]

7.342 The **Panel** notes that the European Communities and the United States at least acknowledge that importers' false declaration or documentation of goods could be considered illegal under their respective domestic legal systems. The complainants contest, however, that these are types of issues that are addressed under a Member's tariff schedule itself as China claims.

7.343 In this connection, China's response to a Panel question informs us that, similar to the complainants' domestic legal systems as described above, China has provisions within its "regular customs laws" that regulate the situation where importers falsely declare imported goods or provide incorrect information. China submits that the Regulation of the People's Republic of China on the Implementation of Customs Administrative Punishment defines various types of customs violations, including the submission of untruthful declarations or actions that violate customs control of goods.[607] Therefore, this type of actions that China asserts is inconsistent with China's tariff schedule and thus needs to be prevented through the measures is already defined in and dealt with by China's Implementation of Customs Administrative Punishment, a legal instrument separate from China's tariff schedule.

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[602] See paragraph 7.322 above.
[603] United States' response to Panel question No. 237 (emphasis added).
[604] United States' response to Panel question No. 142.
[605] Canada's response to Panel question No. 237.
[606] Canada's response to Panel question No. 142. Canada explains that the CBSA's furniture classification case provided specific guidance relating to furniture purchased as one unit at the retail level and shipped separately. According to Canada, there are no situations where attempts to evade customs duties by separate shipments of parts result in those separate shipments being treated separately for purposes of increasing duty beyond the applicable tariff commitments in Canada's Schedule of Concessions. Further, Canada notes that there are no instances where activities taking place after presentation at the border are taken into account in increasing duty beyond the applicable tariff commitments in Canada's Schedule.
[607] China's response to Panel question No. 30.

7.344 Further, as the *Dictionary of Trade Policy Terms* explains[608], the notion of circumvention as used in the WTO context does not include cases of fraud, which are rather addressed under normal domestic legal procedures of the countries concerned.

7.345 Therefore, we conclude that China has not demonstrated that a false declaration or documentation of goods imported is an action inconsistent with the obligations under China's tariff schedule that needs to be prevented through the measures.

(iii) Conclusion

7.346 In sum, we conclude that China has not discharged its burden to prove that the measures "secure compliance" with its tariff schedule, because China has not explained to our satisfaction how the types of actions that China claims amount to "circumvention" of the tariff provisions for motor vehicles (i.e. importing and assembling auto parts in China, with or without any intention to avoid/evade the higher tariff duties for motor vehicles) are inconsistent with the obligations under its tariff schedule and hence need to be prevented through the measures.

(c) Are China's measures "necessary" to secure compliance with China's tariff schedule?

7.347 The Panel has found above that the measures do not secure compliance with China's tariff schedule. Accordingly, the measures cannot be considered as "necessary" to secure compliance with China's tariff schedule.[609] However, even if the measures were to have been found to secure compliance with China's tariff schedule, we do not find, for the following reasons, that China has proved that the measures are "necessary" to secure compliance with its tariff schedule.

7.348 We recall the Appellate Body's statement in *Korea – Various Measures on Beef*, with respect to the necessity of a measure within the meaning of Article XX(d):

> "[d]etermination of whether a measure, which is not 'indispensable', may nevertheless be 'necessary' within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include 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."[610]

7.349 We will follow the guidance provided by the Appellate Body in examining whether China has proved the "necessity" of the measures within the meaning of Article XX(d).

7.350 **China** submits that the prevention of tariff circumvention is clearly an important interest to WTO Members.[611] Relying on the Appellate Body's finding in *Dominican Republic – Cigarettes* that the collection of tax revenues (which would include customs revenues) is an important interest for WTO Members, and especially for developing country Members, China argues that the enforcement

[608] See paragraph 7.333.

[609] The Appellate Body in *Mexico – Taxes on Soft Drinks* stated that "[A] measure that is not suitable or capable of securing compliance with the relevant laws or regulations will not meet the 'necessity' requirement" (Appellate Body Report on *Mexico – Taxes on Soft Drinks*, para. 74).

[610] Appellate Body Report on *Korea – Various Measures on Beef*, para. 164.

[611] China's first written submission, paras. 210-211.

of negotiated tariff concessions, including whatever effect they have on market access commitments, is also an important objective for Members, and especially for developing country Members.[612]

7.351 China contends that in comparison, the measures at issue have little or no restrictive impact on international trade: as their only purpose is to ensure that the correct tariff rates are collected, the measures do not materially affect imports of automobiles or auto parts, other than in the respect that importers must pay the higher tariff rates for motor vehicles when they import collections of parts having the essential character of a motor vehicle.[613] China argues that 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.

7.352 China submits that the measures undoubtedly contribute to realizing China's legitimate interest in ensuring the enforceability of its tariff provisions for motor vehicles. China argues that the measures do so by ensuring that tariff classifications are based on the substance of what a manufacturer imports and assembles, not the form of the shipments.[614]

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[612] China's first written submission, para. 210, citing the Appellate Body Report on *Dominican Republic – Cigarettes*, para. 71; China's second written submission, para. 171. Regarding the level of enforcement China seeks with respect to its tariff schedule, China submits that it seeks to ensure the uniform classification of parts and components that have the essential character of a motor vehicle, without regard to whether they enter China in one shipment or in multiple shipments (China's response to Panel question No. 295). In this regard, the European Communities notes that China's reference to "uniform" and "proper classification" is an attempt to distract from the fact that China has not yet demonstrated the proportionality of its measures (European Communities' comments on China's response to Panel question No. 295, referring to its second written submission, para. 146).

According to China, proper classification of import entries is an objective that, by its nature, customs authorities seek to achieve in respect of all similar entries.

[613] China's first written submission, para. 213; China's second written submission, para. 175. To support its position, China refers to a news report that major auto manufacturers and auto parts manufacturers have noted that the measures have had little or no impact on their operations in China (China's first written submission, para. 213; China's second written submission, para. 175, citing a news report by Reuters, "Fang Yan, *Big car parts makers unfazed by China tax row*, Reuters (15 May 2006)" (Exhibit CHI-33)). Based on import statistics for auto parts from 2004 and 2006, which show that the total value of imported auto parts increased by 19.8 per cent, China submits that the lack of any adverse impact on trade is evidenced most directly by this continued rapid growth of the import of auto parts into China (China's response to Panel question No. 294, referring to the data obtained from the China Automotive Industry Yearbook).

[614] China argues that the example of a vehicle model X illustrates both the importance of the interests furthered by the challenged measures, as well as the contribution that these measures make toward the realization of those interests (China's first written submission, paras. 211-212; China's second written submission, paras. 172-174); also referring to other 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 (China's first written submission, para. 19; China's response to Panel question No. 116)). China further submits that in the absence of the 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 also points to a specific circumstance, as referred to by the United States, in which a manufacturer previously imported parts in the form of CKD kits, but now imports nearly all of the same parts and components in the form of multiple shipments, which China considers is a situation of "splitting a CKD shipment into two or more separate boxes" (China's second written submission, para. 173. China refers to its response to Panel question No. 160 in which China provided the example of a vehicle model Y: According to China, an automobile manufacturer Z previously assembled in China almost exclusively from imported CKD kits, but beginning in 2004, the number of CKD kits that the company Z imported for the model Y dropped dramatically, while its imports of auto parts surged. By 2005, the company Z produced 38,600 automobiles of the model Y, and imported only 24 CKD kits for the model Y in

7.353 The **European Communities** submits that China has not demonstrated that its measures serve to protect such interests and values as "prevention of tariff circumvention", "collection of tax revenues" and "enforcement of negotiated tariff concessions".[615] In the European Communities' view, China has not demonstrated there is in reality a problem of tariff circumvention or that its measures serve the collection of tax revenues or the enforcement of negotiated tariff concessions. Automobile manufacturers who import auto parts for their assembly into a motor vehicle in China do not circumvent any tariffs. On the contrary, the measures disregard the negotiated tariff concessions by imposing charges in excess of what is provided in China's tariff schedule.[616]

7.354 The European Communities argues that the adoption of Policy Order 8 in 2004 was followed by a dramatic fall of EC exports of auto parts to China: in just a few months, exports dropped to 53 per cent, and then to as low as 33 per cent of their May 2004 level. Thereafter, exports of parts began to grow slowly and appear to have now stabilized at the level of May 2004[617], which, according to the European Communities, must be considered against the booming Chinese demand and production of vehicles and the much steadier growth rates of EC exports observed before May 2004. The European Communities argues that a comparison between EC exports of auto parts and Chinese production of motor vehicles suggests that the adoption of Policy Order 8 prompted auto manufacturers to switch as quickly as possible to domestic parts suppliers in order to adapt to the local content requirements imposed by the measures.[618] In comparison, recent industry analysis suggests that Chinese companies are becoming increasingly aggressive and there are growing fears that with government support and incentives, foreign companies will eventually be sidelined.[619]

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that year. China submits that as verified under the provisions of Decree 125, the company Z continues to import seven out of the eight major assemblies for the production of the model Y). China considers that while this is not 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.

[615] European Communities' response to Panel question No. 293, also referring to its second written submission, para. 146.

[616] The European Communities points out that according to the negotiated tariff concessions laid down in China's tariff schedule, imported auto parts should be charged at 10 per cent, and not – as the measures provide – at 25 per cent for the mere reason that they are manufactured into vehicles with imported auto parts exceeding the thresholds set out under the measures.

[617] European Communities' response to Panel question No. 294, referring to the graphics provided in Exhibit EC-37: the European Communities submits that the statistics for Chinese production of motor vehicles have been obtained from the website of the National Bureau of Statistics of China (http://www.stats.gov.cn/english/statiscaldata/index.htm).

[618] The European Communities submits that this resulted in a reduction of EC auto parts' market share, which now seems to have become permanent as evidenced by the steady gap between the two curves. China submits in its comments on the complainants' responses to Panel question No. 294 that the European Communities' claim that the measures have had an impact on its exports of auto parts to China suffers from a basic flaw of logic and causation: Policy Order 8, by itself, did not impose any obligations on auto manufacturers, or have any impact on the classification and assessment of duties on motor vehicles or parts of motor vehicles. Rather, it was not until the adoption of Decree 125 in April 2005 that the measures could have had any conceivable impact on sourcing decisions. China further argues that the European Communities' exports of auto parts to China, however, resumed their upward trend in early 2005, as the European Communities' own data illustrate, just as Decree 125 took effect (referring to European Communities' second written submission, para. 146). Since that time, the value of EC auto part exports to China has reached record heights, reaching its highest point as recently as March 2007, according to the European Communities' own data. China submits that this is hardly consistent with the proposition that the challenged measures have had an adverse impact on trade.

[619] Referring to an article entitled "Asian Automotive Industry Forecast Report, Volume I" by Global Insight (August 2006, Exhibit EC-38), in particular the last bullet point in page 3, the European Communities

7.355 The European Communities submits that the measures can only be justified under Article XX(d) if they are necessary to secure compliance with the 25 per cent tariff duty on complete vehicles.[620] However, the measures are not suitable to enforce China's tariff schedule since they in the overwhelming majority of cases impose a 25 per cent duty where there is no import of a complete vehicle, which is at variance with China's tariff schedule.

7.356 The **United States** argues that the asserted rationale of the measures does not match the scope of the measures.[621] Instead, the measures sweep broadly to cover all imports of bulk parts for manufacturing purposes, not just instances of CKDs split into two separate shipments. Therefore, in the United States' view, the measures are not necessary to secure compliance with China's provisions for motor vehicles because they are drastically broader in scope than measures intended to stop such types of "evasion" alleged by China.

7.357 **Canada** submits that the measures do not protect important common interests or values because there is no known concept of "circumvention" as it applies to ordinary customs duties.[622] According to Canada, even if China could show evidence of tariff arbitrage, and even if such a practice were improper, the vital interest at stake would be some limited amount of revenue that China claims it should receive. China has not, for example, indicated any safety concerns with foreign auto parts, only that those parts are escaping higher duties.

7.358 According to Canada, the measures are significantly trade-restricting, in that they do not target isolated incidents, but impose blanket coverage on all imported auto parts based on arbitrary thresholds that presume tariff arbitrage in all instances.[623] Canada argues that both the internal charge and the administrative burden placed on vehicle and parts manufacturers that use imported auto parts discourage the importation of such parts because vehicle manufacturers cannot risk using imported

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submits that the risks for foreign investors are growing. Furthermore, the European Communities contends that China's choice of reference periods (i.e. 2004-2006) in its response to the Panel question No. 294 is vitiated by the fact that Policy Order 8 was announced in May 2004, which was followed by a dramatic reduction of EC exports of parts to China as shown in Exhibit EC-37 (-60 per cent between May and December 2004) (European Communities' comments on China's response to Panel question No. 294). The European Communities argues that the 19.8 per cent growth of imports of parts should be compared with the growth of Chinese production of automobiles (i.e. an increase of 46.8 per cent between 2004 and 2006) (European Communities' comments on China's response to Panel question No. 294: the European Communities explains that according to the calculations based on data from China's Statistics bureau, China produced 5,186,400 cars in 2004, and 7,611,500 cars in 2006, which gives an increase of 46.8 per cent, more than double the growth in parts imports. The European Communities submits that these figures were obtained by adding the monthly figures contained in Exhibit EC-36 ("Percentage in the value of a complete vehicle of combination of imported parts representing 60 per cent of the value of an assembly"). The European Communities further adds that as explained in the exhibit, data for January and December 2006 are not available and were inferred as the average of the values for the previous and following months. Even limiting production of cars in 2006 to the 10 months for which data are available (February to November 2006), this would add up to 6,361,300 units, i.e. an increase of 22.7 per cent compared to 2004), which shows that more and more parts are sourced from local suppliers. The European Communities submits that a more detailed analysis of the effects of the measures on the basis of monthly data, considering the relation between imported parts and Chinese production of cars, shows that Chinese production of cars grew between the announcement of Policy Order 8 and the last comparable figures (March 2007) by 101 per cent, while EC exports of auto parts grew only by 18 per cent (European Communities' comments on China's response to Panel question No. 294, referring to the second graph of Exhibit EC-37).

[620] European Communities' second written submission, para. 146.

[621] United States' response to Panel question No. 293, referring to its response to Panel question No. 280.

[622] Canada's second written submission, paras. 98-99.

[623] Canada's second written submission, para. 100; response to Panel question No. 294.

parts over the arbitrary thresholds under the measures due to the price sensitivity of the Chinese market.[624] This factor forces companies to carefully plan to avoid importing parts at levels that approach the threshold limit and also requires auto parts manufacturers that import auto parts to sign contracts with vehicle manufacturers guaranteeing that only domestic parts are supplied.[625]

7.359 Canada argues that the measures make little or no contribution to the objective of complying with China's tariff schedule and China has failed to show that there is even a problem that needs enforcing.[626] In Canada's view, the problem alleged by China is that importers are evading tariff commitments, namely avoiding paying one tariff rate in favour of another, by splitting shipments that otherwise would have arrived at the border together and properly be classified as motor vehicles into multiple shipments. China does not explain why importers cannot take advantage of tariff rates that are mutually agreed to by Members and that in any event, China has presented no evidence that this is happening. Instead, the measures simply presume that there is tariff avoidance in all instances where imported parts (including those imported by third parties) pass the thresholds under the measures.[627] Canada submits that since there is no legal foundation to the claim that tariff arbitrage is improper and there is no real evidence that this arbitrage, even if styled as "tariff evasion", actually occurs with any frequency, let alone with any intent, the measures cannot contribute to rectifying a problem that does not exist.

7.360 The **Panel** recognizes that yielding revenues by collecting legitimate tariff duties imposed on imported goods is an important interest for WTO Members. In fact, tariff duties imposed under a Member's schedule serve to, *inter alia*, raise revenues for the importing government. In our view, the importance of a fiscal interest pursued by a Member, such as the interest (revenue collection) pursued

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[624] Canada submits that to the extent the Panel needs to make a factual finding on the trade impact brought by the measures, it is an inference that can easily be drawn (Canada's response to Panel question No. 294); Canada also refers to the Appellate Body's statement in *Canada – Aircraft* , "[C]learly, in our view, the Panel had the legal authority and the discretion to draw inferences from the facts before it…" (Appellate Body Report on *Canada – Aircraft*, para. 203). With respect to the effect on parts manufacturers outside China, whose imports are those discriminated against by the measures, Canada notes that the Canadian Auto Parts Manufacturers' Association specifically indicated its concern about the measures, reflecting the effect they have had on trade (*Automotive Parts Manufacturers' Association News*, "President's Message: Driving Canada's Future", page 2, November 2006 (Exhibit CDA-45)).

[625] Canada also refers to statements by Chinese business people after the entry into force of the measures to support its position: For example, a director of China Automotive System, a Chinese-owned company and one of the largest auto parts suppliers in China, referred to one of the pillars supporting the growth of auto parts production in China being the government policy that requires local content (i.e. the measures), noting that "[t]hey really boost the sales for China auto part markers" ("China Automotive Systems, Roth Capital Conference, Presentation Transcript, 21 February 2007 (http://china.seekingalpha.com/article/277000) (Exhibit CDA-46)," referred to in Canada's response to Panel question No. 294); and, an analyst from Global Insight, in a July 2006 article discussing the auto industry in China, noted that the measures have already had a big impact on some luxury brands with low production volumes, citing a stop in production of Cadillacs by GM in particular, and stating that other vehicle manufacturers "may follow in its footsteps" (*Assembly Magazine*, "The Great Race", 1 July 2006 (Exhibit CDA-47), referred to in Canada's response to Panel question No. 294).

[626] Canada's second written submission, paras. 93-97.

[627] Canada's second written submission, para. 93 and footnote 106: In Canada's view, China is required to show, not assume, large-scale evasion of tariffs by importers of auto parts to justify the measures, rather than presume that any time imported parts are shipped separately the purpose is to evade duties (Canada's second written submission, para. 95, referring to the company Z and other examples submitted by China in China's first written submission and China's responses to Panel question Nos. 12(a), 77 and 160. Canada submits that these examples simply show general import statistics and refer to the number of cases where parts have been characterized as complete vehicles under the measures).

by China in the present case, must be carefully weighed against its impact on trade and the degree of contribution the measures make to the achievement of that interest.

7.361 In this regard, logically speaking, given our finding above that China has not proved specific actions considered inconsistent under its tariff schedule that need to be prevented through the measures, the measures cannot be considered as contributing to the achievement of the objective allegedly pursued by the measures. However, even if we were to assume for a moment that the measures could be considered as enforcing its tariff provisions for motor vehicles, for example, by preventing importers from falsely declaring or documenting their imports[628], the scope of the measures is too broad to be viewed as necessary for the prevention of such an action. As examined in the previous section, the measures encompass even a situation where automobile manufacturers/importers use imported auto parts for their assembly into motor vehicles in the normal course of their business operations without any intention to avoid the higher tariff duties imposed on motor vehicles, let alone any intention to falsely declare or document the specific content of importation. In our view, this is far more than what is necessary to enforce China's tariff provisions for motor vehicles.[629]

7.362 The evidence before us also shows that the time necessary for some of the administrative procedures required for the imposition of the charge can take up to a couple of years.[630] In addition, we are also of the view, based on the available evidence on the record, that the measures do not necessarily correspond to the commercial realities of the modern automobile and auto parts industries. The evidence overall illustrates that the economic reality of the automotive industry is that auto parts have become more standardized and thus can be interchangeably used among different vehicle models. In particular, by sharing platforms[631], parts, and components for various vehicle models, automobile manufacturers appear to have increased the number of vehicle models produced from common parts and components and thereby realize economies of scale. For example, one approach widely adopted by automobile manufacturers is the platform strategy in which common components

[628] We recognize in our finding above that China has not proved that this is an action considered inconsistent under China's tariff schedule. However, if this were to be considered as an action inconsistent with China's tariff schedule, the measures would seem to prevent such an action, not because the measures are designed specifically to prevent such an action, but because the broad scope of the measures happens to encompass various types of actions described by China, including importers' false declaration and documentation of imported goods. In this regard, we note a finding by the Panel in *Canada – Periodicals* useful: "Tariff Code 9958 cannot be regarded as an enforcement measure for Section 19 of the Income Tax Act. It is true that if a government bans imports of foreign periodicals with advertisements directed at the domestic market, as does Canada in the present case, the possibility of non-compliance with a tax provision granting tax deductions for expenses incurred for advertisements in domestic periodicals will be greatly reduced. It would seem almost impossible for an enterprise to place an advertisement in a foreign periodical because there would be virtually no foreign periodical available in which to place it. Thus, there would be no way for the enterprise legally to claim a tax deduction therefore. However, that is an incidental effect of a separate measure distinct (even though it may share the same policy objective) from the tax provision which is designed to give an incentive for placing advertisements in Canadian, as opposed to foreign, periodicals. ..." (para. 5.10) (original footnote omitted).

[629] As Canada submits, the measures do not target isolated incidents, but impose a blanket coverage on all imported auto parts based on arbitrary thresholds that *presume* tariff arbitrage in all instances (Canada's second written submission para. 100).

[630] The European Communities' responses to Panel question Nos. 8 and 171; Exhibit EC-26. See paragraphs 7.62-7.65 above.

[631] Initially, a platform referred to a shared chassis, but now refers to a shared set of components common to a number of different automobiles, in particular the chassis, the steering mechanisms and suspensions (*Wikipedia, the free encyclopedia*, "Automobile platform", http://en.wikipedia.org/wiki/Automobile platform (Exhibit EC-12)).

are shared whenever possible between different vehicles models.[632] Automotive industry reports also indicate that platforms can be used with a variety of automobiles in the same family resulting in a 60 per cent to 70 per cent share of common parts.[633] Regarding China's argument that the degree of commonality among auto parts and components is very low, we agree to the extent that evidence also shows that the interchangeability of some auto parts remains limited because of the specific function or performance such parts are used for.[634] However, based on the evaluation of the evidence presented by the parties, we conclude that notwithstanding some variance in the degree of interchangeability, auto parts have been sufficiently standardized so that identifying a specific vehicle model into which certain auto parts will be incorporated would prove unnecessarily trade restrictive.

7.363 Further, the European Communities submits that China has failed to consider less burdensome means to secure compliance with its tariff schedule, although China could have employed many reasonably available alternatives, for example, by investigating only individual instances of alleged evasion under its customs laws, instead of imposing charges under the measures on all imported auto parts that are assembled into vehicles that do not satisfy the thresholds set out under the measures.[635] China argues that the question of tariff evasion, in the present context, is one of ensuring the correct classification of what is imported, and one important objective of customs classification is to achieve the same classification of an article whenever it is imported.[636] To achieve this uniformity of classification, the same classification results should apply in all like circumstances, not only in those cases in which customs authorities dedicate the necessary resources to investigate specific import entries. According to China, this is why the measures cannot be limited to "individual instances", as the objective of the measures is to ensure the consistent classification of parts and components that have the essential character of a motor vehicle, in all cases.[637]

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[632] The exhibits before us show that numerous automobile manufacturers have implemented platform standardization: (i) Ford, for example, uses its EUCD platform on which five different current models and five future models (Volvo, Ford, Jaguar) are based (Exhibit EC-15); (ii) Ford implements a globally-used engine series in module production for Ford North America, Ford Europe, Matsuda and Jaguar (Exhibit CDA-33); (iii) GM and Ford developed jointly a new six-speed automatic transmission for use in models produced by both companies (Exhibit CDA-34); and (iv) Volkswagen has used its D platform for large luxury automobiles under the Volkswagen, Audi, and Bentley brands (Exhibit EC-21).

[633] Exhibits EC-24, 25.

[634] China's reference to the lack of interchangeability of strut suspension system for a derivative of the VW Passat B6 and for the VW Sagitar refers to the distinct performances and sizes of the vehicles (Exhibit CHI-46).

[635] European Communities' second written submission, para. 146.

[636] China's second written submission, para. 176; China's response to Panel question No. 296.

[637] China's response to Panel question No. 296. Further, China submits that in the absence of the measures, China would have essentially no mechanism for determining whether multiple shipments of parts and components are related to each other through their common assembly into a single article. In other words, there is no basis to investigate and determine whether any given shipment of auto parts and components results in the evasion of China's tariff provisions for motor vehicles. It is this lack of transparency into the commercial reality of what an auto manufacturer is importing that the challenged measures seek to remedy.

The European Communities submits in its comments on China's response to Panel question No. 296, that "acts of customs evasion, the danger of which China has still not demonstrated, would by their nature be individual acts. Therefore, it would be possible for China to ensure the 'uniform classification' of vehicles and parts through individual investigation. China's reference to the possibly limited resources of its customs authorities cannot justify otherwise disproportionate measures. Furthermore, China has not demonstrated why it needs a 'mechanism for determining whether multiple shipments of parts and components are related to each through their common assembly into a single article'. In the view of the EC, a 'mechanism' creating fictions such as the ones contained in the measures is not suitable, necessary or proportionate to further the objective of uniform customs classification."

7.364 As the European Communities submits[638], however, China's arguments relating to the availability of other WTO-consistent alternative measures are premised on its own definition of the actions considered inconsistent under its tariff schedule, which China has failed to prove. To that extent, we agree that China has not explained why investigating individual cases as the need arises cannot serve as an alternative to the measures, if, as we assumed above, the measures were to be considered as securing compliance with China's tariff schedule in certain limited circumstances. Therefore, considered against the trade-restrictiveness of the measures with respect to imported auto parts as well as an alternative measure seemingly available to China, we conclude that China has failed to prove that the measures are "necessary" to secure compliance with China's tariff schedule.

(d) Conclusion

7.365 In light of the foregoing, we find that China has not demonstrated that the measures are justified under Article XX(d). Therefore, it is not necessary for the Panel to examine whether the measures satisfy the requirements under the chapeau of Article XX.

C. TRIMS AGREEMENT

7.366 The **complainants** argue that the measures are in violation of Article 2 of the TRIMs Agreement, which prohibits the use of trade-related investment measures inconsistent with Articles III:4 and/or XI:1 of the GATT 1994.[639]

7.367 **China** responds that because the measures are border measures, they fall outside of the scope of Articles III:4 and XI:1 of the GATT 1994 and consequently also outside the scope of the TRIMs Agreement.

7.368 We recall our findings above at paragraph 7.272 that China has acted inconsistently with Article III:4 of the GATT 1994. We consider that these findings are sufficient for the resolution of the dispute brought before us by the complainants. Consistent with previous panels which have faced similar claims, in particular those on *Canada – Autos* and *India – Autos*[640], we also take the view that bringing the measures into conformity with China's obligations pursuant to our findings under Article III:4 of GATT 1994 would also remove any inconsistency of those measures with the TRIMs Agreement. We therefore exercise judicial economy in respect of the complainants' claims under the TRIMs Agreement.

D. ARTICLE II OF THE GATT 1994

7.369 We found in Section VII.B.1 that China's measures impose an internal charge inconsistently with Article III:2 of the GATT 1994.

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[638] The European Communities submits that China's position that no other alternatives are available to achieve the objective under its tariff schedule is based on its mistaken belief that a mechanism such as one under the measures is necessary for determining whether multiple shipments of parts and component are related to each other through their common assembly into a motor vehicle (European Communities' comments on China's response to Panel question No. 296).

[639] All three complainants have made their claims under Article 1(a) of the Illustrative List of the TRIMs Agreement, and the European Communities and the United States have also made claims under Article 2(a) of the Illustrative List. However, the United States clarified in response to a question from the Panel that the United States was not pursuing its claim under Article 2(a) of the Illustrative List (United States' response to Panel question No. 165).

[640] Panel Report on *Canada – Autos*, para. 10.91 and Panel Report on *India – Autos*, para. 7.324.

7.370 The complainants have made an alternative claim under Article II of the GATT 1994 in the event the Panel finds that the charge under the measures constitutes an ordinary customs duty. The complainants submit that even if the charge were to be considered as an ordinary customs duty, the charge is still in violation of Article II:1(b) because it is imposed in excess of the concessions made by China under the relevant tariff headings for auto parts of China's Schedule of Concessions. China argues that the charge is an ordinary customs duty imposed in accordance with China's commitments under its Schedule of Concessions.

7.371 In this section, we will examine the complainants' alternative claim under Article II with respect to the charge imposed under the measures on auto parts imported in multiple shipments for the assembly of motor vehicles in China and characterized as motor vehicles based on the criteria provided in the measures.[641]

7.372 For the purpose of this consideration, we will first examine the multiple shipment aspect of the measures, i.e. whether, under China's Schedule of Concessions, the tariff provisions for motor vehicles include in their scope auto parts imported separately in multiple shipments that are found to have the essential character of a motor vehicle based on their assembly into a motor vehicle. Then, we will examine whether the criteria set out in the measures, mainly Articles 21 and 22 of Decree 125, for the essential character of a motor vehicle are compatible with China's concessions under its Schedule of Concessions. In this regard, the criteria for the essential character determination, if applied to imported auto parts in a single shipment, can be considered as an element that would make the charge under the measures fall within the scope of Article II:1(b) of the GATT.

1. Treatment of auto parts under China's Schedule CLII

7.373 China's Schedule of Concessions in relevant part provides as follows:[642]

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[641] For the same reasons the Panel identified in *Canada – Dairy*, we note that the following elements support our analysis of the complainants' alternative claim: **(i)** all the complainants made an alternative claim under Article II of the GATT 1994; **(ii)** the complainants and China disagree on whether the measures are consistent with Article II of the GATT 1994 in the event the charge would fall within the scope of Article II of the GATT 1994; (**iii**) the precise borderline between Articles III:2 and II of the GATT 1994 may not always be clear-cut; **(iv)** if our finding under Article III:2 would be reversed, the Appellate Body could be called upon to examine the claims made under Article II, which would require a complex factual assessment and the weighing of evidence submitted by the parties to this dispute, an exercise which could go beyond the jurisdiction of the Appellate Body and make it impossible for the DSB to provide recommendations and rulings on all legal claims within the time-frame prescribed by the DSU; (**v**) if the DSB adopts our findings on Article III, the DSU's declared objectives of "prompt settlement" of disputes (Article 3.3 of the DSU), of a "satisfactory settlement of the matter in accordance with the rights and obligations under [the DSU] and the covered agreements" (Article 3.4 of the DSU), of "a positive solution to a dispute" (Article 3.7 of the DSU) and of "effective resolution of disputes to the benefit of all Members" (Article 21.1), may be facilitated if the parties would have at their disposal the Panel's examination of the matter under Article II of the GATT 1994.

[642] China submits that it is sufficient, for purposes of this proceeding, to assume that the tariff rate applicable to motor vehicles is 25 per cent, and that the tariff rate applicable to parts and assemblies of motor vehicles is 10 per cent (China's first written submission, para. 15). The complainants submit that the final bound rate for auto parts is 10 per cent, while it is generally 25 per cent for whole vehicles, and the 25 per cent charge is effectively a payment of the 10 per cent bound parts rate plus an additional 15 per cent. In certain cases the amount may be as much as 12 ½ times more, such as for the HS code 84099991 (parts for engines with an output of greater than 180 hp), where the Schedule commits China to a bound rate of 2 per cent, but a 25 per cent charge could be imposed if the measures apply (Part D.1 of the Factual Background Section jointly submitted by the complainants; also Exhibit JE-2).

	Tariff headings for motor vehicles	Bound tariff rates
87.02	Motor vehicles for the transport of ten or more persons, including the driver	Final bound rate of 25% [643]
87.03	Motor cars and other motor vehicles principally designed for the transport of persons, other than those under heading 87.02, including station and racing cars	Final bound rate of 25%
87.04	Motor vehicles for the transport of goods	Final bound rates of 6%, 15%, 20%, 25%
87.06	Chassis fitted with engines, for the motor vehicles of headings Nos. 8701 to 8705	Final bound rates of 10%, 20%
87.07	Bodies (including cabs), for the motor vehicles of headings Nos. 8701 to 8705	Final bound rate of 10%
87.08	Parts and accessories of the motor vehicles of headings Nos. 8701 to 8705	Final bound rates of mostly 10%[644]
84.07	Spark-ignition reciprocating or rotary internal combustion piston engines (Reciprocating piston engines of a kind used for the propulsion of vehicles of Chapter 87)	Final bound rate of 10%[645]
84.08	Compression-ignition internal combustion piston engines (diesel or semi-diesel engines) (Engines of a kind used for the propulsion of vehicles of Chapter 87)	Final bound rates of 5%, 5.4%[646]

7.374 China's Schedule of Concessions, as summarized in the table above with respect to the most relevant tariff headings in this case, provides separate tariff headings for motor vehicles, intermediate categories (so-called assemblies) of auto parts, and parts and components of motor vehicles: the tariff rates applicable to auto parts and components and assemblies (10 per cent on average) are lower than those applicable to complete motor vehicles (25 per cent on average). China's Schedule does not contain any specific terms or qualifications concerning the tariff headings at issue. The complainants claim that China's measures impose ordinary customs duties on imported auto parts in excess of those set forth in China's Schedule inconsistently with the obligations under Article II:1(a) and (b) of the GATT 1994.

7.375 Article II:1 of the GATT in relevant part provides:

> "(a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.
>
> (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their

[643] In China's Schedule CLII, a final bound tariff rate of 4 per cent is indicated in tariff heading 9802.1020 (Exhibit JE-2).

[644] A final bound tariff rate of 15 per cent is indicated for tariff heading 8708.6020 and 25 per cent for tariff headings 8708.9920 and 8708.9940.

[645] A final bound tariff rate of 8 per cent is indicated for tariff headings 8407.2100 and 8407.2900.

[646] Also, for certain tariff headings and sub-headings, 9-25 per cent are indicated as bound rates at date of accession.

> 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. Such products shall also be exempt 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."

7.376 The ultimate question before us is therefore whether under the measures, imported auto parts are subject to an ordinary customs duty in excess of China's concessions contained in the relevant tariff headings of China's Schedule so as to violate the first sentence of Article II:1(b), and consequently Article II:1(a) of the GATT 1994 for according less favourable treatment to imported auto parts than China's concessions under China's Schedule.[647]

2. Treatment of auto parts under China's measures – *multiple shipments*

7.377 Under the measures, auto parts are classified and assessed at the tariff rates applicable to motor vehicles once they are assembled into a motor vehicle in China and meet certain thresholds set out in the measures, even if such auto parts are imported separately in multiple shipments.[648] The complainants argue that the measures are in violation of Article II:1(b) of the GATT 1994 since they impose on auto parts imports ordinary customs duties (25 per cent on average) that exceed China's concessions for auto parts (10 per cent on average) under its Schedule. China argues that it must be able to interpret the tariff headings for motor vehicles in a manner that gives them meaningful effect and collect duties applicable to motor vehicles. Auto parts imported in multiple shipments therefore must be counted together for the assessment of whether they have the essential character of a motor vehicle. The question before us is therefore whether the tariff provisions for motor vehicles of China's Schedule of Concessions are interpreted to include auto parts imported separately in multiple shipments for domestic assembly, if such parts would have the essential character of a motor vehicle had they been imported in a single shipment.[649]

(a) Interpretation of China's Schedule of Concessions

7.378 Pursuant to Article 3.2 of the DSU and following the approach adopted by panels and the Appellate Body in previous cases[650], we will interpret China's Schedule of Concessions in accordance with the interpretive rules under the *Vienna Convention*.

(i) Ordinary meaning of the tariff term "motor vehicles"[651]

7.379 As examined in Section VII.E concerning the parties' claims with respect to CKD and SKD kits, the ordinary meaning of "motor vehicles" is limited in providing guidance on the interpretation of the tariff headings at issue: the dictionary definitions of the terms do not indicate whether the tariff headings for motor vehicles are interpreted to include auto parts and components imported in multiple

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[647] Also see Panel Report on *EC – Chicken Cuts (Brazil)*, paras. 7.54, 7.79-7.80, 7.87-7.94. We agree with the interpretative task as framed by the Panel in *EC – Chicken Cuts* regarding a Member's commitment contained in its Schedule of Concessions and consequently its obligations under Article II:1 of the GATT 1994.

[648] See paragraphs 7.67-7.69 above.

[649] As noted above in paragraph 7.371, we examine the essential character test under China's measures, i.e. Article 21(2) and (3), in Section VII.E below.

[650] See paragraph 7.652 below.

[651] See paragraphs 7.653-7.657 below.

shipments that can be considered as having the essential character of a motor vehicle had they been imported altogether. Thus, we turn to the context of the tariff term "motor vehicles".

(ii) Context[652] *for the tariff term "motor vehicles"*

Other terms in the tariff headings for motor vehicles and other tariff headings in Chapter 87

7.380 The **European Communities** submits that when examined in the context of other terms in the tariff headings for motor vehicles (87.02, 87.03 and 87.04)[653] as well as other terms under the tariff headings such as 87.06, 87.07, 84.07 and 84.08, there is nothing that supports the view that parts or some parts for motor vehicles could be classified under the relevant headings covering complete motor vehicles.[654] The European Communities submits that there is a very clear distinction between the terms of the headings for complete motor vehicles, parts thereof and the intermediate categories between motor vehicles and parts under Chapter 87 of China's Schedule.[655] According to the European Communities, there is nothing in the tariff headings for motor vehicles (e.g. 87.02-87.04) or headings for parts (87.06-87.08, 84.07-84.09 and 85.03) that would even remotely suggest that auto parts for complete motor vehicles should be classified under the tariff headings for motor vehicles.[656]

7.381 **China** has not provided any direct counter arguments in this regard. Instead, China submits that the context of GIR 2(a) is required in interpreting the term "motor vehicles" and that Explanatory Note (VII) to GIR 2(a) provides further context.

7.382 The **Panel** observes that other terms under tariff headings 87.02, 87.03 and 87.04 describe the purpose of vehicles falling under each heading, such as the transport of "persons" or "goods". Nothing in the terms of these headings suggests, however, that parts of complete motor vehicles are classified under the same headings for motor vehicles. If anything, these terms appear to confine the scope of the headings to complete motor vehicles, since parts and components of motor vehicles, by definition, cannot perform the functions described under each heading such as transporting persons or goods.

Harmonized System[657]

General Interpretative Rules for the HS: relationship between GIRs 1 and 2

7.383 At the outset, we note that **China**'s position concerning the interpretation of the tariff term "motor vehicles" hinges upon the application of GIR 2(a) – namely, that GIR 2(a) allows parts imported in multiple shipments and assembled later into a motor vehicle to be classified as a motor vehicle if they have the essential character of a motor vehicle.

7.384 The **complainants** do not dispute the fact that the GIR is one of the rules comprising the HS and thus could be in principle relevant to the interpretation of China's tariff schedule, but emphasize that GIR 2(a) can be relevant only after applying GIR 1.[658]

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[652] See paragraphs 7.662-7.667 below.

[653] Although the European Communities has submitted that other terms in the relevant tariff headings are relevant context for the term "motor vehicles", it has not provided specific arguments regarding other terms in these headings to support its position that the meaning of motor vehicles as provided in China's concessions does not include anything other than complete motor vehicles.

[654] European Communities' first written submission, para. 250.

[655] European Communities' second written submission, paras. 78-79.

[656] European Communities' second written submission, paras. 81-89.

[657] See paragraphs 7.663-7.667.

7.385 GIR 1 provides:

> "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 the headings and any relative Section or Chapter Notes and provided such headings or Notes do not otherwise require, according to the following provisions."

7.386 The **Secretariat of the World Customs Organization ("WCO Secretariat")**[659] explains that based on the language of GIR 1, all the rules in GIR should be consulted when classifying articles in the HS.[660] This means that GIR 2 must always be considered, in conjunction with GIR 1, provided the headings and legal notes do not otherwise require. The WCO Secretariat further explains that "provided the headings and legal notes do not otherwise require" means that a heading providing specifically for a collection of unassembled parts or an incomplete article would prevail by application of GIR 1 because GIR 2 would not apply (that is, because such headings or Notes ... otherwise require). The WCO Secretariat considers that tariff headings 87.06 and 87.07 would be examples of such an understanding.

7.387 Further, according to the WCO Secretariat, this principle is expounded in Explanatory Note (V) to GIR 1:

> "In provision (III)(b), the expression "provided such headings or Notes do not otherwise require" is intended to make it quite clear that the terms of the headings and any relative Section or Chapter Notes are paramount, i.e., they are the first consideration in determining classification. For example, in Chapter 31, the Notes provide that certain headings relate only to particular goods. Consequently those

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[658] Reponses of the European Communities and Canada to Panel question No. 114; complainants' responses to Panel question No. 208. **Canada**'s response to the Panel question No. 114 is based on a caveat that GIR 2(a) is broadly relevant to the extent it may apply, in certain limited instances, within the HS to interpreting China's Schedule and that GIR 2(a) is not context on its own, but can be taken into consideration after applying GIR 1. Canada agrees that Members have the discretion to classify parts which have the essential character of the finished good either as parts or as the finished good, in accordance with the rules of the HS, including GIR 2(a) (Canada's response to Panel question No. 208, also referring to its second written submission, footnote 77). The **European Communities** submits that the overwhelming majority of tariff classification situations are decided on the basis of GIR 1, which is the backbone of the application and interpretation of the HS and hence the tariff schedules of most WTO Members such as China. The European Communities is of the view that there is a clear hierarchy between the rules, and that if the classification can be determined according to the terms of the headings and any relative Section and Chapter notes, other rules are simply not applicable. The European Communities submits that the classification of auto parts can be determined on the basis of the terms of headings. There is a very clear distinction between the terms of the headings for complete motor vehicles, parts thereof and the intermediate categories between motor vehicles and parts. The **United States** submits that China's measures are directly contrary to GIR 1, in particular because China under its measures classifies auto parts as whole vehicles when the HS has headings specific to auto parts (United States second written submission, para. 39).

[659] In these reports, our reference to the comments provided by the WCO means those provided by the WCO Secretariat, not the WCO Members. To that extent, the Panel is not relying on or incorporating the WCO Secretariat's comments as the official view of the WCO Members.

[660] WCO's letter of 30 July 2007, page 1. The WCO Secretariat explains that the words "and..., according to the following provisions" in GIR 1 requires that all the GIRs be consulted when classifying articles in the HS.

> headings cannot be extended to include goods which otherwise might fall there by reason of the operation of Rule 2(b)".[661]

7.388 The WCO Secretariat advises that although the application of the GIR is commonly explained as sequential, to be precise, when classification is by GIRs 1 and 6, it does not mean that other GIRs have not been consulted. Rather, it merely means that application of the text of GIR 1, in particular the phrase, "provided such headings or Notes do not otherwise require," makes GIR 2 inapplicable.[662]

7.389 The **Panel** first notes that the text of GIR 1 indicates that the Contracting Parties to the HS are obliged to classify goods in accordance with the terms of the headings and any relevant Section or Chapter Notes *and* according to the provisions following GIR 1 (i.e. GIRs 2-6), provided the relevant tariff headings or Section or Chapter Notes do not otherwise require. Based on the ordinary meaning of GIR 1, we consider that all the rules under the GIR, starting with GIR 1, are relevant for classification of goods. This means, in our view, GIRs 2-6 should not be ignored simply because a good can be classified by applying GIR 1. Such an understanding would render the existence of other rules under the GIR and the phrase "and provided such headings or Notes do not otherwise require, according to the following provisions" inutile. As commented by the WCO Secretariat and pointed out by the complainants, classification should be based, first, on the terms of the headings, relevant Section or Chapter Notes pursuant to GIR 1 *and* provided such headings or Notes do not otherwise require, according to the provisions of GIRs 2-6.

7.390 The tariff headings concerned in the present case (87.02-87.05) do not have language that would make GIR 2(a) irrelevant for the classification of auto parts under Chapter 87. We also observe that the Notes to Section XVII to which Chapter 87 belongs do not contain any requirements that would restrict the Contracting Parties' reliance on other provisions in the GIR for classification. Further, the General Explanatory Notes to Chapter 87 provide that "[a]n incomplete or unfinished vehicle is classified as the corresponding complete or finished vehicle provided it has the essential character of the latter (see Interpretative Rule 2(a))...".[663] The explicit reference in the General Explanatory Notes to the application of GIR (2)(a) shows that GIR 2(a) is applied, as necessary, for the classification of goods under the tariff headings in Chapter 87.

7.391 Accordingly, we find that both GIR 1 and GIR 2 can constitute part of the context for the interpretation of the term "motor vehicles" in the present case. We will examine how these interpretative rules under the HS are applied to the interpretation of the tariff term "motor vehicle", bearing in mind that GIR 2(a) can only be applied in conjunction with GIR 1.[664]

> Application of GIR 2(a), in conjunction with GIR 1, to the tariff headings for "motor vehicles"

7.392 As we have examined above, the terms of the tariff headings under Chapter 87 do not suggest that the term "motor vehicles" must be interpreted to include auto parts imported in multiple

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[661] WCO's letter of 30 July 2007, pages 1 and 2.

[662] The WCO Secretariat further comments that a classification opinion promulgated by the HS Committee includes a statement of applicable GIRs, and the Committee now includes GIR 1 in every statement of applicable GIRs (other Section or Chapter Notes are sometimes also cited).

[663] The General Explanatory Notes to Chapter 87 further provide some examples of incomplete or unfinished vehicles that would be classified as the corresponding complete or finished vehicles by applying GIR 2(a). These examples are (A) A motor vehicle, not yet fitted with the wheels or tyres and battery and (B) A motor vehicle not equipped with its engine or with its interior fittings.

[664] WCO Secretariat's letter of 20 June 2007, page 3.

shipments for domestic assembly. Nor do the Notes to Section XVII provide any guidance that would support such an interpretation. We now turn to the principle of GIR 2(a).

7.393 GIR 2(a) provides:

> "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." (emphasis added)

7.394 **China** submits that the interpretive rules of GIR 2(a) result in a continuum of circumstances under which parts and components of an article will be classified as the complete article and that there is no clear separation between tariff headings for a complete article and tariff headings for the parts and components of that article. Relying on GIR 2(a), China submits that the importation, in multiple shipments, of the parts necessary to assemble a complete motor vehicle is also the importation of a motor vehicle, not the parts of a motor vehicle, provided that the imported parts, when assembled, have the essential character of a motor vehicle.

7.395 In particular, China argues that the term "as presented" in GIR 2(a) 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.[665] China is of the view that if the term "as presented" were limited to the contents of a single shipment, there would be no scope for the HS Contracting Parties to apply the principles of GIR 2(a) to goods assembled from multiple shipments.

7.396 China considers that the term "as presented" in GIR 2(a) is, on its own, susceptible to different interpretations when applied to unassembled or disassembled articles that are imported in multiple shipments. However, the conclusion that the term "as presented" does not preclude the application of GIR 2(a) to multiple shipments of parts and components arises as a necessary implication of the interpretation of the HS Committee Decision adopted in 1995.[666] China considers that in finding that the situations in paragraph 10 of the HS Committee Decision are applications of GIR 2(a) to be determined by each country in accordance with its national laws and regulations, the HS Committee must have considered that the term "as presented" does not preclude these applications of GIR 2(a).[667] The fact that the HS Committee has found that members of the HS may apply the

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[665] China's second written submission, paras. 34, 38, China's response to Panel question No. 110.

[666] China's response to Panel question No. 210(a). China submits that "both of the circumstances referred to in paragraph 10 of the HS Committee Decision *necessarily* entail an application of GIR 2(a) to classify parts and components that arrive in more than one shipment." The HS Committee decision referred to by China is "Decision of the Harmonized System Committee, HSC 39.235 (HSC/15), Interpretation of General Interpretative Rule 2(a) (Annex IJ/7 to Doc. 39.600 E (HSC/16/Nov. 95)" as provided in Exhibit CHI-29. Paragraph 10 of this decision states:

> "10. The [HS] Committee decided, by 12 votes to none, to include the Nomenclature Committee's decision in its Report. Thus, the Committee decided 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."

[667] China's response to Panel question No. 210(a).

principle of GIR 2(a) to goods assembled from multiple shipments can only mean that the term "as presented" is not limited to a single shipment.

7.397 China submits that the HS Committee has interpreted GIR 2(a) specifically as it pertains to "the classification of goods assembled from elements originating in or arriving from different countries."[668] Given the interpretation adopted by the WCO, "as presented" should therefore be read to include "as presented in a customs declaration or other documentary evidence," or "as presented in light of the facts and circumstances surrounding the import transaction".[669]

7.398 The **European Communities** submits 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.[670] According to the European Communities, the intentions of the importer and differing duty rates are irrelevant.

7.399 Because there is no ambiguity on where complete vehicles, intermediate products and parts of complete vehicles should be classified under China's tariff schedule, the European Communities argues that the other rules, 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.[671] Specifically, the European Communities contends that GIR 2(a) is of extremely limited relevance for the present case, and recourse to GIR 2(a) can only be relevant in very specific individual cases "as presented" to customs where a given incomplete or unfinished article as presented to customs appears to have the essential character of the complete article, and not at the level of China's tariff schedules generally as China submits.[672] Further, the General Notes to Chapter 87 contain a specific application of GIR 2(a) in the context of Chapter 87 (a *"lex specialis*"), namely the two examples provided therein.[673] The European Communities considers China's interpretation of GIR 2(a) concerning multiple shipments and essential character of a motor vehicle as an unprecedented reading of GIR 2(a).[674]

7.400 Regarding the term "as presented" in GIR 2(a), the European Communities submits that China's position amounts to nothing less than tariff classification at will and that there is no basis for the interpretation advanced by China.[675] The European Communities is of the view that the words "as

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[668] China's response to Panel question. No. 110.

[669] China's second written submission, para. 41; China's responses to Panel question Nos. 110, 112. China submits that the HS Committee Decision falls within the scope of Article 31(3)(a) of the *Vienna Convention* – namely the scope of "any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions". We understand that this is related to China's view that the WCO has adopted the HS Committee's interpretation of GIR 2(a), including paragraph 10, pursuant to Articles 7 and 8 of the HS Convention.

[670] European Communities' second written submission, para. 73. The European Communities submits that all parties and third parties to the dispute, except for China, who have submitted their arguments on Article II of the GATT 1994 share this view. The European Communities also refers to the Appellate Body's statement in *EC – Chicken Cuts* that "[w]e 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" (Appellate Body Report on *EC – Chicken Cuts*, para. 246).

[671] European Communities' second written submission, paras. 90, 94.

[672] European Communities' second written submission, para. 94.

[673] European Communities' second written submission, paras. 95, 96; and responses to Panel question Nos. 115, 139.

[674] European Communities' second written submission, para. 98.

[675] European Communities' second written submission, paras. 100, 104.

presented" mean literally what they say and are merely a reflection of the basic principle[676] behind customs classification.[677] In the European Communities' opinion, it is clear from the ordinary meaning of the words and the reply from the WCO Secretariat that the concept does not and cannot cover "several moments" and "several places", which are necessary preconditions for China's position.[678] According to the European Communities, China's interpretation of GIR 2(a) renders the good "as presented" to mean, not the good presented to Customs, but the good that will be later manufactured in the customs territory on the basis of elements that are imported at different times, in different places and from different countries.[679]

7.401 Furthermore, the European Communities argues that the HS Committee Decision referred to by China does not support an interpretation that it allows the Members to apply the principle of GIR 2(a) to multiple shipments of parts and components, when the words "multiple shipments" do not even appear in the concerned Decision.[680] According to the European Communities, the situations[681] referred to in the Decision are inter-related and concern trade facilitation issues in the context of some very large goods or goods that are otherwise difficult to transport and where in some instances the manufacture has been completed in two or more different countries and where the shipping of the good into its final destination needs to be split into two or more consignments.[682]

7.402 The **United States** submits that both importers and customs authorities are legally obligated to classify imported merchandise pursuant to GIR 2(a) when applicable to importations of incomplete, unfinished, unassembled, or disassembled goods.[683] Furthermore, for the purposes of GIR 2(a), "as presented" refers to the condition of the good at the time of its importation.[684] The United States interprets the term "as presented" as explicitly precluding the application of GIR 2(a) to shipments of goods that are not imported together.[685] As the legal basis for its position, the United States submits the following four grounds: (i) the obligation under the HS Convention to apply GIR 1 and the relevant Section and Chapter Notes, which requires the Contracting Parties to the HS to base classification on the physical condition of the good, and not what processes the good will subsequently undergo; (ii) the plain meaning of "as presented"; (iii) the fact that "as presented"

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[676] The European Communities refers to the basic principle of tariff classification that goods are classified on the basis of the objective characteristics of the product at the time of importation, as imported and presented to Customs on a shipment-by-shipment basis. The European Communities also emphasizes that the Appellate Body has confirmed this (European Communities' response to Panel question No. 210(b), citing the Appellate Body Report on *EC – Chicken Cuts*, para. 246). According to the European Communities, the notion of multiple shipments of product goes directly against this formulation of the Appellate Body as multiple shipments denotes several products that are presented to customs at different times and at different places.

[677] European Communities' second written submission, paras. 109, 110.

[678] European Communities' response to Panel question No. 210(b).

[679] European Communities' second written submission, para. 111.

[680] European Communities' second written submission, para. 105.

[681] The situations here refer to "split consignments" and "the classification of goods assembled from elements originating in or arriving from different countries". See paragraph 7.425 below for the text of paragraph 10 of the HS Committee Decision concerned.

[682] European Communities' second written submission, paras. 105-107, response to Panel question No. 138.

[683] United States' response to Panel question No. 224. The United States submits that in applying GIR 2(a), customs officials can see the entire article at the time of entry and that if an article is not classifiable by GIR 2(a), then GIR 1 requires the separate classification of the components (United States' response to Panel question No. 112).

[684] United States' response to Panel question No. 110. The United States submits that under US customs law, it is well settled that classification is based on the condition of goods at the time of importation.

[685] United States' response to Panel question No. 210(b).

replaced "as imported," and is intended to have the same meaning; and (iv) the object and purpose of the HS Convention of ensuring consistency of import and export statistics and of facilitating trade.[686]

7.403 The United States argues that the HS Committee Decision does not address the questions of multiple shipments and the phrase "as presented".[687] Rather, paragraph 10 of the discussion by the HS Committee was about the treatment of split consignments and the treatment of goods *for origin purposes*, not about the interpretation or application of GIR 2(a).[688]

7.404 The United States also elaborates that as the decision was only reflected in the report of the Committee and no amendments were made to the Explanatory Notes nor was a classification adopted, paragraph 10 has little weight. Moreover, the United States submits that the HS Committee Decision does not mean that a member customs administration can abrogate the requirements of the GIR by regulation at the domestic level.[689]

7.405 **Canada** is of the view that GIR 2(a) permits customs authorities to determine whether a good, based upon its state as it arrives at the border, has the essential character of a finished product.[690] According to Canada, this involves elements such as visual inspection, reference to documents, and if necessary further testing or analysis (based upon the state of the good as it passes the border). Canada submits that the term "as presented" in GIR 2(a) means that the assessment of whether an incomplete or unfinished article has the "essential character" of the complete or finished article must be made based on the objective characteristics of that article, and solely that article, in the state it is presented to customs officials at the border (i.e. the "snapshot").[691] No consideration is to be given to separate consignments arriving at different times, end-use or value of the article, but simply to objective characteristics of the product as presented at the border.[692]

7.406 Recalling that the interpretative weight to be given to the HS Committee Decision in interpreting China's WTO commitments is affected by its legal nature, its temporal relation to the conclusion of China's accession, and the awareness Members had of that statement, Canada submits that the HS Committee Decision at issue is irrelevant for the following reasons[693]: (i) no reference is made to split shipments in the Explanatory Notes to GIR 2(a) and the Nomenclature Committee that developed GIR 2(a) specifically considered and rejected the inclusion of the concept of split shipment

[686] United States' response to Panel question No. 210(b).

[687] United States' comments on China's response to Panel question No. 110; comments on China's response to Panel question No. 210(c).

[688] United States' comments on China's response to Panel question 215(b). The United States also submits that the HS Committee Decision removed the reference to "simple assembly" from the Explanatory Notes to GIR 2(a) and that as an explanatory note can neither expand nor restrict the terms of the HS, US Customs believes that the interpretation of GIR 2(a) has been unaffected (United States' response to Panel question No. 112).

[689] United States' comment on China's response to Panel question No. 110, response to Panel question No. 210(c).

[690] Canada's responses to Panel question Nos. 139, 224.

[691] Canada's response to Panel question No. 110, also referring to the Appellate Body's statement in *EC – Chicken Cuts*. Canada submits in the context of the term "on their importation" in Article II:1(b) that "the ordinary meaning of 'on their importation' in Article II:1(b), read in the context of Articles I, III and XI, and as evinced by Member practice, demonstrates clearly that ordinary customs duties must be imposed based upon the state of a product as presented at the border" (Canada's second written submission, para. 17).

[692] Canada considers that it is unnecessary for the Panel to decide all the precise situations in which the term "as presented" in the HS may apply to certain shipments of multiple goods (Canada's response to Panel question No. 210(b)). In Canada's view, that would be a matter for the WCO, not the WTO.

[693] Canada's second written submission, para. 59 and its footnotes (including footnote 67, citing the Appellate Body Report on *EC – Chicken Cuts*, para. 291).

in that rule; (ii) the practice on which the comment was based related specifically to a handful of products (principally machinery) imported in separate shipments as one product, and did not include motor vehicles or their parts; (iii) parts used for the manufacturing process and shipped separately were specifically not intended to be covered by GIR 2(a); and (iv) at the time of China's accession, there was no established practice among Members to apply this decision to multiple shipments.

7.407 Concerning the circumstances in which a need for customs authorities to apply the principle of GIR 2(a) arises, the **WCO Secretariat** is of the view that GIR 2(a) should always be applied when the following three conditions are met:

1. the entry under consideration is presented incomplete, unfinished, unassembled or disassembled;

2. as presented, it has the essential character of the complete or finished article; and

3. the heading and Legal Notes of the HS do not otherwise provide for the entry.[694]

7.408 The WCO Secretariat explains that the term "as presented" in GIR 2(a) could be understood to mean 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 nomenclature. The WCO Secretariat adds that the HS is silent on "as presented" and the HS Committee has not considered its meaning except in the context of the issue of *split consignments*.[695]

7.409 The WCO Secretariat replies that during the HS Committee discussions at issue, the Committee reaffirmed its earlier decision[696] that the possible treatment of *split consignments* as a single entity for purposes of GIR 2(a) was a matter to be handled exclusively at the discretion of each individual administration, taking into account national laws and regulations. This decision was never codified in legal or Explanatory Note texts, although it was informally noted by the Committee from time to time. The WCO Secretariat notes that, based on the Secretariat's experience, national regulations and laws appear to differ with respect to the applicability of GIR 2(a) to split consignments. The WCO Secretariat also notes that it would expect that those administrations which permit such consolidation of entries would consider requests for that treatment on a case-by-case basis, applying standards set forth in national laws and regulations.

7.410 Furthermore, decisions of the HS Committee, including the Explanatory Notes and any amendments thereto, are not binding pursuant to Article 3.1(a) of the HS Convention.[697] Rather, the Contracting Parties to the HS are requested to inform the Secretariat in case they are not able to implement any decision by the HS Committee, and the Secretariat has not received such a notification with respect to the decision at hand. Regardless, the nature of the commitments posed by the Explanatory Notes, classification opinions and other advice rendered by the Committee, even when

[694] WCO's letter of 30 July 2007, page 2.

[695] The WCO Secretariat is of the view that "split consignments", although not formally defined, is widely used to describe a range of trading practice and would be identified with the situation where parts to be assembled into a complete article arrive separately in multiple shipments, including those arriving at different times, in different ports and from different places of origin.

[696] Reported in paragraph 81 of Doc. 11.000, NC/11/Oct. 63.

[697] The WCO Secretariat explains that Article 3 of the HS Convention obligates Contracting Parties to use the GIR, Legal Notes and texts of the headings and subheadings in their national nomenclatures, along with the relevant numerical codes (WCO's letter of 20 June 2007, page 3). The WCO Secretariat points out that decisions of the HS Committee, including the Explanatory Notes and any amendments thereto, are not binding under Article 3.1(a) of the Convention (WCO's letter of 20 June 2007, page 4).

specifically approved by the Council pursuant to Article 8 of the HS Convention, is in the nature of advisory rather than conventional.[698]

"As presented" – ordinary meaning

7.411 The **Panel** notes that China has focused its arguments concerning the interpretation of the term "motor vehicles", in particular whether it includes in its scope auto parts imported in multiple shipments, on the meaning of "as presented"[699] in GIR 2(a). In this regard, the parties do not dispute that GIR 2(a) is applied when customs authorities need to determine whether parts and components of a complete good, imported and presented in a single shipment, have the essential character of the complete good.[700] The parties, however, do dispute whether GIR 2(a) also applies to parts and components imported in *multiple shipments*, presented to customs officials separately and assembled to a complete good in the importing country. The issue before us is therefore whether the term "as presented" in GIR 2(a) includes, as argued by China, the situation where parts are imported in multiple shipments and presented to customs authorities separately.

7.412 The plain meaning of the term "as presented" denotes a temporal meaning, i.e. the moment when a good is presented to the customs authority: the word "as" can be defined as "B. *rel. adverb* or *conjunction* III Of time or place. ... 8. At or during the time that; when, while; whenever."[701], and the word "present" as "verb. I Make present, bring into the presence of. 6. *verb trans.* a. Put before the eyes of someone; offer to sight or view; show, exhibit, display".[702] When these definitions are combined, we understand the term "as presented" to mean "when something is offered for the eyes of someone, offered to sight or view". In the absence of any other modifying words, "as presented" in the context of GIR 2(a) thus appears to point to the moment when goods are offered to customs authorities for examination, without necessarily encompassing situations where parts and components of a good are offered at different times for observation or examination and later assembled together into a complete good.

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[698] WCO Secretariat's letter of 20 June 2007, page 3.

[699] The Panel notes that the term "as presented" appears in the first sentence of GIR 2(a), whereas the second sentence has the word "presented". We understand for the purpose of this dispute that the parties' use of the term "as presented" in their discussion of GIR 2(a) refers to both "as presented" and "presented" in the first and second sentences of GIR 2(a). The parties agree that "as presented" in the first sentence in GIR 2(a) has the same meaning as "presented" referred to in the second sentence of GIR 2(a) (Parties' responses to Panel question No. 218).

[700] Canada submits that "[t]he 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 vast majority of necessary parts, and thus have the essential character of a whole vehicle in accordance with GIR 2(a)" (Canada's second written submission, para. 55). See also the responses of the European Communities and the United States to Panel question Nos. 113, 129.

Furthermore, the Panel notes the cases in which the complainants' customs authorities have also relied on the principle of GIR 2(a) in classifying parts and components of a complete good imported in a single shipment: see China's first written submission, paras. 102-103 and footnote 74, citing Exhibits CHI-19, 20, 21.

[701] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 126. The Panel recognizes that the word "as" has an extensive list of dictionary meanings. However, none of the definitions other than the highlighted above seems to make sense when considered in conjunction with "presented" as used in GIR 2(a) for the phrase "as presented".

[702] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 2, page 2332.

7.413 We also note that, as the United States explains[703], the term "as presented" was a replacement for the term "imported" in GIR 2(a) to the CCCN (i.e. a nomenclature preceding the HS) to align it with the French word "présenté" and was intended to cover not only "import" but also "export" trade statistics. Furthermore, in a letter provided by the Nomenclature Directorate in response to a question from one of the signatories to the HS concerning the scope of the term "presented" in the text of GIR 2(a), the Director of the CCC (the immediate precursor to the WCO) states that the editorial amendment of replacing the word "imported" with "presented" was adopted to make it clear that GIR 2(a) applies to a given article in the state in which it is presented for customs clearance.[704]

7.414 We consider that if the term "as presented", in the sense of "as imported", was intended to broadly cover parts and components imported and presented at different times so long as they would eventually be assembled together into a complete good in the importing Member's territory, the drafters would not have included the term "as presented" in the text of GIR 2(a). In other words, given that the ordinary meaning of the term "as presented" denotes a temporal meaning: the moment when a good is presented, if the drafters had intended the scope of the term to be broader than this ordinary meaning, they would have either excluded the term connoting such an obvious temporal meaning from the text of GIR 2(a) *or* been more specific about the scope of the term.

7.415 Therefore, the ordinary meaning of the term "as presented", considered together with the context in which the term was introduced into GIR 2(a) by the CCC, supports the view that its scope is limited to the specific moment when goods are presented to the customs authority for classification. We consider that this interpretation is also in line with the basic principle of classification as observed by the Appellate Body in *EC – Chicken Cuts*, i.e. goods must be classified based exclusively on their objective characteristics, which refer to their condition as they are presented to customs authorities at the time of importation.[705]

"As presented" – the HS Committee Decision

7.416 China, however, argues that the interpretation of "as presented" should be read in light of the HS Committee Decision 1995 concerning the interpretation of GIR 2(a)[706], in particular paragraph 10 of the Decision.

7.417 We will commence our analysis with the parties' contentions on the interpretative weight to be given to the HS Committee Decision in the interpretation of China's Schedule of Concessions.

Interpretive weight to be given to the HS Committee Decision

7.418 The **complainants** submit that the HS Committee Decision at issue is not binding on the contracting parties of the HS and that decisions that do not reflect a consensus of the WCO membership must be accorded less weight in the interpretative hierarchy of the HS, after the GIR, Section and Chapter Notes and Explanatory Notes.[707]

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[703] The United States refers to the Decisions of the Nomenclature Committee in 1979 and a "Letter from Nomenclature and Classification Directorate" dated 2 October 1989 (United States' comment on China's response to Panel question No. 110, citing Exhibit US-1, which is also the same document as that provided in Exhibit CDA-15).

[704] Exhibit US-1 and Exhibit CDA-15, page 2.

[705] Appellate Body Report on *EC – Chicken Cuts*, para. 246.

[706] HSC/16/Nov.95, DOC.39.600 (Exhibit CHI-29).

[707] Complainants' responses to Panel question Nos. 110, 111; United States' comment on China's response to Panel question No. 110.

7.419 **China** is of the view that the Decision is relevant to the Panel's assessment of how the GIR affects the interpretation of China's tariff provisions for motor vehicles.[708] China bases its argument, first, on the Appellate Body's finding that interpretations of the GIR adopted by the HS Committee and the WCO are relevant to a panel's assessment of how the GIR affects the interpretation of a Member's Schedule of Concessions and, second, on the fact that the HS Committee Decision at issue was adopted by the HS Committee and, as such, can be deemed to be approved by the WCO if no member objects to its adoption under Article 8 of the HS Convention.[709]

The **European Communities** submits that the HS Committee decided to include the Nomenclature Committee's decision relating to "split consignments" into its report, as a completely separate issue from "assembly". However, GIR 2(a) has not been amended in any way pursuant to the discussion in the Committee. Thus, the European Communities is of the view that China's submission that the Decision would somehow affect the "as presented" criterion under GIR 2(a) in the context of split consignments is entirely without merit. (European Communities' response to Panel question No. 111). According to the **United States**, decisions of this committee are considered advice and guides to the interpretation of the HS and that the US Customs considers that these decisions often provide valuable insight into how the HS Committee views certain provisions and that Decisions of the [HS Committee] that are merely given in the report should be given little weight (United States' response to Panel question No. 111). **Canada** is also of the view that decisions that do not reflect a consensus of the WCO membership, including the HS Committee Decisions, must be accorded less weight in the interpretative hierarchy of the HS, after the GIR, Section and Chapter Notes and Explanatory Notes. Canada notes however that although Explanatory Notes have less probative value than Chapter Notes, the Appellate Body has *not* indicated that WTO Members, in applying duties under their Schedules, have the discretion to ignore the Explanatory Notes (Canada's second written submission, para. 42, footnote 36, also referring to its response to Panel question No. 111). Canada points out that panels or the Appellate Body did not give the same weight to the HS Committee Decisions as to the Explanatory Notes in their analysis (Canada's second written submission, footnote 36).

[708] China also submits that 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. Rather, 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 (China's second written submission, para. 43 and footnote 22).

[709] China's second written submission, para. 43. China first submits that the question of whether the decision of the HS Committee is formally binding on the WCO members is not relevant to the present dispute. In finding that the application of GIR 2(a) to multiple shipments is a matter to be resolved under national laws and regulations, the WCO has necessarily interpreted GIR 2(a) as containing no prohibition on this particular application of the rules, and has found that this application of the rule is not otherwise consistent with the HS. The fact that the WCO Secretariat has received no notification from WCO members concerning their inability to implement the HS Committee decision simply confirms that this decision has not proven to be particularly controversial or detrimental to the operation of the HS (China's response to Panel question No. 210(c)).

Article 8 of the HS Convention in relevant parts provides as follows:

> "Article 8
> Role of the Council
>
> ...
>
> 2. The Explanatory Notes, Classification Opinions, other advice on the interpretation of the Harmonized System and recommendations to secure uniformity in the interpretation and application of the Harmonized System, prepared during a session of the Harmonized System Committee under the provisions of paragraph 1 of Article 7, shall be deemed to be approved by the Council, if not later than the end of the second month following the month during which that session was closed, no Contracting Party to this Convention has notified the Secretary General that it requests that such matter be referred to the Council."

7.420 The **Panel** notes that the parties do not dispute that the concerned HS Committee Decision is not binding on the HS Contracting Parties within the meaning of Article 3.1 of the HS Convention, which is an exclusive provision setting out the obligations of the Contracting Parties. At the same time, as pointed out by China and referred to by the WCO Secretariat, materials such as Explanatory Notes or other advice prepared as guides to the interpretation of the HS are deemed to be approved by the WCO if no Contracting Party to the HS notifies the Secretary General of its request that such matter be referred to the Council.[710] Even so, this means, according to the response from the WCO Secretariat, that the commitments posed by Explanatory Notes, Classification Opinions and other advice rendered by the Committee, even when specifically approved by the Council pursuant to Article 8 of the HS Convention, are *advisory* rather than conventional in nature.[711]

7.421 Under Article 3.1 of the HS Convention, classification rules binding on the Contracting Parties to the HS are the GIR, Section and Chapter Notes, and texts of the headings and subheadings. Therefore, other materials such as Explanatory Notes and Classification Opinions and other advice from the HS Committee are not binding on the HS Contracting Parties. In light of this, we agree with the complainants that the HS Committee Decision, in particular parts of the Decision that have not been codified into legal texts of the HS or Explanatory Notes to the HS, do not afford the same evidentiary weight as the GIR itself or the HS Committee Decisions that have been codified into legal texts or Explanatory Notes.[712] The Appellate Body also stated in *EC – Chicken Cuts* that the Chapter

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Article 7, in turn, provides in relevant part:

> "Article 7
> Functions of the Committee
> The Harmonized System Committee, having regard to the provisions of Article 8, shall have the following functions:
> ...
> (b) to prepare Explanatory Notes, Classification Opinions or other advice as guides to the interpretation of the Harmonized System;"

[710] The WCO Secretariat advises that it has not received any such notification. The United States submits that it is not surprising that the WCO Secretariat has not received notification that a Contracting Party has not been able to implement the second "decision", since that second decision is not one that could be implemented by the Contracting Parties as it was not a decision but a statement that these matters were not within the purview of the HS (United States' response to Panel question No. 210(c)).

[711] WCO Secretariat's letter of 20 June 2007, page 3. Based on the text of the provisions of the HS Convention and the explanation from the WCO Secretariat, the Panel understands that the Contracting Parties to the HS are obliged to respect only the HS legal texts, which consist of the GIR, Legal Notes (Section, Chapter and subheading Notes) and texts of the headings and subheadings. The rest of the materials, such as Explanatory Notes, Classification Opinions and other advice rendered by the Committee, even when they are approved by the Council pursuant to Article 8 of the HS Convention, are advisory rather than conventional.

[712] See footnote 707 for the complainants' statements in this regard. For example, the Panel observes that the part of the HS Committee Decision that GIR 2(a) should imply a certain range of expected assembly operations was embodied in Explanatory Note (VII) to GIR 2(a). In this connection, the WCO Secretariat explains that as a result of discussions on GIR 2(a) in the HS Committee, Explanatory Note (VII), first paragraph, was amended to the current text (WCO letter of 20 June 2007, page 5). On the other hand, paragraph 10 of the HS Committee Decision was never codified in legal or Explanatory Note texts, although according to the WCO Secretariat, the possible treatment of "split consignments" as a single entity (the first question) as mentioned in paragraph 10 of the HS Committee Decision was informally noted from time to time by the Committee.

Notes to the HS, which are binding, may have greater probative value than the Explanatory Notes to the HS, which are not binding.[713]

7.422 However, regardless of the exact interpretative weight to be given to the HS Committee Decision at issue, the Contracting Parties can refer to such a decision at the very least as guidance to the interpretation of the HS. The United States itself has also stated that its national customs regulations on split consignments is consistent with paragraph 10 of this HS Committee Decision.[714] If one of the issues included in the same provision of the HS Committee Decision can be consulted by the HS Contracting Parties, in our view, it should also be the case for the other issues contained in that provision. The European Communities and Canada do not contest either that the Decision can serve the Contracting Parties at least as guidance on relevant issues. We find support for our view in the Appellate Body's statement in *EC – Chicken Cuts* that the probative value of a Note, either Chapter Note or Explanatory Note, will also depend on how relevant it is to the interpretative question at issue.[715]

7.423 Furthermore, concerning the HS Committee decisions, as China argues, the Appellate Body in *EC – Computer Equipment* states: "[i]n interpreting the tariff concessions in [the European Communities' Schedule in that case], decisions of the WCO may be relevant; and, therefore, they should have been examined by the Panel".[716] Following the Appellate Body's guidance, the Panel in *EC – Chicken Cuts* considered that decisions of the HS Committee of the WCO, even if not binding, could well be a useful source of information on the subsequent practice of WTO Members, a large proportion of whom are signatories to the HS Convention and, thus, are members of the HS Committee.[717] In light of our considerations above, we will now examine whether the HS Committee Decision concerned could provide guidance on the interpretation of GIR 2(a).

The HS Committee Decision[718] and the interpretation of "as presented" in GIR 2(a)

7.424 We now turn to the substantive relevance of the HS Committee Decision to the interpretation of GIR 2(a) as argued by China.

7.425 The HS Committee Decision in relevant part provides as follows:

> "9. The Chairman then invited the Committee to rule on whether the present Report should include the decision[719] previously taken by the Nomenclature

[713] Appellate Body Report on *EC – Chicken Cuts*, para. 224. The Appellate Body further states in a footnote to the same paragraph:

> "The probative value of a Note will, however, also depend on how relevant it is to the interpretative question at issue; as a result, it cannot be excluded that an Explanatory Note that directly addresses a given interpretative question will more probative than a Chapter Note that does not relate specifically to that interpretative question" (footnote 432 to para. 224).

[714] United States' response to Panel question No. 224. Also see footnote 707 above.
[715] See footnote 713 above.
[716] Appellate Body Report on *EC – Computer Equipment*, para. 90.
[717] Panel Report on *EC – Chicken Cuts*, para. 7.298.
[718] See footnote 666.
[719] At the request of the Panel, the WCO Secretariat provided a copy of this decision as an attachment to its letter of 30 July 2007. Paragraph 81 of Doc. 11.000 provides:

> Committee as set out in paragraph 81 of Doc. 11.000 (NC/11/Oct. 63 – Report) and reproduced in paragraph 28 of Doc. 39.235.
>
> 10. The Committee decided, by 12 votes to none, to include the Nomenclature Committee's decision in its Report. Thus, the Committee decided that the questions of *split consignments*[720] 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."[721] (emphasis added)

7.426 Paragraph 10 of the HS Committee Decision thus refers to two specific questions – "split consignments" and "the classification of goods assembled from elements originating in or arriving from different countries". It states that these two questions are matters to be settled by each country in accordance with its own national regulations.

7.427 **China** submits that the second question in paragraph 10, namely "the classification of goods assembled from elements originating in or arriving from different countries," pertains to "as presented" in GIR 2(a) and multiple shipments. Since paragraph 10 provides that this is a matter to be

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> "It was further agreed 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."

Doc. 11.000 (NC/11/Oct. 63 – Report) is a Report by the Nomenclature Committee on the issue of "articles imported unassembled or disassembled" in connection with the Draft Interpretative Rule on the classification of articles imported unassembled or disassembled.

[720] The WCO Secretariat explains that concepts such as "consignments" and "shipments" do not have conventional status in the HS, and therefore there are no official interpretation for those concepts (WCO letter of 30 July 2007, page 5).

[721] The Decision provides in other relevant parts:

> "6. Several delegates pointed out that Rule 2(a) was of key importance for the Rules of Origin, since it determined the classification of articles presented unassembled or disassembled hence the Explanatory Note to that Rule should be examined in the light of its impact on the Rules of Origin. However, this view was not shared by several other delegates who felt that the Rules of Origin had nothing to do with the General Interpretative Rules which provided solely for the classification of goods in the Harmonized System.
> 7. The Chairman drew the Committee's attention to the questions of split consignments and the classification of goods assembled from elements originating in, or arriving from, different countries.
> 8. In this Connection, one delegate said that he favoured an international regulation to deal with split consignments, whereas other delegates felt that the problem had to be resolved in Members' own national regulations, in accordance with the decision taken by the Nomenclature Committee when drafting General Interpretative Rule 2(a) and its Explanatory Rules.
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> ...
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> 11. Finally, the Committee instructed the Secretariat to undertake an additional study on the interpretation of General Interpretative Rule 2(a) and to prepare a corresponding draft Explanatory Note, taking account of the comments by delegates in the meeting. Mr. Kusahara pointed out that the legal text of General Interpretative Rule 2(a) was open to different interpretations."

settled by each country, China argues that it is allowed to apply GIR 2(a) to parts imported in multiple shipments.

7.428 The **complainants** contend that this second phrase in paragraph 10 concerns rules of origin and that China has not proved its claim that it pertains to the issue of "as presented" in GIR 2(a).

7.429 The **European Communities** submits that the classification of goods assembled from elements originating in or arriving from different countries refers to rules of origin as clarified by the WCO Secretariat.[722]

7.430 According to the **United States**, China's position concerning the phrase "the classification of goods assembled from elements originating in or arriving from different countries" is mere conjecture since paragraph 10 of the Decision does not include a definition of this phrase and China has not identified any other documents that would support its interpretation. The United States considers that the WCO Secretariat's response to a question from the Panel[723] supports the United States' view that the second phrase[724] in paragraph 10 of the Decision is referring to origin and not classification and that the question of multiple origin is not addressed by GIR 2(a).[725]

7.431 **Canada** submits that the phrase "the classification of goods assembled from elements originating in or arriving from different countries" in paragraph 10 of the HS Committee Decision refers to the situation where a particular shipment may have elements of different origin, in accordance with particular rules of origin.[726]

7.432 The **WCO Secretariat** responded that "elements originating in or arriving from different countries", which is the second question mentioned in paragraph 10, encompasses the possibility of goods being of (preferential or non-preferential) origin from the country of shipment or from another country. Further, the WCO Secretariat points out that the HS does not direct its Contracting Parties to classify entries differently or alike at the HS level on the basis of single origin as opposed to multiple origin. The WCO Secretariat states that it would be inclined to regard the second situation in paragraph 10 of the HS Committee Decision rather as reflecting the HS Committee's view that the determination whether multiplicity of origin shall affect applicability of GIR 2(a) is a matter left to each Contracting Party and that the HS does not address the applicability of GIR 2(a) to the classification of goods of mixed origin.[727]

7.433 The question before the **Panel** is therefore whether the HS Committee Decision, in particular the phrase "the classification of goods assembled from elements originating in or arriving from different countries" in paragraph 10, interprets the term "as presented" in GIR 2(a) and if so, whether

[722] European Communities' response to Panel question No. 212.
[723] Panel question No. 11.
[724] Classification of goods assembled from elements originating in or arriving from different countries.
[725] United States' comments on China's response to Panel question No. 210(a).
[726] Canada's response to Panel question No. 212.
[727] WCO's letter of 30 July 2007, pages 3, 4. The WCO Secretariat is also inclined to regard that "the classification of goods *assembled* from elements originating in or arriving from different countries" refers to the classification of a collection of articles based on their susceptibility to further assembly. The WCO Secretariat responds to a Panel question that paragraph 10 of the HS Committee Decision seems to connote that, in the Committee's view, whether multiple origin should affect the classification of unassembled or disassembled articles is a matter to be handled exclusively at the discretion of each individual administration, taking into account national laws and regulations.

it touches upon the question of "multiple shipment" in the manner advocated by China.[728] We will begin our analysis by considering the two questions mentioned in paragraph 10, i.e. "split consignments" and "the classifications of goods assembled from elements originating in or arriving from different countries".

7.434 First, regarding "split consignments", all parties appear to share the same understanding with respect to its meaning and the circumstances under which such a question is addressed: generally, "split consignments" refer to a situation where the carrier breaks the consignment of a set of goods into multiple consignments (multiple deliveries) for reasons such as the need to balance loads (in particular in the case of air transport), cost savings in shipment, or the nature of the goods shipped (e.g. large or complex machinery that are difficult to transport in one single consignment).[729] In such

[728] **China**, the **United States** and **Canada** are of the view that "split consignments" and "the classification of goods assembled from elements originating in or arriving from different countries" referred to in the second sentence of GIR 2(a) cover two separate situations, whereas the **European Communities** considers that these are inter-related issues concerning split consignments (parties' responses to Panel question Nos. 138, 212).

China submits that this second question is, in the context, distinguished from a "split consignment", in that the imported parts and components were not necessarily part of a single consignment. China explicitly states in its response to a Panel question that paragraph 10 of the HS Committee Decision refers to two different circumstances (China's response to Panel question No. 212, referring to its response to Panel question No. 138). According to China, "[t]his is evidence from the sentence itself, which refers to the *questions* of 'split consignments' *and* 'the classification of goods assembled from elements originating in or arriving from different countries'. ... The plural structure of the sentence clearly indicates that the paragraph refers to two different circumstances." Decree 125 could apply to either circumstance in paragraph 10, although it will generally apply to the second circumstance referred to in paragraph 10 of the HS Committee Decision (China's response to Panel question No. 213).

Despite this apparent gap in the view of the European Communities and the other two complainants (United States and Canada) on the relationship of the two situations mentioned in paragraph 10, the **Panel** does not consider, however, that the European Communities understands the second situation in paragraph 10 differently from the other complainants. All the complainants consider that the second situation concerns "rules of origin" and has nothing to do with the classification of goods imported in multiple shipments. The difference lies in the European Communities' view that the two questions in paragraph 10 are "inter-related" issues that concern trade facilitation and that the second question provides that the classification of "split consignments" as the complete product even when some elements arrive from different countries is an option for the importer. Regardless of whether these two questions are inter-related as suggested by the European Communities, what is at issue is China's argument that the second situation refers to the multiple shipment situation and the complainants' contention against that argument.

[729] Parties' responses to Panel question Nos. 138, 212. In particular, both China and the United States provide the same definition of "consignment": a consignment refers to a set of goods handed over to the custody of a carrier for delivery, whether those goods are packed in one container or in multiple containers. A consignment is split when the carrier breaks the consignment into multiple deliveries (e.g. it loads the containers making up the consignment onto different vessels). The European Communities submits that in the context of some very large or complex machinery that are difficult to transport in one single consignment the importer may wish to declare the product as a single product irrespective of the fact that the elements of the product are split into different consignments and may not be presented to customs precisely at the same time. According to the European Communities, in some instances an element of the product may need to be transported from two or more countries or may originate from two countries. Canada also submits that "split consignments" refers to practices allowing importers, at their discretion, to classify certain separate shipments of a single product as one item and that this is not an uncommon practice.

a situation, some Members allow, at the importer's request, goods delivered in multiple consignments to be declared as one item.[730]

7.435 Further, we note that the term "consignment" is defined as "1. The act of consigning goods for custody or sale. 2. A quantity of goods delivered by this act, esp. in a single shipment"[731]; "(shipping) Shipment of one or more pieces of property, accepted by a carrier for one shipper at one time, receipted for in one lot, and moving on one bill of lading"[732]; and "3. The action of consigning goods for sale etc. or custody."[733] Therefore, "consignment" refers to goods delivered in a single shipment by the act of consigning them for custody or sale. In turn, "split" means "*adj.* 1. That has split or been split"[734] and "*verb.* 4 ... b *verb intrans. & trans.* Divide or separate into parts."[735] When these definitions are considered together, we understand "split consignments" to refer to a situation where goods were originally consigned for delivery in a single shipment, but have been later split into more than one shipment.

7.436 In light of the parties' understanding of the term "split consignments", relevant customs practices of some Members in this regard[736], and the ordinary meaning of the term "split consignments", we are of the view that situations concerning "split consignments" are distinguished from the multiple shipment situation encompassed under the measures, in that the classification of split consignments concerns a unique situation where imported parts and components were intended to be part of a single consignment, but were then split into multiple consignments for reasons mainly relating to transportation. In this context, we do not consider that multiple shipments of auto parts that are considered as complete vehicles under China's measures are comparable to a "split

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[730] The United States refers to its customs regulations such as 19 C.F.R. § 141.57, which exist for the benefit of importers who intended their goods to have been accommodated on a single conveyance for arrival in the United States as a single shipment, but which were split after consignment to the carrier (United States' response to Panel question No. 224).

We also note China's reference to the US customs regulations in its written submission (China's first written submission, paras. 156-160; Exhibit CHI-28). The concerned Judgment of the US Court of International Trade (Exhibit CHI-28) explains its understanding of this regulation as well as the notion of "split consignments": this regulation addresses two scenarios – first, merchandise that importer intended to be shipped on single conveyance, but which was later split by the carrier and shipped on multiple conveyances on the initiative of the carrier, and, second, merchandise whose size or nature necessitates that it be shipped in an unassembled/disassembled condition on more than one conveyance. The Judgment provides in relevant part:

> "[t]hese so-called 'split shipments' are a routine occurrence, particularly in the context of air-shipped cargo, due to practice considerations including limited cargo space, the need for proper weight distribution, and the offloading of cargo for safety concerns. But, while split shipments are a straightforward matter of logistics for carriers, they often created legal uncertainty and unpredictability for importers. ... The financial repercussions for an importer could be significant where treatment as separate entries resulted in a different classification (and a higher rate of duty) than treatment of the merchandise as a single entry, as the importer had intended. Sensitive to importers' concerns, Congress resolved the inconsistency and clarified the situation by enacting 19 U.S.C. § 1484(j)(2), providing a framework to help ensure that split consignments are consistently classified as importers intend. ..."

[731] *Black's Law Dictionary*, Seventh edition, 1999, page 303.

[732] *Handbook of the Global Trade Community, Dictionary of International Trade*, E. Hinkelman, Fourth Edition, 2000, page 49.

[733] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 493.

[734] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 2, page 2964.

[735] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 2, pages 2967-2968.

[736] See footnotes 729-730.

consignment" situation.[737] "Split consignments" also tend to be allowed for the benefit of importers and considered by customs officials at the specific request of the importer concerned, which is not the case for the multiple shipment situation covered by the measures.[738]

7.437 Concerning the second question mentioned in paragraph 10 of the HS Committee Decision, "the classification of goods assembled from *elements originating in or arriving from different countries*", China considers that this question refers to "the classification of goods assembled from *imported parts and components (or 'elements') that arrive in the customs territory in multiple shipments*".[739] The complainants argue that the second question in paragraph 10 refers to rules of origin, not multiple shipments in the manner the concept is covered under the measures.

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[737] The United States submits that the treatment of split consignments mentioned in the HS Committee decision does not provide support for China's over-reaching measures (United States' response to Panel question No. 210(b)). See China's responses to Panel question Nos. 138 and 212.

[738] The Panel notes the European Communities' view that China's position concerning its understanding of "split consignments" and "multiple shipments" has evolved throughout this proceeding (European Communities' second written submission, para. 106). Specifically, the European Communities argues that China initially treated the notions of "split consignments" and "multiple shipments" synonymously (referring to paragraph 156 of China's first written submission), but, later in the proceeding, it distinguished one notion from the other (referring to China's response to Panel question No. 138).

Although we recognize the European Communities' point, we do not consider that China necessarily has changed its position on "split consignments" and "multiple shipments". Rather, while acknowledging the differences in these two concepts, China made an attempt to analogize the "multiple shipment" situation covered under the measures to the "split consignment" situation addressed by some other Members.

For example, in the section where the European Communities submits China treats these two notions synonymously, China submits that the types of anti-circumvention practices, which, according to China, Members adopt to prevent the circumvention of ordinary customs duties or anti-dumping/countervailing duties that apply to complete articles (i.e. in the same sense as China's measures), are not the only circumstances in which WTO Members examine the commercial intention of the importer when classifying "multiple shipments" of parts. China argues that this also occurs in the case of so-called "split shipments" (or "split consignments"), where an importer imports in multiple shipments an item (or group of item) that is the subject of a single contract, invoice, or transaction. Also, China submits that the HS Committee Decision acknowledges the arbitrary classification results that can occur when a set of related parts and components is broken into multiple shipments and that this can occur in the context of "split consignments" or in the context of "multiple shipment" (i.e. when a manufacturer imports parts and components in multiple shipments and assembles them domestically). These statements, in our view, show that China itself acknowledges that "split consignments", although also concerning multiple (split) shipments (*albeit* in different sense from that used in the measures), addresses a situation different from the situations relating to so-called anti-circumvention practices.

This becomes more obvious when China refers to the examples of customs regulations of the United States and the European Communities concerning "split consignments" (China's first written submission, paras. 156-160; Exhibit CHI-28). Both regulations of the United States and the European Communities, in these examples, "allow at the request of the importer", not require, multiple entries of unassembled or disassembled merchandise to be treated as a single entry for customs classification purposes.

In any event, even if China were intending to treat these notions synonymously, this would not affect our analysis because, as pointed out above, the evidence shows that split consignments are distinguished from the multiple shipment situation encompassed by the measures at issue. Further, China has also clarified its position during the proceedings, as pointed out by the European Communities, and acknowledged that "split consignments" in paragraph 10 of the HS Committee Decision is not particularly pertinent to the question of "multiple shipments" under the measures.

[739] China's response to Panel question No. 138. In a footnote, China further submits that the reference to "different countries" cannot, in the context, mean that the decision of the HS Committee applies only in the case of goods assembled from parts and components that arrive from more than one exporting country. According to China, the number and identity of the exporting country or countries would only be relevant, if at all, for the purpose of applying rules of origin – a matter that is not within the scope of GIR 2(a). Moreover,

7.438 China's argument is based on the assumption that the phrase "*elements originating in or arriving from different countries*" of the second question in paragraph 10 means "*multiple shipments of parts and components (elements)*".[740] As a legal basis for its argument, China submits that paragraph 10 is the result of the recognition by the CCC and subsequently the HS Committee that the arbitrary classification results can occur when a set of related parts and components is broken into multiple shipments, which encompass both the "split consignments"[741] situation as well as the situation where a manufacturer imports parts and components in multiple shipments and assembles them domestically.[742] In particular, China argues that the CCC recognized the existence of this issue when it first drafted GIR 2(a) in the early 1960s and that it was at that time the CCC agreed that the application of GIR 2(a) to "split consignments" and "multiple shipments" was a matter "to be settled by each country in accordance with its own national regulations," an interpretation that the HS Committee reaffirmed in the context of the HS Decision in 1995.

7.439 We do not, however, find any evidence supporting China's claim that when drafting GIR 2(a) in the 1960s, the CCC recognized that the situation where a manufacturer imports parts and components in multiple shipments to assemble them into a complete product poses the same kind of classification issue as in the split consignment situation. A document relating to the discussions on GIR 2(a) at the Nomenclature Committee of the CCC shows that the question of whether the draft Interpretative Rule concerning unassembled and disassembled articles[743] should apply to "articles imported unassembled or disassembled *for industrial assembly*" had been discussed at the Nomenclature Committee. The Secretariat of the CCC concluded, however, in accordance with the instructions of the Nomenclature Committee, that the draft Interpretative Rule should *not* cover such cases.[744] In particular, the following observation by the Secretariat of the CCC provides some useful information on historical background with respect to the introduction of GIR 2(a):

> "It is quite obvious that the principle of assimilating unassembled or disassembled articles to assembled articles of the corresponding kind was laid down in certain Chapters of the Nomenclature solely in order to ensure that if a complete article is specified or included in one particular heading it should not be classified in several different headings where, in particular cases, it cannot be imported assembled.
>
> The only purpose of this principle is to preserve the systematic method of classification on which the Nomenclature rests; it hence reflects technological considerations only. There is therefore every justification for its application to articles disassembled or unassembled solely by reason of their bulk or weight, or of packing and handling difficulties.

China argues, there is no reason why the classification of goods assembled from parts and components that arrive from a single exporting country should be any different than the classification of goods assembled from parts and components that arrive from more than one exporting country.

[740] See China's response to Panel question No. 210(A).

[741] China explains "split consignments" as a situation when a single import transaction is broken into "split consignments," usually for reasons of shipping and often without the prior knowledge of the importer (China's response to Panel question No. 112).

[742] China's response to Panel question No. 112.

[743] This question appears to correspond to the second sentence of the current GIR 2(a) concerning goods imported unassembled or disassembled.

[744] Exhibit CDA-19 (Customs Co-operation Council, Nomenclature Committee, 10th Session, Brussels, February 26, 1963, Document No. 10.195E, "Articles (Machinery, Appliances, etc.) Imported Unassembled or Disassembled", page 3. See Canada's second written submission, para. 59, footnote 70.

> However, if the imported goods are parts which are not assembled by the manufacturer, although he could easily do so before shipment, the aim is mainly to supply the assembly industry in the importing country; such practices involve economic considerations, which in the Secretariat's view, cannot be accommodated at the technological level of the Nomenclature. It is for each importing country to take such steps as may be felt necessary in the economic field (e.g. in relation to Customs duties) to assist its assembly industry."[745]

7.440 This piece of evidence[746] informs us how the classification of "unassembled or disassembled" goods as the complete good of the corresponding kind became part of GIR 2(a): at least based on the evidence before us, GIR 2(a) was not intended to apply to goods (parts and components) imported for industrial assembly, which is the multiple shipment situation covered under the measures. Rather, to the extent the rule concerns goods imported unassembled or disassembled, GIR 2(a), second sentence seems to have been intended to mainly cover the situations relating to goods that are difficult to be imported assembled.

7.441 Such an understanding by the Contracting Parties is now reflected in Explanatory Note (V) to GIR 2(a), which provides that when the goods are presented unassembled or disassembled, it is *usually* for reasons such as "requirements or convenience of packing, handling or transport".[747] Given that this phrase was not included in the main text of GIR 2(a) and the word "usually" is inserted, we also understand that those mentioned in Explanatory Note (V) to GIR 2(a) are not the only circumstances under which GIR 2(a), second sentence applies. Nevertheless, the evidence as a whole indicates that the drafters of GIR 2(a) did not intend to have the rule applied to the multiple shipment situation.[748] More importantly, China has not directed us to any evidence showing that the second question in paragraph 10 of the HS Committee Decision refers to the multiple shipment situation of parts and components imported for the assembly of motor vehicles.

7.442 The WCO Secretariat's opinion also demonstrates that the second phrase at issue in paragraph 10 does not concern the multiple shipment situation. The WCO Secretariat states that it is inclined to regard the reference in paragraph 10 to "the classification of goods assembled from elements originating in or arriving from multiple countries" rather as reflecting the HS Committee's

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[745] Exhibit CDA-19, pages 2-3. Based on the text of this document, the Panel understands that the situation addressed in that document concerned the situation where tariff rates were lower for complete goods than for components of the corresponding complete goods.

[746] In a background document prepared by the WCO Secretariat in 1996 in relation to the discussions on the text of the Explanatory Notes to GIR 2(a), in particular the current Explanatory Note (VII), the WCO Secretariat points to an observation by Sweden during the creation of GIR 2(a): "[I]t transpires that this Rule was a proposal by Sweden concerning articles which are 'imported unassembled or disassembled for convenience of transport and can be put together by rather simple operations (e.g. screwed together). If the parts are intended for industrial production of the articles in question the parts are, as a rule, classified as such in their appropriate headings'" (Doc. 8.333, Observation by Sweden). Although this was an observation by one Member of the WCO concerning GIR 2(a), it provides information on how GIR 2(a), in particular the part on the classification of "unassembled or disassembled" goods, came about. Even when considered against the limited interpretative weight to be given to this type of document, this still goes against the interpretation advocated by China.

[747] The WCO Secretariat mentions that the text of the Explanatory Notes is merely an explanation of historical reasons for articles being shipped unassembled or disassembled (WCO's letter of 30 July 2007).

[748] The Panel also notes a comment by the Secretariat of the Nomenclature Committee that classifying unassembled or disassembled articles with assembled articles of the corresponding kind obliges importers to produce all the components of the article in question *simultaneously*, unless they have the benefit of an incomplete articles rule or of national provisions on split consignments (emphasis added) (Exhibit CDA-19, page 3).

view that the determination whether "multiplicity of origin" shall affect the applicability of GIR 2(a) is a matter left to each Contracting Party and that the HS does not address the applicability of GIR 2(a) to the classification of goods of mixed origin.[749]

7.443 Furthermore, a copy of the document concerning discussions at the CCC in 1962, submitted by Canada, includes, *inter alia*, a note by the Austrian administration and observations of the Nomenclature Directorate on that note.[750] In that document, the Austrian administration raised the question of whether the unassembled or disassembled articles must be consigned by one exporter or at least by several exporters in the same country (i.e. whether GIR 2(a) must be confined to goods imported unassembled or disassembled from one country, as opposed to different countries). In this regard, the Nomenclature Directorate has noted the following:

> "The main classification criteria used in the Nomenclature are: nature, kind, structure or composition and use of the goods. The origin never affects classification.
>
> It would hence be against the spirit and the letter of the Nomenclature for the Interpretative Rule on the corresponding Explanatory Note to introduce a discrimination based on the origin of goods imported unassembled or disassembled.
>
> Moreover, it is common practice for "sub-assemblies" of large plants to be despatched directly by their manufacturers to the country of destination.
>
> *Although this matter lies outside the field of Nomenclature*, the Nomenclature Directorate considers that such consignments, whether simultaneous or split (insofar as the latter are provided for by national regulation), should be eligible for the facilities afforded by the draft Interpretative Rule, provided that all the other conditions are met."[751]

7.444 The language of this document evinces that the Nomenclature Directorate considered the question of goods imported unassembled or disassembled from different countries to relate to rules of origin and thus to be outside the field of nomenclature. In our view, this evidence is unsupportive of China's argument that there is no reason to believe that the HS Committee Decision, which refers to "goods assembled from elements originating in or arriving from different countries", is not equally relevant to "goods assembled from elements originating in or arriving from a *single* country" and that the number and identity of the countries from which the parts originated would only be relevant, if at

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[749] The WCO Secretariat further states that in the Secretariat's opinion, "[i]t seems that paragraph 10 of the HS Committee decision connotes that, in their view, whether multiple origin should affect the classification of unassembled or disassembled articles is a matter to be handled exclusively at the discretion of each individual administration, taking into account national laws and regulations" (WCO Secretariat's letter of 30 July 2007, page 4).

[750] Exhibit CDA-18 (Customs Co-operation Council, Nomenclature Committee, 9th Session, Brussels, July 19, 1962, Document No. 9550E, "Articles (Machinery, Apparatus, etc.) Imported Unassembled or Disassembled"), referred to in footnote 69 of Canada's second written submission. As Canada notes, the Directorate also provides on page 2 that the second paragraph of General Note I on Section XVI of the Geneva Nomenclature (machinery – a separate section from motor vehicle in Section XVII) reads that the importation of *machines* in an unassembled state, even if forwarded in several consignments, shall not affect their classification. Further, Canada points to page 3 where it reads that many countries have similar provisions in their national tariffs, and recommended that there simply be a reference to this practice in the Committee's Report, Document No. 11.00 NC/11/Oct. 63, which is the report ultimately referred to in paragraph 9 of the HS Committee Decision (Exhibit CHI-29) relied on by China.

[751] Exhibit CDA-18, page 4.

all, for purposes of applying rules of origin.[752] China goes on to claim that as pointed out in paragraph 6 of the HS Committee decision[753], the GIR pertains solely to classification under the HS, and has no bearing on rules of origin. We agree with China that the HS pertains only to classification, not rules of origin. The evidence shows that the Contracting Parties to the CCC were aware of the fact that rules of origin were outside of the field of the nomenclature, and nonetheless decided to mention that the question of "the classification of goods assembled from elements originating in or arriving from different countries" concerning rules of origin was an issue to be dealt with by each country in accordance with their own national regulations.

7.445 In conclusion, we do not agree with China's argument that the HS Committee Decision proves that the WCO has interpreted the relevant GIR in a manner that is directly relevant to the interpretation of the term "motor vehicles" in China's Schedule of Concessions.[754] Specifically, China has not presented sufficient evidence to show that the second situation in paragraph 10 pertains to "as presented" in GIR 2(a) so as to allow the application of GIR 2(a) to parts and components imported in multiple shipments for assembly.

7.446 However, even if we were to accept China's argument that the HS Committee Decision should be read as giving discretion to the Contracting Parties to apply "as presented" in GIR 2(a) to goods imported in multiple shipments, this is far from saying that China is *required* to classify auto parts and components, imported in multiple shipments and presented separately, as a motor vehicle based on their assembly into a motor vehicle. Unlike GIR 2(a) itself, which China has submitted that the Contracting Parties to the HS are *required* to apply, China does *not* insist that "as presented" in GIR 2(a) considered in light of the HS Committee Decision *requires* the application of the principle of GIR 2(a) to the multiple shipment situation. Rather, China considers that a Contracting Party is afforded *discretion* to so classify based on the language of paragraph 10 of the HS Committee Decision. As pointed out by Canada[755], we consider that if discretion were afforded to those HS Contracting Parties who are also WTO Members, such discretion must be exercised in a manner compatible with Members' obligations under the WTO.[756]

7.447 Furthermore, China has submitted that the need for customs authorities to apply GIR 2(a) in the manner advocated by China arises *only* in the specific circumstances in which there is a *significant* difference in duty rates between the complete article and the parts of that article.[757] When this need arises, China argues, customs authorities must implement a process to determine whether specific importers are importing parts and components in multiple shipments that, in their entirety, have the essential character of the complete article that is subject to the higher rate of duty.[758]

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[752] China's response to Panel question No. 112 (emphasis added).

[753] See footnote 721 for the text of paragraph 6 of the HS Committee Decision.

[754] See China's response to Panel question No. 112.

[755] Canada submits that a WCO decision that is not adopted in the form of a modification or addition to the GIR or included as an Explanatory Note to the GIR, may provide guidance but cannot be determinative of how to apply the GIR and that any discretion that might be afforded to Members on how to classify split shipments must naturally be limited so as not to violate tariff commitments (Canada's response to Panel question No. 112). As a result, the Decision should have no bearing on the interpretation of GIR 2(a).

[756] See, for example, Canada's response to Panel question No. 138.

[757] China's responses to Panel question Nos. 38, 238(b). According to China, the same need could arise in the case of ordinary customs duties or in the case of other types of duties such as anti-dumping or countervailing duties.

[758] At the same time, China also argues that "challenged measures fall within the scope of measures that national customs authorities routinely adopt to ensure the proper interpretation of their tariff schedules and to ensure the proper classifications of imports" (China's response to Panel question No. 13(b)).

7.448 However, as pointed out by Canada, the HS, including its interpretative rules under the GIR, is a classification rule and was never designed as a rule to prevent the so-called "circumvention" of duties that China allegedly tries to prevent through the measures.[759] We note that Article 9 of the HS Convention states, "the Contracting Parties do not assume by this Convention any obligation in relation to rates of Customs duty."[760] In this regard, we also recall the statement by the Secretariat of the CCC, cited above, that practices involving economic considerations cannot be accommodated at the technological level of the nomenclature and must be addressed by each importing country by taking steps necessary in the economic field such as in relation to customs duties.[761] In addition, as the European Communities points out, China's view would seem to imply that the rule has a different meaning in situations where the tariff rate difference is small or where there is no difference.[762] We do not find support for such a proposition. Further, for the same reason that the HS is about tariff classification, not about economic considerations, we do not regard the so-called unique classification challenges under Chapter 87 of the HS – in the sense Chapter 87 has tariff headings for complete goods, intermediate goods and parts – as presenting a fiscal concern where a Member maintains a significant difference in duty rates between a complete good and parts of the complete good.[763]

7.449 This is not to say, however, that classification is irrelevant to tariff duties. As acknowledged by the parties, classification of a good into the proper tariff heading is an essential first step for assessing the appropriate tariff duty on the product.[764] However, in light of the evidence discussed above, we are not persuaded that an interpretative rule on tariff classification under the HS was intended to address issues relating to the circumvention of tariff duties.[765]

7.450 Finally, we also note China's argument that it would be arbitrary to conclude that the same collection of parts and components, used to assemble the same finished article, would obtain a different classification result based solely on whether the parts and components are contained in one shipment or in multiple shipments, because such an interpretation would vitiate the rule's resolution of the relationship between parts and wholes.[766] This argument is, however, once again predicated on China's own understanding that GIR 2(a) is a rule resolving the relationship between parts and wholes with significant differences in tariff rates, which we have found not to be the case. To this extent, we are equally not persuaded by China's argument. Further, China considers that even if GIR 2(a) did not exist, China (along with other customs authorities) would still need a means of defining and enforcing

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[759] Canada's responses to Panel question Nos. 186, 225. **Canada** submits that China attempts to turn a WTO dispute into a WCO dispute, and also ignores proper classification, starting with GIR 1, and that classification is a prerequisite for assessment of duties, but, as the WCO Secretariat points out, "[t]he application of customs duties is outside the legal purview of the WCO".

The **European Communities** also submits that China confuses the interpretation of a general rule with the fiscal consequences of a tariff difference between parts and complete products and that a rule cannot be applied differently just because the consequence of its application may be more significant (European Communities' comments on China's response to Panel question No. 238(b)).

[760] The **WCO Secretariat** considers that Article 9 of the HS Convention makes it clear that the purview of the WCO, its instruments and its Committees does not extend to tariff-based issues (WCO's letter of 30 July 2007, page 2.)

[761] See paragraph 7.439 above; Exhibit CDA-19, page 3.

[762] European Communities' second written submission, para. 118.

[763] China's response to Panel question No. 238(b).

[764] Canada's second written submission, para. 44, referring to Exhibit CDA-16 (WCO, *HS Classification Handbook*, Part II, Chapter 4, at page II/27) and its response to Panel question No. 113. Also see paragraph 7.710.

[765] Canada's second written submission, para. 59, footnote 69; Canada's response to Panel question No. 224; Exhibit CDA-18. Also see paragraphs 7.443-7.444 above for the relevant text of this evidence.

[766] China's response to Panel question No. 110.

the boundary between parts and wholes, and this is what the challenged measures do.[767] Otherwise, in its view, it would violate the general principle that substance should prevail over form in the administration of customs laws. China has not provided, however, any legal or factual basis, apart from its arguments relating to GIR 2(a), to support its position that defining and enforcing the boundary between parts and wholes necessitates the assessment of parts imported separately in multiple shipments for domestic assembly in the importing country for classification of such parts as wholes.

Conclusion

7.451 In light of the foregoing, the **Panel** does not find that the context of the term "motor vehicles" supports the interpretation that the term "motor vehicles" in China's Schedule includes parts and components imported in multiple shipments and assembled into a motor vehicle in the importing country.

(iii) Object and purpose[768]

7.452 **China** submits that Members may interpret their Schedules of Concessions in accordance with the rules of the HS, (and consistent with the practice of other WTO Members in like circumstances) and in a manner that is consistent with the object and purpose of securing the benefit of reciprocal and mutually advantageous tariff concessions.[769] China considers that the importation and assembly of auto parts components through multiple shipments undermines the value of the tariff concessions that China negotiated, whether the auto manufacturer has an intention to evade the higher duty rates on motor vehicles or not.[770] Referring to the Appellate Body's statements in previous cases, China argues that it is consistent with the 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.[771] Further, in China's view, 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, since 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 submits that its 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.

7.453 The **European Communities** submits 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 of trade.[772] This is because the measures classify parts of products as complete products in a context where its tariff schedules provide for a clear separation between the products and parts thereof. The European

[767] China's second written submission, paras. 167, 168.
[768] See 7.699 below.
[769] China's response to Panel question No. 38.
[770] China's response to Panel question No. 13.
[771] China's second written submission, paras. 92-93.
[772] European Communities' second written submission, para. 69, also citing the Appellate Body Report on *EC – Chicken Cuts*, para. 243.

Communities further submits that 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, which goes to the very heart of the WTO Agreement and the GATT 1994. The European Communities argues that there seems to be no limit to the flexibility that China needs under the HS and that China's interpretation of GIR 2(a), namely to include the multiple shipment situation as envisaged under the measures, is a fundamental and serious attack on the very premise on which members' tariff commitments have been negotiated.[773] The European Communities submits that it cannot emphasize more the seriousness of such a position to the multilateral trading system.

7.454 The **United States** submits that China ignores the object and purpose of the HS Convention.[774] According to the United States, two key objects and purposes of the Convention are, first, 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, second, to facilitate international trade. The United States argues that China's interpretation of GIR 2(a) is totally at odds with these objects and purposes of the Convention: first, it will destroy the comparability of trade statistics collected by different members and the comparability between import and export statistics; and, second, it will destroy the certainty and predictability of tariff classification as well as serve as a serious impediment to trade, because under China's measures, goods are not classified as imported at the border, but only after 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.

7.455 **Canada** submits that customs duties are applied for the purpose of affording domestic producers a measure of protection from foreign import competition (although in some countries, particularly developing, they can also represent an important source of revenue). To ensure predictability as to tariff classification and liability, according to Canada, the HS bases the tariff classification of goods on their physical description at the time of their importation and admits of only one heading (or sub-heading) for each product.[775] Therefore, according to Canada, to countenance China's attempt to increase the tariff on auto parts under the guise of enforcing the customs duty on automobiles instead of renegotiating their tariff concession on this item under the relevant provisions of the WTO would undermine the predictability and value of WTO tariff concessions made by Members on parts, more broadly.

7.456 The **Panel** now examines the interpretation of the treaty term concerned – i.e. the tariff term "motor vehicles" contained in the tariff headings of China's Schedule of Concessions – in light of the object and purpose of the WTO Agreement and the GATT 1994.[776]

7.457 One of the objects and purposes of the WTO Agreement, generally, as well as of the GATT 1994, as clarified by the Appellate Body, is the security and predictability of "the reciprocal and

[773] European Communities' second written submission, para. 101.
[774] United States' second written submission, paras. 33-37.
[775] Canada's response to Panel question No. 140. Canada also submits that China agreed to provide Canada with a lower rate for auto parts than motor vehicles, and cannot use Article XX(d) to justify unilaterally altering this commitment and derogating from its Schedule simply because it is now dissatisfied with this commitment (Canada's second written submission, para. 77).
[776] As found by the Panel in *EC – Chicken Cuts*, we consider that the WTO Agreement and the GATT 1994 are also the treaties at issue for the treaty term at issue in this case (i.e. tariff term "motor vehicle" in the tariff headings of China's Schedule of Concession) given that China's Schedule becomes an integral part of the GATT 1994 and the WTO Agreement in light of Article II:7 of the GATT 1994 and Article II:2 of the WTO Agreement respectively. See also Panel Report on *EC – Chicken Cuts*, para. 7.317.

mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade".[777]

7.458 The parties in the present case do not dispute that an object and purpose of the WTO Agreement and the GATT 1994 is the security and predictability of tariff concessions. The parties, however, disagree whether the security and predictability of tariff concessions will be undermined if the tariff term "motor vehicles" contained in China's tariff concessions under China's Schedule of Concessions is interpreted to include parts and components imported in multiple shipments to be assembled into a motor vehicle in China.

7.459 China argues that it is consistent with the objective of maintaining the security and predictability of tariff concessions 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 European Communities submits that China's interpretation undermines the whole system of tariff classification and the object and purpose of the treaty, namely "the security and predictability" of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers of trade.[778] Canada is also of the view that the interpretation of the tariff term at issue as advocated by China would undermine the predictability and value of WTO tariff concessions made by Members on parts, more broadly.

7.460 First, as noted above, the main purpose and objective of the WTO Agreement and the GATT 1994 is to maintain the security and predictability of reciprocal market access arrangements manifested in tariff concessions. This, in our view, means that tariff concessions must be interpreted to benefit both the importing Member, China, and exporting Members. Connecting this purpose and objective of the treaty at issue to the facts of this case, we consider that China is entitled to revenues from the higher tariff rates applicable to motor vehicles under the relevant tariff headings of China's Schedule, while the exporting countries should be able to export parts and components of motor vehicles at the tariff rates applicable to auto parts under the appropriate tariff headings. Considered in this context, an interpretation of the tariff term "motor vehicles" to include auto parts and components imported in multiple shipments for assembly into a motor vehicle in the importing country could indeed undermine the objective and purpose of maintaining security and predictability of the reciprocal market access arrangements in China's tariff concessions. This is particularly so given that one of the objects and purposes of the WTO Agreement in general as well as of the GATT 1994 is *directed to the substantial reduction of tariffs and other barriers to trade*, as found by the Appellate Body.

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[777] Appellate Body Report on *EC – Chicken Cuts*, para. 243, quoting Appellate Body Report on *EC – Computer Equipment*, para. 82. The Appellate Body also notes that "security and predictability" is also mentioned in Article 3.2 of the DSU. We also note the reference by the Panel in *EC – Chicken Cuts* to the Appellate Body's statement in *Argentina – Textiles and Apparel* 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" (Panel Report on *EC – Chicken Cuts*, para. 7.319).

[778] European Communities' second written submission, para. 69, also citing the Appellate Body Report on *EC – Chicken Cuts*, para. 243.

7.461 We also consider that the object of the Members' negotiations on trade facilitation[779] shed further light on the interpretative issue before us. The object of the negotiations on trade facilitation is "further expedition of the movement, release and clearance of goods".[780] In our view, this object can be read in consonance with the overall object and purpose of reducing barriers to trade under the WTO Agreement. Therefore, any discretion a Member may have on trade-related matters must be exercised in a manner not only consistent with its obligations under the WTO Agreement, but also supportive of the overall objects and purposes of the WTO Agreement, including the negotiations on trade facilitation.

7.462 For the reasons above, we find that an interpretation of the term "motor vehicles" to include parts and components imported in multiple shipments for assembly into a motor vehicle could undermine that very object and purpose of the entire WTO Agreement and the GATT 1994.

(iv) Subsequent practice[781]

7.463 We now examine, based on China's own practice as well as the practice of other Members since China's accession to the WTO, whether China has proved the existence of a subsequent practice that implies agreement among the WTO Members regarding the interpretation of the tariff headings concerned, in particular the application of GIR 2(a) to goods with separate tariff headings for a complete good and parts of the complete good.

China's own practice

7.464 **China** submits that prior to the adoption of the measures, China did not have a procedure for determining whether multiple shipments of parts and components were related to each other through their common assembly into a specific vehicle model.[782] China also submits that it does not have a general law or regulation that deals with each circumstance where there is a significant tariff rate difference between a complete article and parts of that article.[783] In China's view, the fact that China has established a customs process to resolve the tariff classification relationship between parts and wholes in one context does not mean that it needs to establish a similar customs process in other such contexts. Rather, China allocates its customs administration resources based on a variety of

[779] The Panel notes that in November 2001, WTO Members agreed to launch negotiations on trade facilitation. The mandate of these negotiations provides that "[n]egotiations shall aim to clarify and improve relevant aspects of Articles V, VIII and X of the GATT 1994 *with a view to further expediting the movement, release and clearance of goods, including goods in transit*". The Members further agreed, "the negotiations shall further aim at provisions for effective cooperation between customs or any other appropriate authorities on trade facilitation and customs compliance issues" (Decision adopted by the General Council on 1 August 2004, Annex D, para. 1).

[780] The WCO Secretariat commented that the preamble to the original BTN Convention (15 December 1950) notes the desirability of "a common basis for the classification of goods in customs tariffs" (WCO's letter of 30 July 2007, page 2.)

[781] Also see paragraphs 7.702-7.705 in the CKD and SKD kits section.

[782] China's response to Panel question No. 12(b).

[783] China's response to Panel question No. 57, referring to its response to Panel question No. 12(c). As examples of such circumstances where there is a significant tariff rate difference between a complete article and parts of that article, China provides fans (8414.5110) with the tariff duty of 21.7 per cent (at the time of accession) and parts for a complete fan (8414.9020) with the tariff duty of 21.0 per cent and air conditioners (8415.1000) with the tariff duty of 21.0 per cent (at the time of accession) and parts for a complete air conditioner (8415.9010) with the tariff rate of 11.7 per cent.

considerations, including the commercial significance of the products at issue, the volume of imports, and the potential revenue loss from misclassification of the imports.[784]

7.465 In this connection, the **European Communities** submits that the fact that China has adopted the measures in 2004 and 2005, which is three and four years after China's accession to the WTO, demonstrates that China has interpreted GIR 2(a) differently prior to the adoption of the measures, despite its claim that the interpretation it now advances has been the premise under which it negotiated its accession to the WTO.[785] Therefore, China's anti-circumvention theory is a mere creation *ex post facto* for the purposes of defending the measures before the Panel. The European Communities submits that there is not a single reference, let alone more detailed justification in the measures, that would even remotely point to GIR 2(a) or its language.[786]

7.466 Given the absence of any practice relevant to the interpretation of tariff headings concerned before the adoption of the measures in China, the **Panel** does not find any examples of subsequent practice, insofar as China's own practice is concerned, that could establish the Members' agreement on the interpretation of the tariff headings at issue as advocated by China. Since its accession to the WTO, China has always maintained higher tariff rates for motor vehicles than those for auto parts in its Schedule.[787] China informs us, moreover, that no mechanisms or measures comparable to the measures at issue existed before the introduction of the current measures in 2004 and 2005. Nor has China provided any proof that it has been interpreting the tariff headings concerned in the same manner under the measures as before the adoption of the measures. Our consideration is further supported by the fact that no other tariff headings under China's Schedule that have separate lines for a complete good and parts of the complete good are subject to the same kind of tariff interpretation at issue.

Other Members' practice – *In general*

7.467 **China** submits that numerous WTO Members, including all three complainants in this proceeding, have maintained, both prior and subsequent to China's accession to the WTO, measures that prohibit the use of domestic assembly operations as a means of circumventing duties, whether they are ordinary customs duties or antidumping/countervailing duties.[788] According to China, these measures demonstrate a practice among Members of interpreting the term for a complete article to include the importation and assembly of the component parts of that article, when necessary to prevent the circumvention of duties. Further, this subsequent practice implies a level of agreement as to how WTO Members may interpret the term for a complete article to include the parts and components of that article, and the measures that Members may adopt to discipline the use of domestic assembly operations as a means of circumventing duties on complete articles. More specifically, China refers to a classification decision by Canada on certain furniture import, which China considers is directly comparable to China's measures[789], anti-circumvention measures taken by other Members in relation to anti-dumping and countervailing duties, and other Members' measures concerning split shipments. China further submits that other than these examples, China is *not* aware

[784] China's response to Panel question No. 57.
[785] European Communities' second written submission, para. 120, referring to China's responses to Panel question Nos. 12(b) and 111.
[786] European Communities' second written submission, para. 121.
[787] See China's response to Panel question No. 2.
[788] China's first written submission, paras. 111, 146-148.
[789] China's response to Panel question No. 238(b).

of any measures adopted by another party to the HS Convention that are directly comparable to the measures at issue in this dispute.[790]

7.468 The **European Communities** argues that the fact that China is not able to present any evidence of comparable measures in other countries necessarily implies that China is not able to provide any evidence of international customs practice that could sustain its position.[791] The European Communities submits that in the European Communities, GIR 2(a) applies only to goods presented at the same time and place. Moreover, the European Communities is of the view that China is mixing correct and incorrect information on customs classification together with its position on the relevance of anti-dumping measures to the measures at issue, while anti-dumping measures have nothing to do with tariff classification.[792]

7.469 The **United States** submits that unlike China, it has not applied the interpretative rules of GIR 2(a) to classify multiple shipments of parts and components as having the essential character of the complete article.[793] Instead, the US Customs has found that bulk shipments for inventory purposes are not covered by GIR 2(a), as bulk shipments for inventory are not for the convenience of packing, handling or transport. Furthermore, in the United States, it is not considered a circumvention of duty liability when parts of a machine, subject to a lower rate of duty than the complete machine, are separately imported in different shipments into the United States and entered at their respective lower rates of duty for subsequent assembly or manufacture into the final machine.[794]

7.470 **Canada** submits that it has shown clear subsequent practice that WTO Members who are also WCO members interpret "as presented" to mean classification based on the objective characteristics of a product in a single shipment.[795] Canada argues that a single act of one WTO Member cannot constitute subsequent practice and that China has not been able to point to "acts or pronouncements" of WTO Members in relation to the interpretation of the tariff headings concerned.[796] Canada considers that anti-circumvention measures in the context of anti-dumping and countervailing duties are not legally relevant to measures concerning ordinary customs duties.

7.471 In sum, to prove the existence of subsequent practice corresponding to the measures at issue, China essentially relies on three types of measures adopted by other Members: first, a classification decision by the Canadian Border Services Agency ("CBSA") on furniture import; second, anti-circumvention measures imposed by other Members in relation to anti-dumping and countervailing duties; and, third, measures that allow unassembled or disassembled entities imported on multiple conveyances to be treated as a single entry for tariff classification purposes (so-called "split consignments" situation).[797] The **Panel** will examine these measures in turn.

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[790] China's response to Panel question No. 238(b). At the same time, China submits that given that there are 124 Contracting Parties to the HS Convention, it is impossible for China to undertake a comprehensive review of all the national laws and regulations of these countries that are comparable to the measures at issue. Although acknowledging difficulties a party may face in searching and producing particular evidence relevant to its case, the Panel recalls that the party asserting a claim, factual or legal, has the burden to prove its claim.

[791] European Communities' comments on China's response to Panel question No. 238(b).

[792] European Communities' response to Panel question No. 116.

[793] United States' response to Panel question No. 116.

[794] United States' response to Panel question No. 116.

[795] Canada's response to Panel question No. 210(b), cross-referring to its response to Panel question No. 186.

[796] Canada's response to Panel question No. 116.

[797] In response to a Panel question, China submits that other than the CBSA furniture classification decision and the measures taken in relation to anti-dumping/countervailing duties, China is *not* aware of any

Other Members' practice – *Canada's furniture classification decision*

7.472 The CBSA furniture classification decision referred to by China concerns Canada's policy in relation to the tariff classification of furniture imported in a disassembled condition:[798] when the importer/retailer purchased complete furniture abroad, and disassembled it into parts for importation separately into Canada over a period of time, the CBSA concluded as follows:

> "[I]n order to determine if articles are to be classified as disassembled furniture [within the meaning of GIR 2(a)], the commercial reality of the transaction between the importer and exporter must be considered (i.e. *what was actually purchased* by the importer - complete furniture or unrelated parts)"[799] (emphasis added).

7.473 The CBSA considered that while certain business operations and practices may require that articles be ordered as complete units, but shipped separately over a period of time for various reasons, these shipping practices nonetheless do not change the fact that the goods were ordered as complete units and not as parts.

7.474 **China** alleges that the CBSA's furniture tariff classification described above is indistinguishable from China's interpretation of its own Schedule of Concessions:[800] (1) both measures apply GIR 2(a) to conclude that the importation and assembly of parts can, under certain circumstances, be classified as the importation of the complete article; (2) both measures prevent the circumvention of the higher duty rate on the complete article since, in both cases, a tariff schedule imposed a higher rate of duty on the complete article than on parts of that article; (3) the purpose and effect of both measures is to determine the "commercial reality" of the underlying import entries; and (4) both measures lead to the result that the separate headings for "parts" of the article encompass the importation of (i) replacement parts and (ii) parts that are combined with domestic parts to produce an article that would not be classified as a complete imported article under GIR 2(a).

7.475 **Canada** submits that the CBSA furniture decision should be distinguished from the measures concerned in this dispute in light of, *inter alia*, the following considerations:[801] (1) the CBSA decision covers only complete furniture that is manufactured abroad, but disassembled for importation and subject to re-assembly in Canada (it does not apply to domestic furniture manufactured in Canada); and (2) to determine what the importer was in fact importing, Canadian customs officials examined the purchase orders and import documentation in order to ascertain that the imported goods were covered under the same purchase order, without any assumption of a violation.

7.476 The **Panel** notes, as argued by China, that the CBSA decision concerns the application of GIR 2(a) to goods (parts of a complete good) imported in multiple shipments. Also, in both cases, tariff rates for complete goods are higher than those applicable to parts of the complete goods. We also notice, however, certain differences between the CBSA decision and the measures at issue in applying GIR 2(a) to the parts imported in multiple shipments.

7.477 First, we consider that in the CBSA decision, GIR 2(a) is more narrowly applied than under the measures. As Canada submits, the CBSA decision covers only complete furniture that is

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measure adopted by another party to the HS Convention that is directly comparable to the measures at issue in this dispute (China's response to Panel question No. 238(b)).

[798] Canada Border Services Agency, "Tariff Classification of Furniture Imported in Disassembled Condition," Memorandum D10-14-38, March 23, 2006 (Exhibit CHI-22).

[799] Exhibit CDA-22, para. 6.

[800] China's first written submission, para. 119.

[801] Canada's response to Panel question No. 124(b) and (c).

completely manufactured abroad, disassembled for importation and then subject to re-assembly in Canada. In the relevant paragraph, the CBSA decision indicates that articles imported specifically either as "replacement parts" or "to be incorporated with domestic components in the manufacture of domestic furniture"[802] will be classified in their own right under the appropriate HS headings. The decision therefore does not apply GIR 2(a) to domestic furniture manufactured in Canada. In comparison, however, the measures at issue do not confine the application of GIR 2(a) to motor vehicles that were manufactured and disassembled abroad to be subject to re-assembly in China. Rather, the measures cover a variety of situations, including auto parts imported to be incorporated in the manufacture of domestic motor vehicles.

7.478 In this connection, what is described as "the commercial reality" in the CBSA decision, which Canadian customs officials considered most pertinent in applying the principles of GIR 2(a), is also distinguishable from the type of considerations under the measures at issue. China argues that although the decision does not elaborate on this commercial reality, its purpose appears to be to discern whether the importer's *intention* was to import whole furniture in disassembled condition or whether its intention was to import unrelated furniture parts. Read in this light, China argues that this is also the case for the measures at issue. Under the measures, the commercial reality of the underlying import transaction is determined by the intention of the importer to assemble a motor vehicle with imported auto parts above certain thresholds set out in the measures.[803] According to China, the only difference is that, compared to the CBSA determination which does not elaborate on the standard to determine the commercial reality, the measures at issue define the precise thresholds at which China will classify multiple import entries as equivalent to the complete article, which makes the measures more transparent and predictable.[804]

7.479 We do not, however, agree with China's understanding of the "commercial reality" considered by the CBSA in the furniture case. The CBSA decision indicates that the commercial reality means the actual transaction between the exporter and the buyer (phrased as "what was actually purchased"). There is no reference in the decision to the importer's intention in the decision. To the extent the CBSA decision does not determine the commercial reality of the underlying import transaction based on the intention of the importer to assemble complete furniture with imported furniture parts, we do not consider that the two measures are comparable as China argues.

7.480 Furthermore, the measures at issue in this dispute purport to prevent the use of domestic assembly operations as a means of circumventing duties on complete articles.[805] We do not find such a purpose in the CBSA decision. Rather, the decision clarifies that it will classify articles that are

[802] Regarding "articles imported to be incorporated with domestic components in the manufacture of domestic furniture" (paragraph 6 of the decision), which the decision says will be classified as "parts", Canada submits there is no threshold level of domestic content (Canada's response to Panel question No. 124(c)).

[803] However, we also recall China's statement that "Customs authorities interpret and enforce their tariff schedules in accordance with the rules of the HS, not the intention of the importer to evade applicable duty rates" (China's response to Panel question No. 13).

The Panel finds it difficult to reconcile this statement with China's analogy above between the measures at issue and the CBSA decision based on the intention of the importer. The Panel also does not understand why one type of intention should be taken into account in interpreting a tariff provision, while another type of intention does not matter.

[804] China's response to Panel question No. 124(a).

[805] China's first written submission, para. 153.

imported to be incorporated with domestic components in the manufacture of domestic furniture in their own right under the appropriate HS headings.[806]

7.481 Therefore, apart from whether the principle of GIR 2(a) has been correctly applied in the CBSA decision, which is outside the scope of this dispute, we do not find that the CBSA decision is precisely comparable to the measures at issue in respect of the application of GIR 2(a). In any event, even if Canada's measure were directly comparable to the measures at issue, this measure alone would not amount to "subsequent practice" within the meaning of Article 31(1)(b) of the *Vienna Convention*, which can be established only by a pattern of common, consistent, and concordant actions by WTO Members.

Other members' practice – *Anti-circumvention of anti-dumping and countervailing duties*

Anti-dumping duties and ordinary customs duties

7.482 **China** also argues that practices of Members in preventing the circumvention of anti-dumping or countervailing duties is applicable to measures designed to prevent the circumvention of ordinary customs duties.[807] In China's view, in the anti-dumping and countervailing duty order context, it is permissible for a Member to apply an anti-dumping or countervailing measure to imports of the parts and components of a complete product, when necessary to prevent circumvention of the anti-dumping or countervailing duties that apply to that complete product. Therefore, as a matter of treaty interpretation, the resolution of this interpretive issue should be the same with respect to both anti-dumping/countervailing duties and ordinary customs duties.

7.483 More specifically, in China's view, both customs and anti-dumping duties are "duties" governed by Article II of the GATT 1994 and require national authorities to determine whether imported merchandise is properly classified. China argues that there are no rules on anti-circumvention in the context of anti-dumping duties either and that "whatever the legal basis for the imposition of duties, duties are duties once they are validly in place" and they can all be circumvented.[808] China submits that the existence of separate tariff headings for parts and components of an article does not dictate the manner in which a Member may interpret and enforce a tariff heading for the complete article. Accordingly, China considers that national authorities should be able to draw a dividing line between the importation of the complete article and the importation of the parts of that article based on a "reasonable and practical approach" as adopted by other Members in the context of anti-dumping duties.[809] China does not consider that the purpose of anti-dumping duties is more relevant than the acknowledged purpose of ordinary customs duties[810], when both can be undermined as effectively. If anything, the extraordinary nature of anti-dumping duties should make it more difficult for Members to extend the scope of these measures to include parts and components of a product.[811]

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[806] Exhibit CHI-22, paragraph 7. Canada's response to Panel question No. 210(b), cross-referring to its response to Panel question No. 186.

[807] China's first written submission, paras. 120, 138-145.

[808] China's second writen submission, para. 70.

[809] China is referring to the *LNPPs from Germany and Japan* case of the US Commerce Department (See paragraphs 7.501-7.507 below). China also refers to an argument by the United States in *EEC – Parts and Components*, which in China's view, analogizes the circumvention of AD/CV duties to the circumvention of ordinary customs duties (China's first written submission, para. 143, citing para. 4.37 of the panel report).

[810] According to China, the purpose of ordinary customs duties is to regulate market access for imports and generate customs revenues.

[811] China's second written submission, paras. 72-78.

7.484 The **European Communities** submits that the antidumping circumvention rules cannot be relied upon to establish a subsequent practice relevant to the interpretation of China's obligations under Article II of the GATT 1994 and its Schedule of Concessions, as this would totally ignore that anti-dumping duties and customs duties follow a completely different logic and are rooted in two different sets of WTO obligations.[812]

7.485 The European Communities argues that anti-dumping duties are not customs duties under Article II of the GATT 1994, but rather as an exception to Article II of the GATT 1994 and to the MFN principle. Also, anti-dumping duties may be imposed only after an investigation establishing that dumped imports are causing injury to domestic industry.[813] The European Communities argues that anti-dumping duties are subject to detailed obligations under Article VI of the GATT and the Anti-Dumping Agreement and aim at re-establishing fair trade conditions between the dumped imports and the domestic like products and protecting the domestic industry from the injury caused by the dumping.[814]

7.486 The **United States** submits that China's analogy to Members' anti-dumping practices is irrelevant in the absence of any proceeding initiated by China under the rules of Article VI of the GATT 1994 and the Anti-Dumping Agreement, since the rules governing anti-dumping are different from Article II of the GATT 1994 rules and thus have no relevance to China's measures.[815]

7.487 The United States argues that in respect of anti-dumping duties, the investigating Member is not required to impose them on the basis of tariff lines, and thus, in the anti-dumping context, unlike customs duties governed by Article II, tariff lines and how tariff concessions are set forth in a Member's Schedule are not relevant.[816] The United States submits that anti-dumping measures are authorized only in certain circumstances, i.e. where the investigating Member makes findings of dumping, injury and causal link.[817] Furthermore, the United States argues that when anti-dumping duties are imposed in the circumvention context, they are not applied in the way that China seeks to apply the charges under the measures at issue: the investigating Member does not impose the same anti-dumping duties on the products governed by a circumvention ruling as that imposed on the products that were clearly within the scope of the anti-dumping order from the outset.[818] There is no one uniform amount of duty imposed on any of the products within the scope of the anti-dumping order at least under the US system. Rather, the anti-dumping duties are assessed on the basis of the amount of dumping found for particular transactions involving particular products.

7.488 **Canada** is also of the view that there is a separate regime that governs application of anti-dumping duties under the Anti-Dumping Agreement, and anti-dumping duties are measures that do not qualify as either "ordinary customs duties" or "other duties or charges" under Article II of the GATT 1994.[819] Canada submits that anti-dumping duties are fundamentally different from ordinary

[812] European Communities' response to Panel question No. 132.
[813] European Communities' response to Panel question No. 132.
[814] European Communities' response to Panel question No. 132.
[815] United States' response to Panel question No. 140.
[816] China agrees that anti-dumping duties are defined by reference to the scope of the investigation, not by reference to its tariff, but this is a distinction without a difference. Anti-dumping measures and tariff provisions both refer to specific products. The United States offers no explanation as to why the resolution of the issue, whether a reference to a product includes a reference to the parts and components if assembled into the complete product, should differ simply because the product to which the duty applies is described in the scope of an anti-dumping measure, instead of in a tariff line (China, second written submission, para. 79).
[817] United States' responses to Panel question Nos. 67, 140.
[818] United States' response to Panel question No. 140.
[819] Canada's response to Panel question No. 140.

customs duties in that anti-dumping duties are temporarily applied to remedy a situation where imports from another Member are being dumped in a Member's internal market and are causing injury to domestic producers of those like products.[820] In contrast, ordinary customs duties do not correct a situation of wrongdoing ("injury"), nor does it relate to activity within the internal marketplace. The lack of "wrongdoing" and the need to correct such actions is the reason that the concept of anti-circumvention measures does not apply to valid and legitimate customs duties, and is only spoken of in terms of anti-dumping duties, which by their nature are designed to combat actions already found to be illegal under a Member's domestic law.

7.489 To support its argument that the rationale behind anti-circumvention measures in relation to anti-dumping or countervailing duties also extends to China's interpretation of the tariff headings concerned, China starts from the proposition that there is no difference between anti-dumping duties and ordinary customs duties, as both are "duties" regardless of the legal basis for anti-dumping duties and ordinary customs duties and as both can be circumvented. First, the **Panel** notes that ordinary customs duties and anti-dumping are governed by two different sets of rules under the WTO Agreement, namely Article II and Article VI of the GATT 1994 and the Anti-Dumping Agreement. The Anti-Dumping Agreement, in particular, provides detailed rules on the application of anti-dumping duties, including specific preconditions such as the finding of dumping, injurious effects to the relevant domestic industry and causation between these two factors. These rules are not in any manner related to the interpretation of a Member's Schedule of Concessions.

7.490 Moreover, the reference to anti-dumping duties in Article II:2 of the GATT 1994 does not mean that anti-dumping duties are also ordinary customs duties within the meaning of Article II of the GATT 1994. As pointed out by the complainants, the types of charges listed in Article II:2 are exceptions to the disciplines under Article II that nothing other than ordinary customs duties as indicated in a Member's Schedule can be imposed on the importation of goods from other Members.[821]

7.491 Further, the purpose of ordinary customs duties, as opposed to that of anti-dumping duties is, in our view, also a factor distinguishing customs duties from the other: ordinary customs duties are to regulate market access for imports and to generate revenues, as submitted by China, whereas anti-dumping duties are allowed, as necessary and upon showing the preconditions set out in the Anti-Dumping Agreement, to address the injurious effects caused by illegally dumped imports on the importing country's domestic market. Moreover, ordinary customs duties are imposed on imported goods under appropriate tariff headings in a tariff schedule without any notion of illegal activity associated with imports.

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[820] Canada's response to Panel question No. 140.

[821] The Appellate Body in *Chile – Price Band System* stated:

> "[w]e observe that Article II:2 of the GATT 1994 sets out examples of measures that do *not* qualify as either 'ordinary customs duties' or 'other duties or charges'. These measures include charges equivalent to internal taxes, anti-dumping and countervailing duties, and fees or other charges commensurate with the cost of services rendered. They too may be based on the value and/or volume of imports, and yet Article II:2 distinguishes them from 'ordinary customs duties' by providing that '[n]othing in [Article II] shall prevent any Member from imposing' them 'at any time on the importation of any product'" (Appellate Body Report on *Chile – Price Band System*, para. 276).

Furthermore, this understanding of Article II:2 of the GATT 1994 is also confirmed in reference materials, such as Jackson, John, *World Trade and the Law of GATT (1969)*, page 210 and Bhala, Raj, *International Trade Law: Theory and Practice* (2001, Second Edition), page 299.

7.492 In light of the above, we do not find that China has proved that there is no difference between ordinary customs duties and anti-dumping duties.

Anti-circumvention measures in respect of anti-dumping duties

7.493 Furthermore, the **complainants** submit that the anti-circumvention concept in the context of anti-dumping and countervailing duties should not be considered as part of the "subsequent practice" for the measure at issue because unlike ordinary customs duties, Members have recognized circumvention in the context of AD duties such as the *Ministerial Decision on Anti-Circumvention*[822]; and Article VI GATT and Anti-Dumping Agreement[823], and because anti-circumvention measures in connection with anti-dumping duties do not change the customs classification.

7.494 More specifically, the **European Communities** submits that anti-circumvention rules on anti-dumping measures find their legitimacy in Article VI of the GATT, the Anti-Dumping Agreement and the Ministerial Declaration on this issue, and thus enforce and relate to a different set of rights and obligations, which are not relevant to the interpretation of the rights and obligations of WTO Members under Article II of the GATT 1994.[824] The European Communities further argues that the anti-circumvention duty is never applied on products leaving the assembly factory in the European Communities.[825] Rather, an investigation is carried out and if it is found that the imports of parts constitute circumvention, the anti-dumping duty is extended to the parts. Also, the European Communities' anti-circumvention measures change neither the customs classification nor the customs duty applicable to the product concerned.[826]

7.495 The **United States** argues that while the WTO Agreement does not define circumvention, Members have traditionally recognized two patterns of trade which they have considered to be circumvention, both of which arise in the context of anti-dumping duty measures and countervailing duty measures – trade patterns involving (i) marginal alterations to the product itself and (ii) marginal alterations in the patterns of shipment and assembly respectively.[827] The United States submits that most Members recognize that circumvention takes place when such marginal modifications as regards merchandise otherwise subject to an anti-dumping or countervailing duty measure are done in a manner which undermines the purpose and effectiveness of trade remedies provided for under the WTO Agreement. Also, according to the United States, the concept of circumvention in the anti-dumping context has also been recognized in a Ministerial Decision, i.e. the *Ministerial Decision on Anti-Circumvention,* adopted by Members at Marrakesh and forming an integral part of the *Final Act Embodying the Results of the Uruguay Round Multilateral Trade Negotiations.* The Decision acknowledged the problem of circumvention in the trade remedies context and recognized the desirability of applying "uniform rules in this area as soon as possible" to prevent the evasion of anti-dumping and countervailing measures through circumvention.[828] The United States argues that in

[822] In addition, Canada also refers to the GATT Panel Report on *EEC – Parts and Components.* See Canada's response to Panel question No. 13(a).

[823] The European Communities is the only complainant who makes this argument.

[824] European Communities' response to Panel question No. 132.

[825] European Communities' response to Panel question No. 132.

[826] The European Communities explains that applied to the example of anti-dumping measures against bicycles from China and the anti-circumvention measures against imports of major bicycle parts, this would mean that the imports of parts would be subject to an anti-dumping duty for bicycles, but the customs duty will remain the one applicable for bicycle parts, as explicitly stated in Article 13(5) of Regulation 384/96 (European Communities' response to Panel question No. 132).

[827] United States' response to Panel question No. 140.

[828] The United States submits that "the Decision confirms that the topic of circumvention formed part of the negotiations which preceded the Anti-Dumping Agreement and referred this matter to the Committee on

contrast, it is not aware of any generally held concept of circumvention under Article II of the GATT 1994.

7.496 **Canada** argues that unlike anti-circumvention of anti-dumping duties, which is a notion recognized by Canada and many other WTO Members, no parallel concept applies in respect of tariff concessions and there exists no generally recognized WTO basis for the application of internal "anti-circumvention" measures related to tariffs.[829]

7.497 **China** considers that the Ministerial Decision on Anti-Circumvention does not, on its face, apply to countervailing duties, but Members have, nonetheless, adopted measures to prevent the circumvention of countervailing duties. In addition, the Decision does not establish rules but simply notes the existence of this issue in the anti-dumping context and refers to the Committee on Anti-Dumping. Nothing in the decision implies that the same problem does not exist in the context of countervailing duties or ordinary customs duties. The evasion of duties is the same for all different types of duties.[830] Further, there are in fact, no "rules" in either Article VI of the GATT or the Anti-Dumping Agreement that legitimize this practice.[831]

7.498 The **Panel** notes that as submitted by the complainants, the notion of anti-circumvention measures applied in connection with anti-dumping duties is recognized in the Ministerial Decision on Anti-Circumvention. The Decision provides:

"Decision on Anti-Circumvention

Ministers,

Noting that while the problem of circumvention of anti-dumping duty measures formed part of the negotiations which preceded the Agreement on Implementation of Article VI of GATT 1994, negotiators were unable to agree on specific text,

Mindful of the desirability of the applicability of uniform rules in this area as soon as possible,

Decide to refer this matter to the Committee on Anti-Dumping Practices established under that Agreement for resolution."

7.499 As shown in the text of the Decision, WTO Members referred issues relating to circumvention of anti-dumping duties to the Committee on Anti-Dumping Practices at the time of the Uruguay Round negotiations. Since then, WTO Members have continued to discuss the relevant issues in accordance with the mandate under the Decision and as part of the Doha negotiations. In contrast, we have no evidence or document showing that comparable recognition or discussion has ever taken place in the context of ordinary customs duties or interpretation of Members' Schedules of

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Anti-Dumping Practices for resolution. To fulfil this mandate, the Committee on Anti-Dumping Practices established the Informal Group on Anti-Circumvention to examine and resolve which rules should apply uniformly to address the problem of circumvention" (United States' response to Panel question No. 140).

[829] Canada's response to Panel question No. 140.

[830] China's second written submission, paras. 80-85. China also refers to the "unresponsive answer" of the United States to Panel question No. 94. China also notices differences in view among the complainants. In particular, China cites the statement of the European Communities that the Decision "recognizes that uniform rules on anti-circumvention of anti-dumping measures have not been defined".

[831] China's second written submission, para. 71.

Concessions within the scope of Article II of the GATT 1994. In the absence of any specific indication or legal basis that the Members' discussions on the notion of circumvention in relation to anti-dumping duties can be also related to ordinary customs duties, we do not find that the circumstances surrounding the notion of anti-circumvention of anti-dumping measures can be extended to the interpretation of Members' Schedules of Concessions.

7.500 In this regard, China argues that since "nothing" in the Decision implies that the same problem does not exist in the ordinary customs duty context, it should be presumed that it also exists in the ordinary customs duty context. We are not persuaded by China's argument. The Decision explicitly notes that WTO Members could not agree on specific text relating to the problem of circumvention of *anti-dumping duty measures*, which formed part of the negotiations which preceded the Agreement on Implementation of Article VI of GATT 1994, which is an agreement on anti-dumping duties. It also expresses the negotiators' "desirability of the applicability of the uniform rules *in this area*" (in the area of anti-dumping measures) (emphasis added). We do not find any basis in the language of the Decision, which is specifically aimed at the negotiators' recognition of the circumvention problem with respect to anti-dumping duty measures, for extending the same consideration to ordinary customs duties.

Anti-circumvention measures: EC bicycle case and US printing press case

7.501 **China** refers to the measures taken by the European Communities and the United States to prevent the circumvention of anti-dumping duties through the importation and domestic assembly of parts to support its argument that anti-circumvention measures in respect of anti-dumping measures constitute the subsequent practice for China's measures in the present case.[832] More specifically, China takes two specific examples of anti-circumvention measures the European Communities and the United States have taken in respect of anti-dumping duties imposed originally on bicycles and printing press imports.[833] Essentially, China submits that the European Communities and the United States have imposed the same anti-circumvention measures as the measures at issue, in the sense that both types of measure employ the same standards such as a value test (consideration of the value of imported parts used in the assembly of a complete good); distinguish the importation of individual parts *per se* (i.e. replacement parts) from the importation of parts for the purpose of assembling what is, in the essential character, a complete good; and adopt customs procedures to facilitate the tracking of imported parts and components - conditions imposed at the time of importation. China submits that the purpose, structure, and operation of the anti-circumvention measures in both cases are indistinguishable from China's measures.

7.502 The **European Communities** submits that the purpose of the rules set out in Article 13(2) of that regulation is to act against shipments of parts which are either assembled in the Community or a third country if these shipments of parts replace the shipment of products which had previously been found dumped and shipped in an assembled form.[834] According to the European Communities, all these actions are linked and must take place in the context of an anti-dumping measure on the assembled product with a view to undermining the remedial effect of these duties. In comparison, the European Communities submits that China's measures are not an action against imports of parts which

[832] China's first written submission, paras. 120-136. Specifically, China refers to the EC Council Regulation (EC) No. 384/96 (as amended by regulation 461/2004) and 19 U.S.C. 1677j(a)(1) (Exhibit CHI-26).

[833] Anti-circumvention measure imposed on *Bicycle Imports from China* under Council Regulation (EC) 71/97 (10 January 1997) (Exhibit CHI-24) and anti-circumvention measure imposed on *Large Newspaper Printing Presses and Components Thereof, Whether Assembled or Unassembled from Germany and Japan* by the US Commerce Department (Exhibit CHI-25).

[834] European Communities' response to Panel question No. 132.

have previously been imported in the form of assembled cars, but rather an action against parts as such with a view to increasing local content and developing a domestic industry for auto parts and complete vehicles. The European Communities points out that its regulation is applied against importers which intentionally circumvented the anti-dumping duty, and this was found out by an investigation.[835] Second, the anti-circumvention duty is never applied on products leaving the assembly factory in the European Communities.[836]

7.503 With respect to the US Final Determination on "Large Newspaper Printing Presses and Components (LNPPs)"[837], the **United States** argues that unlike automobiles, which are routinely imported fully assembled, it is not feasible to import fully assembled LNPPs. Further, the United States submits that "the value test" was part of a process of the Department of Commerce so that importers could demonstrate that their merchandise was not subject to the anti-dumping order.

7.504 In the **Panel's** understanding, China's argument above is that since the mechanisms[838] of the measures at issue and the anti-circumvention measures imposed by the European Communities and the United States are similar, these anti-circumvention measures are indistinguishable from China's measures and therefore establish subsequent practice in respect of China's measures. In assessing China's argument, we first recall our finding above that the recognition of the problem relating to circumvention of anti-dumping duty measures[839] and the rationale underlying anti-dumping duties[840] cannot be in principle extended to the ordinary customs duty context: unlike anti-dumping duty measures, the notion of, or any problems relating to, circumvention in the context of ordinary customs duties does not exist; ordinary customs duties are governed by an entirely separate set of disciplines under the WTO Agreement from anti-dumping duties; and ordinary customs duties are imposed on goods in accordance with appropriate tariff headings in a tariff schedule without any notion of illegal activity associated with imports. Considered against this background, we are not of the view that a mere similarity in the operative mechanisms between the anti-circumvention measures taken in respect of anti-dumping duties as cited by China and China's measures taken in the context of ordinary customs duties would make the measures comparable to the two examples of circumvention measures taken by the European Communities and the Untied States in the context of anti-dumping measures.

7.505 Further, we note the European Communities' point that unlike the measures at issue, its anti-circumvention measure in respect of bicycle part imports from China purports to act against imports of parts which had previously been imported and dumped to the EC market in the form of assembled bicycles so as to cause an injury to the EC domestic bicycle market.[841] In this light, the purpose of the anti-circumvention measures associated with anti-dumping measures cannot be related to the charge imposed under China's measures. Under the measures at issue, the condition triggering the imposition of the charge is the importers' intention to assemble motor vehicles using imported parts above the thresholds set out in the measures[842], without the need to show the preconditions of the kind attached

[835] European Communities' response to Panel question No. 132.

[836] Rather, an investigation is carried out and if it is found that the imports of parts constitute circumvention, the antidumping duty is extended to the parts. See European Communities' response to Panel question No. 132.

[837] United States' response to Panel question No. 126.

[838] See paragraph 7.501 for the operative factors under these two anti-circumvention measures that China argues are comparable to those relating to China's measures.

[839] See paragraphs 7.497-7.499.

[840] See paragraphs 7.489-7.492.

[841] See paragraph 7.502. European Communities' response to Panel question No. 132.

[842] See China's response to Panel question No. 108(d). China states, *inter alia*, that the charge imposed under the measures relates back to the condition attached at the time of importation; when the auto manufacturer

to the imposition of anti-circumvention measures in respect of original anti-dumping duties, for example, a proof that the subject parts had previously been imported in the form of assembled goods and found dumped. If anything, China's tariff schedule itself provides the two different tariff rates for motor vehicles and parts thereof, which is a direct result of the negotiations between China and WTO Members.

7.506 Finally, to the extent China has maintained a position that the notion of "circumvention" for the purpose of this case is a matter of correct tariff classification, China has not explained how anti-circumvention measures in respect of anti-dumping measures, which have no relation with tariff classification, are indistinguishable from the measures taken in the context of ordinary customs duties allegedly for correct classification.[843]

7.507 Overall, given the noticeable legal and factual differences between anti-dumping duties and ordinary customs duties, the **Panel** finds that anti-circumvention measures imposed in relation to anti-dumping or countervailing duties cannot be considered as constituting subsequent practice for the interpretation of tariff headings as suggested by China.

Other Members' practice – "split shipments"

7.508 Finally, China also refers to certain regulations of other Members that allow multiple entries of unassembled or disassembled merchandise to be treated as a single entry for tariff classification purposes (so-called "split shipments" situation).[844] We recall our finding in paragraphs 7.434-7.436 above that regulations addressing split shipments are distinguished from the multiple shipment situation covered under the measures. Therefore, we do not consider that the regulations dealing with split shipments establish subsequent practice for the measures at issue.

Conclusion

7.509 For the reasons above, the **Panel** does not find based on the available evidence before it that there exists a "concordant, common and consistent" sequence of acts or pronouncements by WTO Members that would amount to the subsequent practice for the interpretation of the tariff headings concerned as advocated by China.

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fulfils its stated intention to import and assemble parts and components that have the essential character of a motor vehicle, it will be obliged to pay the applicable duty rate for motor vehicles.

[843] We also note China's argument that the complainants have failed to establish why the practices of WTO Members in respect of anti-dumping duties 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 (China's second written submission, para. 85). As set out in Section VII.A.3, however, the burden of proof rests with the party, be it the complainant or the respondent, who makes an affirmative claim. As regards the issue of WTO Members' practices in respect of anti-dumping measures, it is China who has put forward an argument that such practices constitute the subsequent practice for the measures at issue. Therefore, it is China that bears the burden of proof concerning this particular issue.

[844] China's first written submission, paras. 156-160.

Also, in response to a Panel question whether national customs authorities, as a common practice, make classification determinations after the parts are assembled, the **WCO Secretariat** indicates that it is aware of at "least one Contracting Party who has introduced legal provisions in Section XVI (i.e. Chapters 84 and 85) and for headings 86.08, 88.05, 89.05 and 89.07, stipulating that '[t]he provisions of GIR 2(a) are also applicable, at the request of the declarant and subject to conditions stipulated by the competent authorities, to [machines] [goods of headings 86.08, 88.05, 89.05 and 89.07] imported in split consignments'." (WCO's letter of 20 June 2007, page 5).

(v) Supplementary means of interpretation[845]

7.510 We will now examine evidence submitted in relation to the circumstances of conclusion of China's accession to the WTO, including China's classification practice prior to its WTO accession, that could potentially discern what was, or was not, the common intention of the Members with respect to the tariff term "motor vehicles" in China's concessions contained in the tariff headings of China's Schedule.

7.511 **China** argues that the interpretation of the term "motor vehicles" that China has implemented through the measures is confirmed by recourse to the circumstances surrounding the conclusion of China's accession to the WTO, such as the historical background against which the accession was negotiated.[846] According to China, at the time China negotiated its Schedule of Concessions, many WTO Members, including the United States and the European Communities, had long maintained measures to prevent the circumvention of duties. China submits that these circumstances help discern the common understanding of the parties as to the distinction between complete articles and parts of those articles, and the types of measures that Members are allowed to adopt to delineate the boundary between these two categories.[847]

7.512 The **European Communities** submits that the fact that China has adopted the measures only in 2004 and 2005 demonstrates that China has interpreted GIR 2(a) differently prior to the adoption of the measures despite its claim that the interpretation it now advances has been the premise under which it negotiated its accession to the WTO.[848] The European Communities argues that if China already applied such an interpretation at the time of its accession to the WTO, the measures would be redundant.[849]

7.513 **Canada** submits that at the time of China's accession, there was no established practice among Members to apply the concerned HS Committee Decision 1995 to multiple shipments.

7.514 The **Panel** will first consider China's own practice at the time of, or prior to, its accession to the WTO in 2001. China submits that, prior to the adoption of the measures, China did not have a procedure for determining whether multiple shipments of parts and components were related to each other through their common assembly into a specific vehicle model, which is the situation that has triggered, according to China, the need for the measures at issue in 2004.[850] This seems to be the case although China has been maintaining, including prior to China's accession to the WTO, higher tariff rates for motor vehicles than those for parts and components of a motor vehicle.[851] Specifically, China submits that in 2001, immediately prior to China's accession to the WTO, the average applied

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[845] See paragraphs 7.722-7.725 below.

[846] China's first written submission, paras. 149-150. China refers to the Appellate Body's statement in *EC – Computer Equipment* that the "circumstances of the conclusion" of a treaty includes, "in appropriate cases, the examination of the historical background against which the treaty was negotiated" (Appellate Body Report on *EC – Computer Equipment*, para. 86).

[847] China's first written submission, para. 151.

[848] European Communities' second written submission, para. 120, referring to China's response to Panel question No. 111.

[849] The European Communities also points out that China must be applying GIR 2(a) differently in different contexts given that China does not have similar measures in place in the context of other products where applicable tariff rates are different between the complete articles and their parts (European Communities' second written submission, para. 120, referring to China's response to Panel question No. 57).

[850] China's response to Panel question No. 12(b).

[851] All the parties to the dispute do not dispute that China has always applied lower tariff rates to auto parts than to motor vehicles. Also See China's response to Panel question No. 2.

tariff rate for "motor vehicles" was 63.6 per cent, and the average applied tariff rate for "auto parts" was 24.7 per cent.[852]

7.515 In any event, China has not been able to provide the Panel with evidence showing that China had ever classified, prior to its accession to the WTO, multiple imports of auto parts and components as a motor vehicle, based on their assembly into a motor vehicle in China. Nor has China been able to point to classification practices of other WTO Members that could support China's interpretation of the tariff term "motor vehicles". We note that China has referred to the so-called anti-circumvention measures imposed by other Members such as the United States and the European Communities in the context of anti-dumping duties. However, for the reasons we explained above, we do not consider that the measures imposed in connection with anti-dumping or countervailing duties are comparable to the interpretation of a tariff term in the concessions contained in China's Schedule.

7.516 **China** also argues that the importance of the interpretation of GIR 2(a) adopted by the WCO (referring to the HS Committee Decision) is that WTO Members have been aware, since at least 1995, that the HS allows Members to classify multiple imports of parts and components in accordance with the principle of GIR 2(a). According to China, therefore, this is part of the context in which WTO Members have negotiated and entered into tariff concessions and in turn also part of the context in which China negotiated its Schedule of Concessions with other WTO Members in connection with its accession to the WTO.[853]

7.517 In addressing China's assertion that WTO Members have been aware, since at least 1995, that the HS allows Members to classify multiple imports of parts and components in accordance with the principle of GIR 2(a), the **Panel** first recalls the Appellate Body's observation regarding the HS in *EC – Computer Equipment*:

> "We are puzzled by the fact that the Panel, in its effort to interpret the terms of [the EC Schedule], did not consider the *Harmonized System* and its *Explanatory Notes*. We note that during the Uruguay Round negotiations, both the European Communities and the United States were parties to the *Harmonized System*. Furthermore, it appears to be undisputed that the Uruguay Round tariff negotiations were held on the basis of the *Harmonized System's* nomenclature and that requests for, and offers of, concessions were normally made in terms of this nomenclature."[854]

7.518 We further note that referring to its observation cited above in *EC – Computer Equipment*, the Appellate Body in *EC – Chicken Cuts* made reference to an observation by the Panel:

> "[T]he Panel also pointed out, and no participant in this proceeding contested, that 'the [Harmonized System] was used as a basis for the preparation of the Uruguay Round GATT schedules.
>
> ...
>
> The above circumstances confirm that, prior to, during, as well as after the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties

[852] China's response to Panel question No. 2.

[853] China's response to Panel question No. 111. China adds that under Article 31 of the *Vienna Convention*, the decision of the WCO concerning the interpretation of GIR 2(a) is therefore relevant context for the interpretation of China's tariff provisions for motor vehicles.

[854] Appellate Body Report on *EC – Computer Equipment*, para. 89.

> to use the Harmonized System as the basis for their WTO Schedules, notably with respect to agricultural products. ..." [855]

7.519 As the Appellate Body observed above, given that the Uruguay Round tariff negotiations were held on the basis of the nomenclature of the HS and that requests for, and offers of, concessions were normally made in terms of this nomenclature, the WTO Members were aware of the content of, and their obligations under, the HS at the time of the Uruguay Round negotiations. Furthermore, the Panel in *EC – Chicken Cuts* noted that the membership of the HS was "extremely broad" and included the "vast majority of WTO Members".[856] In light of this, we consider it reasonable to presume that at the time of the Uruguay Round negotiations, the Members recognized the obligations under the HS. As regards the obligations under the HS, Article 3(a)(ii) of the HS Convention provides:

> "[I]t 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."

7.520 The Members' obligation under the HS thus included the application of GIR 2(a), which is a provision under the GIR. Then, to prove that the Members understood at the time of the Uruguay Round negotiations that they were allowed to classify "multiple imports of parts and components" in accordance with GIR 2(a), China must show that GIR 2(a) is interpreted to include "multiple imports of parts and components".

7.521 In this relation, China exclusively relies on paragraph 10 of the HS Committee Decision: that the statement in paragraph 10 of the Decision – "the questions of ... 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" – supports its proposition that the Contracting Parties to the HS were allowed to classify parts and components of a complete good imported in multiple shipments under the corresponding tariff heading for the complete good. As examined above in Section VII.D.2(a)(ii), however, China has not demonstrated that paragraph 10 of the HS Committee Decision addresses the multiple shipment situation as advocated by China. Rather, we found that the evidence before us showed that paragraph 10 of the Decision addressed the question of rules of origin.[857] Therefore, we do not consider that the HS Committee Decision should be understood as indicating the WTO Members' awareness of the interpretation of GIR 2(a) as advanced by China at the time of, or prior to, China's accession to the WTO.

7.522 The considerations above in relation to the supplementary means of interpretation confirm our preliminary finding that the tariff term "motor vehicles" in the concessions contained in the tariff headings of China's Schedule does not require that multiple imports of parts and components of a motor vehicle be included in its scope, based on the assembly of those parts and components into a motor vehicle in China.

(b) Conclusion

7.523 For the reasons above, the **Panel** concludes that the tariff provisions for motor vehicles (87.02-87.05) of China's Schedule of Concessions do not include in their scope auto parts imported in multiple shipments based on their assembly into a motor vehicle. Accordingly, to the extent the measures could be considered as falling within the scope of Article II of the GATT 1994, China's

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[855] Appellate Body Report on *EC – Chicken Cuts*, paras. 196, 199.
[856] Appellate Body Report on *EC – Chicken Cuts*, paras. 196, 199.
[857] See paragraphs 7.444 above.

measures have the effect of imposing ordinary customs duties on imported auto parts in excess of the concessions contained in the tariff headings for auto parts under its Schedule, inconsistently with its obligations under Article II:1(a) and (b) of the GATT 1994.

3. Treatment of auto parts imports under China's measures - *essential character test under Articles 21 and 22 of Decree 125*

7.524 We recall our consideration above that the thresholds to determine the essential character of a motor vehicle, set out in Articles 21 and 22 of Decree 125, could be considered as an element that would characterize the charge as ordinary customs duties, provided the thresholds are by themselves applied to the classification of auto parts and components imported in a single shipment. The complainants argue that the criteria for the determination of the essential character of a motor vehicle set out in Articles 21 and 22 of Decree 125, even if they are applied to auto parts imported in a single shipment, are still in violation of Article II of the GATT 1994. We will thus examine this claim by the complainants in this section on the assumption that these criteria are applied to auto parts imported in a single shipment.[858]

(a) "Essential character" test under GIR 2(a)

(i) Circumstances under which the essential character test under GIR 2(a) is applicable

7.525 As examined above, those WTO Members who are also contracting parties to the HS are obliged under the HS Convention to apply the interpretive rules of the HS, namely the GIR, to the classification of goods. In this connection, we found that in certain classification situations, GIR 2(a) needs to be consulted, in conjunction with GIR 1.[859]

7.526 Specifically, the HS Contracting Parties are required to classify an incomplete or unfinished good, imported either unassembled or disassembled, as the corresponding complete good provided the incomplete or unfinished good, as presented, has the essential character of the complete or finished good. The parties to the dispute do not dispute that the principle of GIR 2(a) applies when customs authorities need to determine whether parts and components of a complete good, imported and presented in a single shipment, have the essential character of the complete good.

7.527 Therefore, in this section, we will examine whether the criteria provided in Article 21(2) and (3) and Article 22 of Decree 125 for the essential character of a motor vehicle, if their application is limited to a single shipment situation, are compatible with the principle of GIR 2(a), China's concessions in the tariff headings for motor vehicles of China's Schedule, and consequently with Article II:1(a) and (b) of the GATT 1994.

(ii) Panel's task in respect of the complainants' claim on the essential character test under the measures

7.528 We observe that no definite guidance exists for the assessment of whether the criteria under Articles 21 and 22 of Decree 125 provide a valid standard for determining the essential character of a motor vehicle under GIR 2(a) and consequently are consistent with China's concessions in the tariff headings for auto parts.

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[858] The complainants' claim relating to China's treatment of CKD and SKD kits under Article 21(1) of Decree 125 is addressed in Section VII.E of these reports.

[859] See paragraphs 7.389-7.391 above.

7.529 In response to questions from the Panel in this regard, the WCO Secretariat has commented that except for several examples cited in the Explanatory Notes to certain areas of the HS, the Nomenclature and Explanatory Notes are largely silent regarding the meaning of the "essential character" of the complete or finished article as it appears in GIR 2(a).[860] Referring to the General Explanatory Note to Chapter 87 as a notable example, the WCO Secretariat states that the question at what point a collection of parts can be considered to substantially compose a complete motor vehicle is one that must be considered on a case-by-case basis. In this connection, the Committee has not formally developed principles, nor has the Committee ruled formally on the classification of unassembled sets of parts for motor vehicles of Chapter 87.

7.530 At the same time, the WCO Secretariat notes that Chapter 87 presents unique classification challenges because in addition to headings describing complete motor vehicles (headings 87.01-87.05) and a heading for parts and accessories (heading 87.08), the Chapter also provides a separate heading for motor vehicle chassis fitted with engines (heading 87.06) and a heading for motor vehicle bodies (including cabs) (heading 87.07). In the view of the WCO Secretariat, some sets of auto parts may be classifiable by application of GIR 2(a) in either heading for complete motor vehicles or headings for intermediate goods (i.e. motor vehicle chassis fitted with engines under heading 87.06 and motor vehicle bodies under heading 87.07).[861] Accordingly, the WCO Secretariat considers that the treatment of collections of parts of motor vehicles could range from individual classification of each part in heading 87.08 or other *eo nomine* provisions in the Nomenclature (see Note 2 to Section XVII)[862], through headings 87.06 and 87.07, to headings 87.01-87.05, although the borderlines among these headings have not been tested in the Committee with respect to unassembled sets of parts.

7.531 Regarding the principles that would affect a decision on the application of GIR 2(a) to the standards set out in Article 21 of Decree 125, the WCO Secretariat comments that the HS criterion is whether the specific collection of parts presented has the essential character of the complete or finished article, bearing in mind the existence of headings for intermediate goods (tariff headings 87.06 and 87.07) in the case of Chapter 87.[863] At the same time, the WCO Secretariat points out that absent specific guidance from the nomenclature (i.e. legal provisions) or the Committee (i.e. interpretation of the nomenclature), it is within the purview of national customs administrations to interpret provisions such as GIR 2(a).[864]

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[860] WCO Secretariat's letter of 20 June 2007, page 2. We also note a reference by the Panel in *EC – Chicken Cuts* to the WCO Secretariat's comments regarding a question on what factors and material are considered when deciding the heading under which a product should be classified to which the WCO [Secretariat] responded: "When goods are classified under the HS, this is always done on the basis of the objective characteristics of the product at the time of importation. ... the factor which determines the essential character of a product will vary from one product to another. ... the determination of the essential character of a product may be done through a visual inspection of the product including indications on the packing. Reference may also be made to accompanying documents" (Panel Report on *EC – Chicken Cuts (Brazil)*, para. 7.314).

[861] The WCO Secretariat further adds that heading 87.07 would cover only those sets in which the engine is already fitted into the chassis, and such assemblies that include cabs are classified in the headings for complete motor vehicles (WCO's letter of 20 June 2007, page 3, referring to Note 3 to Chapter 87).

[862] Note 2 to Section XVII provides a list of articles ((a) – (l)) that would not fall within the scope of the expressions "parts" and "parts and accessories".

[863] WCO Secretariat's letter of 20 June 2007, page 4.

[864] In this regard, the WCO Secretariat further emphasizes that under the provisions of the HS Convention (i.e. Article 10), any dispute between Contracting Parties concerning the interpretation or application of the HS Convention shall, so far as possible, be settled by negotiation between them. If it is not possible to settle the dispute, it shall be referred to the HS Committee to consider the dispute and to make recommendations for its settlement.

7.532 As noted by the WCO Secretariat, the General Explanatory Notes to Chapter 87 provide two examples of incomplete or unfinished vehicles that are classified as the corresponding complete or finished vehicles for having the essential character of the complete or finished vehicles:

(A) A motor vehicle, not yet fitted with the wheels or tyres and battery; and

(B) A motor vehicle, not equipped with its engine or with its interior fitting.

7.533 The European Communities points out that the General Explanatory Notes to Chapter 87, which are a particular application of GIR 2(a) in the context of Chapter 87, provide for a tool in exceptional borderline situations to be applied on a case-by-case basis.

7.534 China considers that the two examples provided in the General Explanatory Notes to Chapter 87 are just examples which do not define the boundaries of the application of the essential character test to motor vehicles.[865]

7.535 In our view, although they may not provide an absolute or exhaustive standard for determining the essential character of a motor vehicle given the non-binding nature of the General Explanatory Notes under the HS, these two examples could be considered as guidance for the question before us.[866]

7.536 We also recall the unique structure of Chapter 87, which consists of the tariff headings for not only complete motor vehicles and parts and components thereof, but also intermediate goods (87.06-87.07). The tariff headings 87.06 and 87.07 provide:

"87.06 – Chassis fitted with engines, for the motor vehicles of headings 87.01 to 87.05

87.07 – Bodies (including cabs), for the motor vehicles of headings 87.01 to 87.05"

7.537 This means that goods satisfying the descriptions in tariff headings 87.06 and 87.07 must be classified under these specific headings pursuant to the principle of GIR 1 and GIR 2(a) (determination whether incomplete or unfinished vehicles should be classified as complete or finished vehicles) will not be applicable.[867]

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[865] China considers the first example ("a motor vehicle, not yet fitted with the wheels or tyres and battery") to constitute at least an "SKD kit", which could be also be classified simply as a motor vehicle, since "wheels, tyres and batteries are all consumable items which are commonly added to the vehicle in the domestic market". According to China, the second example ("a motor vehicle not equipped with its engine or with its interior fittings") would likely correspond to Article 21(2)(b) of Decree 125, as it constitutes a "body ... plus at least three other assemblies" (China's response to Panel question No. 117).

[866] See paragraph 7.586 below and footnote 923 for the Appellate Body's reference to Explanatory Notes of the HS in examining the meaning of a tariff term.

[867] The **WCO Secretariat** comments that these tariff headings would be examples of the situation where the conditional clause under GIR 1 – "provided the headings and legal notes do not otherwise require" – would apply. The WCO Secretariat explains that this conditional clause means that a heading providing specifically for a collection of unassembled parts or an incomplete article would prevail by application of GIR 1 because GIR 2 would not apply. The **European Communities** submits that the classification of a brake cylinder or of a product fulfilling the conditions of heading 87.06 "chassis fitted with engines" would not necessitate recourse to GIR 2(a) and the General Explanatory Notes to Chapter 87 because the classification of the product would be clear on the basis of the heading (European Communities' response to Panel question No. 211).

7.538 Furthermore, we note the WCO Secretariat's comment that the legal text of GIR 2(a) is open to different interpretations and that it is the general concept that interpretation of the HS is the right of every Contracting Party.[868] The WCO Secretariat further explains that, based on the general concept concerning the Contracting Parties' right to interpretation of the HS, there could be interpretations that differ among different Parties. Thus, when the HS Committee makes a determination and issues a Classification Opinion, upon request from a Contracting Party, for the classification of a specific article (or a group of articles presented together), it is not uncommon for the resulting Classification Opinion to be at variance with one or more national classification rulings, BTIs, or other administrative or statutory rules. In such a case, the HS Contracting Parties are expected to seek a way to modify their internal instruments so as to permit application of the Classification Opinion, and they are obligated to inform the Committee when they are unable to do so.

7.539 We will bear in mind the above considerations as guidance in examining the criteria set out in the measures.

7.540 Overall, in light of the fact that there are no clear criteria that the Contracting Parties to the HS are obliged to apply for the essential character determination, our task in this connection is not to decide what should be the correct criteria for the essential character of a motor vehicle under Chapter 87 of China's Schedule. We consider that the scope of our review in respect of the complainants' claim against China's measures, in particular the essential character determination, under Article II:1(a) and (b) of the GATT 1994 is limited to a very narrow question whether any aspect of the criteria set out in the measures will necessarily lead to a violation of China's obligations under its Schedule and consequently Article II:1(a) and (b) of the GATT 1994.[869]

(iii) Preliminary issue: pre-determined criteria for the essential character test

7.541 Before commencing our analysis, we will address the European Communities' argument that the principle of GIR 2(a) is not applicable at the level of the tariff headings and without considering a very specific shipment as presented to customs at the border, and should be considered only on a case-by-case basis.[870]

7.542 The **European Communities** submits that the other rules and in particular GIR 2(a) on which China bases its entire defence strategy are not relevant in interpreting a Member's schedule generally unless one assumes a very specific product or a combination of products that are presented to customs at the same time. 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. The European Communities argues that China's systematic treatment under the measures of imported goods contrary to their

[868] WCO Secretariat's letter of 30 July 2007, page 4.

[869] In response to a question from the Panel, **China** states that although it is not clear whether a measure must be shown to always violate the WTO Agreement to prove an "as such" claim, a party bringing an "as such" claim against the measures must identify and prove the specific circumstances in which the measure "will *necessarily* be inconsistent" with the responding Members' WTO obligations (China's response to Panel question No. 228). The **European Communities** responds that the criteria under Articles 21 and 22 of Decree 125 *would necessarily lead to incorrect classification*. **Canada** submits that the measures "as such" violate Article II by always subjecting auto parts to the motor vehicle rate if the thresholds are exceeded and that it is irrelevant to the analysis of Article II that, in rare instances, a collection of assembled parts large enough to constitute an assembled vehicle under Article 21 of Decree 125 may properly be classified as whole vehicles under the HS.

[870] European Communities' second written submission, para. 90; European Communities' responses to Panel question Nos. 208, 209, 211.

objective characteristics and contrary to the explicit wording of the headings of schedules has nothing to do with discretion.

7.543 **China** considers that, notwithstanding their repeated insistence that GIR 2(a) can only be applied "in casu" or "on a case-by-case basis", the complainants have not challenged the application of Decree 125 as it pertains to any *specific* combinations of auto parts and components.[871] In fact, the complainants, along with Australia, contradict themselves on basic issues of where and how to draw the line between motor vehicles and parts of motor vehicles under GIR 2(a).[872] In this light, China considers that the complainants have failed to make a prima facie case that China has misinterpreted the term "motor vehicles" in respect of where China has drawn the line between motor vehicles and parts of motor vehicles. Consistent with their own understanding of GIR 2(a), such a claim would have to be brought on the facts of a specific case or cases, with evidence and arguments concerning the proper application of the essential character test in each instance. The complainants have chosen not to do this.[873]

7.544 China argues that the fundamental problem with the complainants' case is that they have failed to present evidence and legal arguments sufficient to identify the specific instances in which the challenged measures will necessarily result in a misapplication of the essential character test. The complainants have failed to define the boundaries of the essential character test as it relates to parts and components of motor vehicles under Chapter 87 of the HS, and to substantiate those boundaries by reference to evidence and legal arguments. Nor have the complainants demonstrated a consistent application of the challenged measures that has resulted in a misapplication of the essential character test to parts and components of motor vehicles. Having failed to meet their burden of proof, the complainants have provided the Panel with no basis to distinguish between those instances, if any, in which the measures will necessarily result in a misapplication of the essential character test, and those instances in which it will not. Therefore, China submits that the Panel cannot find that the challenged measures, as such are inconsistent with the essential character test under GIR 2(a).[874]

7.545 The **WCO Secretariat** has responded to a question from the Panel in this regard that there is nothing in the HS Convention or policy decisions of the HS Committee that would preclude an administration from establishing formal criteria for determining when GIR 2(a) is to be applied. Further, it adds that interpretation of the HS is the right of every Contracting Party, and such interpretations could conceivably take the form of advance classification rulings (binding tariff information or BTI), individual classification determinations upon liquidation of a specific formal entry, national court rulings, regulations or statutes.[875]

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[871] China's second written submission, para. 26.

[872] China submits that Australia considers that the engine must be present for an incomplete or unfinished vehicle to have the essential character of a motor vehicle (Australia's response to Panel question to third parties No. 12); the United States and Canada take the position that the engine is not required to establish essential character (United States' response to Panel question No. 117(b); Canada's response to Panel question No. 117(b)); the European Communities suggests that an unfinished or incomplete vehicle cannot be missing anything "essential for the functioning of the vehicle," which would clearly include the engine and transmission (CHI-43). China considers the European Communities' "essential for the functioning" standard inconsistent with the United States' position that what matters is whether the articles are "recognizable" as the machine that they will become (CHI-42).

[873] China's second written submission, para. 30; China's comments on the complainants' responses to Panel question No. 233. See also China's response to Panel question No. 133.

[874] China's response to Panel question No. 206.

[875] WCO Secretariat's letter of 30 July 2007, page 1 (response to question No. 5). The WCO Secretariat further elaborates, "such actions [individual interpretation of the HS by the Contracting Parties]

7.546 The **Panel** considers that the essence of the European Communities' argument in this respect is that determining, based on the principle of GIR 2(a), whether a certain set of incomplete or unfinished goods has the essential character of the corresponding complete or finished good can only be made by examining a specific shipment as presented to customs authorities, and not based on a pre-determined set of criteria at the level of tariff headings. The European Communities argues that the material conditions set out in Articles 21 and 22 of Decree 125 amount to tariff classification at will.

7.547 However, in response to a question from the Panel whether a Member has the discretion to set forth criteria that it will apply to all shipments of parts of a given product to determine whether they have the essential character of the whole, the European Communities acknowledged that Members may adopt instruments and use documents that guide customs authorities and importers in the context of particular kinds of shipments, as long as such guidance is in accordance with the HS and the Members' WTO obligations.[876] The United States has also submitted that a Member may set forth criteria that it will apply to all shipments of parts of a given product so long as the criteria set forth are consistent with the Member's obligations under the GATT 1994 and other WTO Agreements and – if the Member is also a party to the HS Convention – its obligations under the HS Convention.[877] Canada does not take issue either with Members setting forth guiding criteria to apply to particular shipments of goods to determine their classification[878], insofar as such criteria are in accordance with the rules of the HS and consistent with a Member's WTO obligations.

7.548 Further, the WCO Secretariat advises that such interpretations could conceivably take the form of BTIs (advanced classification determinations), individual classification determinations upon liquidation of a specific formal entry, national court rulings, regulations or statutes. In our view, having a pre-determined set of criteria for the essential character test based on a particular Member's interpretation of the HS is not different from providing interpretations in the form of BTIs, individual classification determinations, national court rulings or regulations or statutes, insofar as all these forms of interpretations have a binding effect on their domestic customs authorities and provide a standard to be applied to future cases.

7.549 In light of the responses from the complainants, we understand that they are not in principle objecting to a pre-determined set of criteria for the essential character determination that a Member may have in its domestic legal system, as long as such criteria are consistent with the obligations under the WTO Agreement and the HS Convention, if the Member is also a Contracting Party to the HS. The WCO Secretariat's comment is also in line with this view.[879] Therefore, we consider that the core of the complainants' contention is the consistency of the substantive criteria for the essential

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could result in interpretations that differ among countries. When a CP requests that the Committee consider the classification of a specific article (or group of articles presented together), and the Committee makes a determination and issues a Classification Opinion (CO), it is not uncommon for the resulting CO to be at variance with one or more national classification rulings, BTIs, or other administrative or statutory rules. CPs are expected to seek a way to modify their internal instruments so as to permit application of the CO, and they are obligated to inform the Committee when they are unable to do so."

[876] European Communities' response to Panel question No. 209.

[877] United States' response to Panel question No. 209.

[878] Canada's response to Panel question No. 209. Canada submits that this approach is illustrated with respect to kit cars in Canada (see Exhibit CHI-17) and other shipments elsewhere (e.g. EC Regulation 2127/2005, Exhibit CHI-14). Canada refers to paragraphs 41-51 of its second written submission for its argument why the measures, even if applied to a single shipment of all parts at the border, do not classify imported goods in accordance with the requirements of the HS.

[879] See paragraph 7.545 above.

character of a motor vehicle set out in China's measures with the obligations under the WTO Agreement. We address this question in this section, immediately following the current discussion.

7.550 In this connection, we note China's argument that the complainants have not established their prima facie case that China has misinterpreted the term "motor vehicles" in respect of where China has drawn the line between motor vehicles and parts of motor vehicles. China considers that such a claim would have to be brought on the facts of a specific case or cases, with evidence and arguments concerning the proper application of the essential character test in each instance.

7.551 To support its position, China argues that the complainants have failed to define the boundaries of the essential character test as it relates to parts and components of motor vehicles under Chapter 87, and to substantiate those boundaries by reference to evidence and legal arguments.

7.552 As set out above, a party advancing an affirmative claim, legal or factual, bears the burden to prove its case.[880] To establish a prima facie case for their claim, the complainants therefore have to demonstrate, based on factual and legal arguments, how the criteria for the essential character determination set out in the measures are inconsistent with China's concessions contained in the tariff headings for auto parts. However, in our view, this does not necessarily require the complainants to define themselves the boundaries of the essential character test for the products concerned in this case. We recall that establishing a prima facie case means that if a party asserting a claim adduces evidence sufficient to raise a *presumption* that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.[881] In this connection, the Appellate Body clarified that precisely how much and precisely what kind of evidence will be required to establish such a presumption will necessarily vary from measure to measure, provision to provision, and case to case.[882]

7.553 For the complainants in the present dispute, one way of proving their claim could be by putting forward the "correct" boundaries as China claims. This might indeed be the best way, if possible, to prove their claim, but is not a prerequisite for or the only way of establishing the complainants' prima facie claim concerning the essential character test contained in the measures. As noted by the WCO Secretariat, the Nomenclature and Explanatory Notes of the HS are largely silent regarding the meaning of the essential character of the complete or finished article as indicated in GIR 2(a) and the legal text of GIR 2(a) is open to different interpretations. Further, we are informed that the HS Committee has not formally developed principles in this regard, nor has the Committee ruled formally on the classification of unassembled sets of parts for motor vehicles of Chapter 87.[883] Under these circumstances, therefore, it would not be the appropriate application of the burden of proof if the complainants were required to prove their prima facie case by putting forward what are the correct boundaries for the essential character of a motor vehicle.

7.554 China also argues that the complainants have not demonstrated a consistent application of the challenged measures that has resulted in a misapplication of the essential character test to parts and components of motor vehicles. As China itself has noticed, however, the complainants have brought a claim on the measures as such, not as applied to specific facts.[884] In proving their as such claim, the

[880] See Section VII.A.3 above.
[881] See Section VII.A.3 above.
[882] Appellate Body Report on *US – Wool Shirts and Blouses*, page 14.
[883] See paragraph 7.529 above.
[884] China submits that it considers that the complainants have brought an *as such* claim against the challenged measures and that the European Communities has no basis to assert that Decree 125 is inconsistent with the essential character test in all circumstances to which it might be applied. China points out that even the United States concedes that "there might be a few combinations" of auto parts under Decree 125 "that could

complainants may resort to evidence of the consistent application of the concerned measures.[885] However, we do not consider that this is necessarily required to establish a prima facie case for the as such claim brought by the complainants because what the complainants are required to show in order to prove their claim is the inconsistency of "norms or rules" underlying China's legislation at issue with the WTO Agreement.[886]

(b) Essential character test under the measures at issue

7.555 Articles 21 and 22 of Decree 125 provide:

> "Article 21 Imported automobile parts shall be characterized as complete vehicles if one of the following applies:
>
> (1) imports of CKD or SKD kits for the purpose of assembling vehicles;
>
> (2) within the scope identified in Article 4 of these Rules:
>
> (a) imports of a body (including cabin) assembly[887] and an engine assembly for the purpose of assembling vehicles;
>
> (b) imports of a body (including cabin) assembly or an engine assembly, plus at least three other assemblies (systems), for the purpose of assembling vehicles;
>
> (c) imports of at least five assemblies (systems) other than the body (including cabin) and engine assemblies for the purpose of assembling vehicles; or
>
> (3) the total price of imported parts accounts for at least 60% of the total price of a complete vehicle of that vehicle model. This criterion shall enter into force on July 1, 2006.

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conceivably properly be classified under the HS as whole vehicles" (China's comments on complainants' responses to Panel question No. 233).

[885] As China has provided, the Appellate Body stated:

> "[t]he party asserting that another party's municipal law, as such, is inconsistent with relevant treaty obligations bears the burden of introducing evidence as to the scope and meaning of such law to substantiate that assertion. Such evidence will typically be produced in the form of the text of the relevant legislation or legal instruments, *which may be supported, as appropriate, by evidence of the consistent application of such laws* ..." (Appellate Body Report on *US – Carbon Steel*, para. 157) (emphasis added).

[886] The Appellate Body in *Dominican Republic – Import and Sale of Cigarettes* stated: "[w]e observe that the Appellate Body has consistently affirmed the right of WTO Members to challenge legislation laying down norms or rules 'as such', as well as their right to bring claims against the application of such measures in specific instances" (Appellate Body Report on *Dominican Republic – Import and Sale of Cigarettes*, para. 302).

In *US – 1916 Act*, the Appellate Body also states, "Prior to the entry into force of the *WTO Agreement*, it was firmly established that Article XXIII:1(a) of the GATT 1947 allowed a Contracting Party to challenge legislation as such, independently from the application of that legislation in specific instances. ..." (Appellate Body Report on *US – 1916 Act*, para. 60).

[887] For the term "assembly", see paragraphs 7.88-7.89.

> Article 22 Imported automobile parts shall be characterized as an assembly (system) if one of the following applies:
>
> (1) imports of a complete set of parts for the purpose of assembling assemblies (systems);
>
> (2) imports of key parts or sub-assemblies for the purpose of assembling assemblies (systems), if the quantity of the imported key parts or sub-assemblies reaches or exceeds the specified level as set forth in Annexes 1 and 2[888]; or
>
> (3) the total price of imported parts accounts for at least 60% of the total price of that assembly (system)."

7.556 We will examine each criterion in turn.

(i) Overview of the arguments of the parties

7.557 The **European Communities** considers that the ordinary meaning, context and purpose of headings 87.01 to 87.05 of China's tariff schedule clearly point to complete motor vehicles, and that only in some exceptional situations the General Explanatory Notes to Chapter 87 of the HS foresee that an incomplete or unfinished vehicle may be classified as the corresponding complete or finished vehicle (where it has the essential character of the latter). For a collection of parts to be classifiable as a complete vehicle, "the overwhelming majority of the parts must be present and fitted together".[889] Such a determination has to be made case-by-case based on the objective characteristics of that article, in the state it is presented to customs officials at the border (i.e. the "snapshot").[890] 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 General Explanatory Note to Chapter 87 cannot

[888] As of 1 July 2008, lower quantity thresholds will apply to those key parts identified as class A in Annex 1 to Decree 125. If those thresholds are met, the assembly will be characterized as an "imported assembly" (Note 5 of Annex I to Decree 125 and Article 19 of Announcement 4). The entry into force of this class A/B distinction was initially foreseen on 1 July 2006, but was postponed until 1 July 2008 (CGA Joint Bulletin No. 38 of 5 July 2005) (Exhibit JE-29).

Further, Article 20 of Announcement 4 provides:

> "If the imported parts accounts for more than 60% of the price of the key parts or sub-assemblies, such key parts or sub-assemblies shall be deemed as imported key parts or sub-assemblies. Manufacturers shall provide a list of price ratios of parts needed.
>
> Key parts or sub-assemblies, in principle, shall only be traced back to the secondary suppliers of the manufacturers of complete vehicles.
>
> Imported parts purchased by domestic suppliers or trading companies shall be counted as imported parts."

[889] European Communities' response to Panel question No. 205. See also the European Communities' responses to Panel question Nos. 211, 231 and 250.

[890] European Communities' second written submission, para. 94.

exempt the Chinese measures from being, as such, incompatible with Article II, when it has been established that their application will necessarily result in WTO violations.[891]

7.558 The **United States** acknowledges that under GIR 2(a) incomplete products may be classified as complete ones, if they have their essential character. However, the United States is of the view that China ignores GIR 1 (which provides that "classification should be determined according to the terms of the headings and any relative section or chapter notes"), the HS chapter headings specific to auto parts, and its own schedule of tariff commitments containing detailed descriptions of various parts and auto assemblies and sub-assemblies. The auto parts and auto assemblies imported into China must be classified in accordance with the specific tariff headings listed in China's schedule.[892]

7.559 The United States is of the view that the criteria set out in Articles 21 and 22 of Decree 125 are not the types of criteria commonly used as standards by customs officials in determining whether parts and components of a product should be considered as a complete product.[893] The measures lay down thresholds that arbitrarily define some collection of imported parts as having the character of a whole product, and result in the application of duties for whole products to parts.[894]

7.560 **Canada** recognizes that there may 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. WTO Members can make use of GIR 2(a) in classification of individual shipments of products on the basis of the "snapshot" of goods as they arrive at the border. [895] The "essential characteristics" must be assessed based on the objective characteristics of the product as presented at the border in a single shipment. This involves elements such as visual inspection, reference to documents, and if necessary further testing or analysis (based upon the state of the good as it passed the border).[896] Canada argues that the assessment of whether an incomplete or unfinished article has the "essential character" of the complete or finished article must be made based on the objective characteristics of that article, and solely that article, in the state it is presented to customs officials at the border.[897] No consideration is

[891] European Communities' second written submission, para. 134.

[892] United States' first oral statement, paras. 36-40; United States' second oral statement, para. 24. The United States submits that under the HS, the GIR and the Section notes, goods are required to be classified in their condition as imported under the heading that most accurately describes the good. Following GIR 2(a), customs officials must make a determination as to whether components presented together impart the essential character of a complete or finished article. If not, then the components are to be individually classified. If Decree 125 were considered a valid interpretation of the HS, it would void several headings and subheadings that specifically describe automobile assemblies, subassemblies, and parts (United States' responses to Panel question Nos. 209, 223, 231).

[893] United States' response to Panel question No. 1.

[894] United States' response to Panel question No. 68.

[895] Canada explains in response to Panel question No. 39: "the Explanatory Note VII to GIR 2(a) is meant to cover situations where all parts arrive at the border in one shipment. In such situations, all parts that are necessary to form the article are classified together if they have the 'essential character' of that complete or finished article as presented. Any excess parts not required to form that article contained in that shipment can be classified as parts." In response to Panel question No. 113, Canada adds that "the Explanatory Note VII states 'no further working operations' can be considered when determining whether an article, as presented, has the essential character of a complete or unfinished article".

[896] Canada's responses to Panel question Nos. 68, 125 and 224. Canada's written version of its oral statement at the first meeting with the Panel, paras. 17-20. Canada, in response to Panel question No. 110, also refers to *EC – Chicken Cuts*, in which "the Appellate Body confirmed that classification must be based on the objective characteristics of an article as presented when it quoted the WCO statement that '[w]hen goods are classified in the Harmonized System, it is always done on the basis of the objective characteristics of the product at the time of importation'."

[897] Canada's response to Panel question No. 110.

to be given to separate consignments arriving at different times, end-use or value of the article, but simply to objective characteristics of the product as presented at the border.

7.561 Canada submits that Canadian customs officials perform assessments on a case-by-case basis of those parts presented together at the border, and that they do not base their classification of those parts on a formula that is linked to the number of imported assemblies. Canada points out that this is particularly the case with vehicles since they consist of a great number of individual parts, including assemblies and sub-assemblies.[898]

7.562 **China** considers it important to stress that GIR 2(a) does not provide a licence for national customs authorities to classify imports however they wish. With respect to GIR 2(a), first sentence, the article must be "incomplete or unfinished". With respect to the second sentence of GIR 2(a), the unassembled or disassembled parts must be capable of assembly into the complete article within a carefully circumscribed range of assembly operations. Thus, customs authorities could not invoke GIR 2(a) to classify any collection of parts or materials as a complete article that those parts or material could conceivably form. By the terms of Explanatory Note VII to GIR 2(a), the second sentence applies only to "articles the components of which are to be assembled either by means of fixing devices ... or by riveting or welding, for example, provided only assembly operations are involved." In actual practice, there is a fairly narrow range of products under the HS to which this circumstance applies.[899]

(ii) Criteria under Article 21(2) of Decree 125

7.563 Article 21(2) provides the following three categories of criteria for the essential character of a motor vehicles:

> "(a) imports of a **body** (including cabin) assembly *and* an **engine** assembly for the purpose of assembling vehicles;
>
> (b) imports of a **body** (including cabin) assembly *or* an **engine** assembly, **plus at least three other assemblies** (systems), for the purpose of assembling vehicles;
>
> (c) imports of **at least five assemblies** (systems) other than the body (including cabin) and engine assemblies for the purpose of assembling vehicles;" (emphasis added)

7.564 The **European Communities** submits that even assuming that the parts would arrive in a single shipment, the measures would still fail to meet the "essential character" condition.[900] Under Article 21(2) of Decree 125, imported parts will be classified as complete vehicles even though parts or assemblies essential for the functioning and character of a vehicle will be missing in the combination of imported parts. Further, this is all the more so because an assembly need not be imported in its entirety or even manufactured in China from exclusively imported parts to be Deemed Imported under Article 22 of Decree 125. As a result, the import of a relatively limited quantity or value of parts is sufficient to meet the thresholds of Article 21(2) of Decree 125 and leads to the classification of the imported parts as a complete vehicle.

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[898] Canada's response to Panel question No. 1.
[899] China's response to Panel question No. 68.
[900] European Communities' second written submission, para. 113.

7.565 The European Communities points out that although the average number of parts in a complete vehicle is in the thousands, under the measures, the import of five key parts of the vehicle body and six key parts of the engine will be sufficient to make both assemblies Deemed Imported and all imported parts characterized as complete vehicles for a certain type of vehicle under the measures.[901]

7.566 The European Communities further argues that once the class A/B distinction under Article 22 of Decree 125, the entry into force of which is postponed until 1 July 2008, takes effect, imported auto parts will be classified as complete vehicles under much lower thresholds. For example, the imports of one door, one engine hood, one engine block and one cylinder head will be sufficient to make the vehicle body and the engine Deemed Imported Assemblies, and the imported parts characterized as complete vehicles.[902]

7.567 Regarding Article 21(2)(a) of Decree 125, the European Communities considers that it covers the situation whereby the two main assemblies (the vehicle body and engine), without being fitted together, are imported for the purposes of manufacturing a complete vehicle. Such a situation is "manifestly far away from the categories foreseen by China's Schedule examined in the light of the General Explanatory Notes to Chapter 87 whereby an incomplete or unfinished vehicle may be classified as the corresponding complete or finished vehicle provided it has the essential character of the latter". There is no basis in China's Schedules or in the Notes to the HS that would allow imposing a different tariff than specifically indicated under the relevant China's tariff headings just because the engine and the body are imported in order to be manufactured and fitted together. Instead, these products are subject to their own very specific headings, which provide generally for a bound rate of duty of less than 10 per cent for bodies and relevant engines. The fact that under the measures the imported vehicle body and the engine would be characterized as a complete motor vehicle and subject to the 25 per cent duty for complete vehicles under tariff headings 87.02 to 87.04 is a manifest breach of the bound rates of duty of China under its tariff schedule and consequently a breach of Article II of the GATT 1994.[903]

7.568 With regard to Article 21(2)(b) and (c) of Decree 125, the European Communities points out that Chapter 87 of China's Schedule includes headings for intermediate categories between complete vehicles and parts thereof, such as 87.06 (Chassis fitted with engines) and 87.07 (Bodies (including cabs)). These two headings deal with situations where some automotive parts and accessories are already fitted together with other such parts creating a combination that is destined to be fitted together with other parts in order to build a complete or whole vehicle.[904] Partly based on the Explanatory Notes to tariff heading 87.06[905], the European Communities submits that the product

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[901] European Communities' second written submission, para. 115, referring to first written submission, paras. 40-41; response to Panel question No. 117; Exhibit EC-1.

[902] European Communities' second written submission, para. 115, referring to first written submission, paras. 40-41; response to Panel question No. 117, Exhibit EC-2.

[903] European Communities' first written submission, para. 261-266.

[904] European Communities' first written submission, para. 255.

[905] The Explanatory Notes to tariff heading 87.06 provide:

> "This heading covers the chassis-frames or the combined chassis-body framework (unibody or monocoque construction), for the motor vehicles of headings 87.01 to 87.05, fitted with their engines and with their transmission and steering gear and axles (with or without wheels). That is to say, goods of this heading are motor vehicles without bodies.
>
> The chassis classified in this heading may, however, be fitted with bonnets (hoods), windscreens (windshields), mudguards, running-boards and dashboards (whether or not

foreseen under heading 87.06 is clearly in a very advanced stage of manufacture, yet still not classifiable as a complete or finished vehicle. The European Communities considers that "a chassis fitted with engines" falls within the scope of Article 21(2)(b) and (c) of Decree 125, and would be considered as a "whole vehicle" and subject to the general 25 per cent duty, instead of a bound duty rate between 8 to 20 per cent under tariff heading 87.06. This is a manifest breach of the bound rates of China under its tariff schedule and consequently a breach of Article II of the GATT 1994.[906]

7.569 The **United States** submits that China's interpretation of GIR 2(a) exceeds the discretion a Contracting Party has to interpret GIRs as it eliminates from consideration several headings within the HS such as headings 87.06 and 87.07, which deal with sub-assemblies as well as specific headings that name particular goods such as headings 84.04 and 84.08.[907]

7.570 The United States argues that the criteria set out in Article 21 of Decree 125 in most cases go far beyond what can appropriately be considered to be parts with the "essential character" of a motor vehicle under the HS, including application of the General Explanatory Note to Chapter 87. There might be a few combinations of parts under Article 21 that could conceivably properly be classified under the HS as complete vehicles if presented together in one shipment at the border. For example the body, chassis-frame, transmission, steering system and both axles (which would be one "Main Assembly" and four other "Assemblies" within the meaning of Article 21) might appropriately under the HS be classified as a whole vehicle, based upon the General Explanatory Note example ("a motor vehicle not equipped with its engine"). However, that would require an individual assessment that the additional assemblies and other parts were enough to constitute the "essential character" of a motor vehicle. In the vast majority of cases, however, parts characterized as complete vehicles under Article 21, even if they were presented together at the border, could only be classified as intermediate products or parts.[908]

7.571 With regard to Article 21(2)(a) of Decree 125, the United States submits that, under longstanding classifications by Customs authorities around the world as well as the tariff classification experts at the WCO Secretariat, a vehicle body and an engine for a motor vehicle, even if shipped together, would have to be separately classified (under headings 87.07 and 84.07/84.08). A vehicle body nor an engine would ever be properly considered to have the "essential character" of a motor vehicle, nor would the theoretical combined article of vehicle body and an engine.[909]

7.572 The United States considers that Article 21(2)(b) of Decree 125 presents the same situation as Article 21(2)(a): it defies the longstanding conventions and principles of classifying imported articles in their condition at the time of importation, as set forth in the GIR and their Explanatory Notes. A

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equipped with instruments). Chassis also remain classified here whether fitted with tyres, carburettors or batteries or other electrical equipment. However, if the article is a complete or substantially complete tractor or other vehicle it is not covered by this heading.

The heading also excludes:

(a) Chassis fitted with engines and cabs, whether or not the cab is complete (e.g., without seat) (headings 87.02 to 87.04) (see Note 3 to this Chapter).
(b) Chassis not fitted with engines, whether or not equipped with various mechanical parts (heading 87.08)"

[906] European Communities' first written submission, paras. 255-260.
[907] United States' comments on China's response to Panel question No. 238(a).
[908] United States' response to Panel question No. 117.
[909] United States' response to Panel question No. 128.

vehicle body or an engine combined with any 3 of the other specified assemblies could never be properly classified as an article with the essential character of a complete motor vehicle. For example, a vehicle body with brakes, a steering system and drive axle, but no engine simply is not a motor vehicle. It is an odd assortment of automotive parts. The same holds true for any other combinations envisioned by subparagraph (2)(b). Proper classification of any combination of the imported assemblies would be according to the individual assembly in its condition at the time of importation, with each assembly separately classified, even if all assemblies were shipped together.[910]

7.573 Concerning Article 21(2)(c) of Decree 125, the United States submits that classifying the specified assemblies without a body or an engine as a complete motor vehicle or more specifically as having the "essential character" of a complete motor vehicle takes the well-established principles and conventions of tariff classification even further afield. None of these assemblies, even if impossibly classified together as a single article, would ever be considered to have the "essential character" of a complete motor vehicle and, therefore, could never be classified as such.[911]

7.574 **Canada** notes that Article 21(2) of Decree 125 considers that parts in a vehicle are characterized as a complete vehicle if a certain number of assemblies are Deemed Imported (an assessment made separately under Article 22), based on three separate thresholds: (a) body and engine; (b) body or engine plus three other assemblies (chassis-frame, steering system, transmission, brake system, drive axle, and non-driving axle); and (c) five or more other assemblies. With regard to the first threshold, Canada submits that these should be classified separately (i.e., the body under heading 87.07 and the engine under heading 84.07). Concerning threshold (b), Canada considers that if the Main Assembly is the engine, these combinations could at best constitute a chassis with engine of heading 87.06, and then only if the chassis was one of the other assemblies; however, in all other combinations, each article should be classified separately (*i.e.*, the body under heading 87.07, the engine under heading 84.07, and the other assemblies under heading 87.08). With respect to the third threshold (c), Canada is of the view that regardless of the combinations each article should be classified separately under the appropriate subheading of heading 87.08.[912]

7.575 Canada is of the view that China has not shown subsequent practice of other Members supporting its method of classifying parts and motor vehicles that could be relevant in interpreting Article II:1(b) of the GATT 1994. Canada acknowledges that China has provided some practice related to the propositions that (1) when parts are presented together in one shipment at the border that constitute all, or virtually all, the parts necessary to assemble a whole product, those parts may be classified as that whole product; and that (2) where a shipment includes most of the parts necessary to assemble a complete product, on an individual basis those parts may be classified as that whole vehicle product if the parts presented are determined to constitute the "essential character" of the

[910] United States' response to Panel question No. 128.
[911] United States' response to Panel question No. 128.
[912] Canada's responses to Panel question Nos. 117 and 128. Canada refers to a chart that it argues sets out the proper application of GIR 1 and the relevant headings to the various combinations of Deemed Imported Assemblies that, under the measures, are sufficient to find parts characterized as a complete vehicle (See the chart in Canada's second written submission, page 20). The chart shows that only in a few situations (the bottom three lines), even assuming that all the parts in a Deemed Imported Assembly are imported and contained in a single shipment, parts characterized as complete vehicles under Article 21(2) could properly be classified as whole vehicles under the HS. In all other cases, the measures do not follow the HS for classification, and as a result the charge imposed under the measures, even if properly characterized as an ordinary customs duty, violates Article II of the GATT 1994 (Canada's second written submission, paras. 48-51).

finished product.[913] However, 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. Therefore, Canada considers that 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 vast majority of necessary parts, and thus have the essential character of a whole vehicle in accordance with GIR 2(a).[914] The measures classify parts contrary to Article II:1(b) of the GATT 1994.[915]

7.576 **China** argues that the different combinations of auto parts and components set forth in Article 21 of Decree 125 all result in an incomplete article that is plainly recognizable as a motor vehicle and that these combinations therefore have the essential character of a motor vehicle under GIR 2(a). [916]

7.577 China submits that there are a variety of factors that customs authorities consider in evaluating whether an incomplete or unfinished article has the essential character of a complete or finished article. With respect to machines, such as motor vehicles, a principal consideration is whether the incomplete or unfinished article is *recognizable* as that type of machine in its assembled condition.[917] The essential character test does not require the presence of every component that is "essential" to the use or operation of the machine in its finished form.[918]

7.578 Moreover, China is of the view that the fact that certain assemblies only constitute a certain portion of the value of the assembled motor vehicle does not necessarily mean that those assemblies do not, in their entirety, have the essential character of a motor vehicle. The ratio of a particular assembly to the value of the assembled vehicle will change from one vehicle to another. While a ratio of imported parts beyond a certain value level may indicate that those parts have the essential character of the complete article, the fact that the ratio of imported parts is below a certain value is not necessarily determinative under the essential character test.

7.579 The **Panel** begins its analysis by considering the view of the European Communities and Canada that an auto part combination "a chassis fitted with engines", which is classified under tariff heading 87.06 of China's Schedule, would fall within the scope of Article 21(2)(b) of Decree 125 and be subject to the tariff rates applicable to motor vehicles in violation of Article II of the GATT 1994.[919]

7.580 Article 21(2)(b) of Decree 125 stipulates that the following category of combinations of auto parts has the essential character of a motor vehicle:

> "imports of a **body** (including cabin) assembly *or* an **engine** assembly, **plus at least three other assemblies** (systems), for the purpose of assembling vehicles" (emphasis added)

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[913] Canada refers to GIR 2(a); China's first written submission, paras. 81-103; Exhibits CHI-14, CHI-16 to CHI-20 and CHI-43.

[914] Canada points out that such shipments of parts are often labelled CKD or SKD kits.

[915] Canada's second written submission, paras. 52-55.

[916] China's response to Panel question No. 117.

[917] China submits three exhibits drawn from US customs practice where the "recognizable" test was used: CHI-42, CHI-43 and CHI-44.

[918] China's response to Panel question No. 117. China refers to Exhibit CHI-14 concerning the EC classification determination of incomplete pick-up trucks.

[919] The United States considers that it would fall under Article 21(2)(a) of Decree 125.

7.581 Accordingly, one type of the auto parts combinations under this provision could be "*engine* plus at least three other assemblies (systems)" among the *chassis* assembly, the transmission assembly, the drive-axle assembly, the non-drive axle assembly, the steering system and the brake system. Thus, if "*a chassis fitted with engines*" was imported with at least two other assemblies, fitted or not, it would indeed fall within the scope of Article 21(2)(b) of Decree 125 and accordingly be classified as a "motor vehicle". China does not dispute this.[920]

7.582 We recall an observation above by the WCO Secretariat that Chapter 87 provides a unique challenge in that it has tariff headings 87.06 and 87.07 for intermediate goods which fall in between complete motor vehicles and parts and components thereof. We are also mindful of the principle that GIR 2(a) must be applied in conjunction with GIR 1, which would imply in the case of tariff headings 87.06 and 87.07 that if auto parts imported in a single shipment "as presented" fit the description of one of these two headings, they would have to be classified under either heading in accordance with GIR 1.

7.583 Tariff heading 87.06 and the Explanatory Note to the heading provide:

> "87.06 Chassis fitted with engines, for the motor vehicles of headings 87.01 to 87.05.
>
> This heading covers the chassis-frames or the combined chassis-body framework (unibody or monocoque construction), for the motor vehicles of headings 87.01 to 87.05, fitted with their engines and with their transmission and steering gear and axles (with or without wheels). That is to say, goods of this heading are motor vehicles without bodies. ..."

7.584 Therefore, the text of tariff heading 87.06, read in the context of the Explanatory Note to the heading, illustrates that a "chassis fitted with engines" fitted with the transmission assembly, the steering system and the axle assemblies falls within the scope of tariff heading 87.06. Under Article 21(2)(b) of Decree 125, however, the same "chassis fitted with engines" with the transmission assembly, the steering system and the axle assemblies would be considered as having the essential character of a motor vehicle and thus classified under tariff headings for motor vehicles (87.02-87.05) instead of tariff heading 87.06 as required under GIR 1. This implies that Article 21(2)(b) requires a "chassis fitted with engines" with the transmission assembly, the steering system and the axle assemblies to be always classified as a motor vehicle inconsistently with the terms of tariff heading 87.06.

7.585 In this regard, China argues that the European Communities' position presumes that the Explanatory Note to tariff heading 87.06 is binding on what constitutes the essential character of a motor vehicle. In China's opinion the Explanatory Notes do not form part of the HS and are not binding at all.[921]

7.586 The Panel does not consider that the European Communities' arguments necessarily presume that the Explanatory Note to tariff heading 87.06 is binding on what constitutes the essential character

[920] See China's response to Panel question No. 131. China does not specifically respond to a question from the Panel to comment on the European Communities' statement in its first written submission that "a chassis fitted with engines", which is classified under tariff heading 87.06, falls within the scope of Article 21(2)(b) and (c) of Decree 125. China submits that the European Communities' argument is premised on the assumption that the Explanatory Note to heading 87.06 is binding as to what constitutes the essential character of a motor vehicle. This issue is addressed in paragraphs 7.585-7.586 below.

[921] China refers to the Appellate Body Report on *EC – Chicken Cuts*, para. 214, n. 416.

of a motor vehicle. The European Communities has referred to the text of the Explanatory Note to 87.06 to further support its position that "a chassis fitted with engines" under tariff heading 87.06 falls within the scope of Article 21(2)(b) and (c) of Decree 125.[922] Moreover, we recall that in interpreting a tariff term at issue, the Appellate Body in *EC – Chicken Cuts* also considered, *inter alia*, whether a proposed meaning of the term could be derived from the relevant Explanatory Notes to a HS chapter as well as a tariff heading.[923] Therefore, based on the terms of tariff heading 87.06 considered in their context and the types of auto parts combinations falling within the scope of Article 21(2)(b), we conclude that the application of Article 21(2)(b) would necessarily lead to a result that "a chassis fitted with engines" within the scope of tariff heading 87.06 is classified as a complete motor vehicle.

7.587 China also points out that the European Communities itself has classified as a complete vehicle an incomplete and unassembled vehicle that was missing substantially more than the "tyres and battery" referred to in the example provided in the Chapter Notes to Chapter 87.[924] However, a classification decision of another Member, whether correct or not under the relevant classification rules, would not render justifiable an element of the measures at issue that is inconsistent with the terms of tariff headings 87.06 and consequently China's concessions contained in that heading.

7.588 In sum, we find that Article 21(2) of Decree 125 has an element that would necessarily lead to a result that "a chassis fitted with engines" within the scope of tariff heading 87.06 is classified as a complete motor vehicle and consequently assessing them at the tariff rate applicable to a motor vehicle inconsistently with China's concessions contained in the tariff headings of China's Schedule.

(iii) Criterion for essential character under Article 21(3) of Decree 125

7.589 Article 21(3) of Decree 125 provides:

> "(3) the total price of imported parts accounts for at least 60% of the total price of a complete vehicle of that vehicle model. This criterion shall enter into force on July 1, 2006."[925]

7.590 The **European Communities** considers that Article 21(3) of Decree 125 provides for a criterion, which cannot even remotely be associated with the basic categorisation of products under Chapter 87 of China's Schedule and the HS. This criterion does not even attempt to use any technical language to disguise the inconsistency between the measures and China's Schedule and hence Article II of the GATT 1994. A criterion of 60 per cent of the aggregate price of the parts not only

[922] European Communities' first written submission, para. 255. The European Communities states that the Explanatory Note to tariff heading 87.06 is *particularly interesting*, before quoting the actual text of the Explanatory Note (emphasis added).

[923] Appellate Body Report on *EC – Chicken Cuts*, paras. 196, 214, also citing the Panel's reference to the relevant finding in this regard in the Appellate Body Report on *EC – Computer Equipment*, para. 89.

[924] China's response to Panel question No. 131, referring to Exhibit CHI-14.

[925] The entry into force of this third criterion is postponed until 1 July 2008 (CGA Joint Bulletin No. 38 of 5 July 2005) (Exhibit JE-28). In response to the Panel's question concerning the postponing of this criterion, China has explained that it is primarily because of the administrative complexity of implementing this particular criterion and that once auto manufacturers and customs officials have gained more experience with the implementation of Decree 125, and have laid a solid foundation of record-keeping and reporting for the administration of the measure, it will be easier for manufacturers and customs authorities to determine and account for the value of imported parts and components (China's response to Panel question No. 59). Further, concerning the specific nature of the complexity relating to the implementation of Article 21(3) of Decree 125, China submits that the specific difficulty encountered by the customs is how to identify the fair value of the parts (China's response to Panel question No. 170).

means that the parts are not necessarily fitted and/or equipped together but also means that fundamentally important parts may be missing. The European Communities is of the view that this is a manifest breach of Article II of the GATT 1994 as the full vehicle duty is imposed on auto parts that under China's Schedule are subject to a tariff of 10 per cent or less.[926]

7.591 According to the European Communities, it is clear that the examples of incomplete or unfinished vehicles in the General Explanatory Notes to Chapter 87 do not operate on the basis of the aggregate price of the parts, which is an entirely alien concept to customs classification. As China itself admits, the combinations of imported parts that will make up the 60 per cent threshold will vary from one model to another and will also vary depending on the respective evolution of the prices of auto parts in China and abroad.[927] The European Communities therefore considers it impossible even to begin any reasonable comparison between the examples of Chapter 87 of the HS and Article 21(3) of Decree 125 because they are based on completely different criteria the latter having nothing to do with customs rules.[928] The parts should instead be classified under the applicable headings for the specific parts.[929]

7.592 The **United States** submits that no imported articles are ever properly classified according to their value, and that the GIR does not provide for this way of classification. Classification addresses the physical qualities and sometimes the function of the article without any regard to its value or its relative value with respect to the nature or purpose of the finished good.[930]

7.593 **Canada** submits that there is nothing in any of the HS that suggests that value may be used to classify products.[931] 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.[932]

7.594 Canada considers that China has not shown a common and consistent practice that value thresholds can be used as a classification tool.[933] In Canada's view, the value of imported content is properly used only for determining origin of imported products; not for determining their tariff classification. Canada therefore submits that the 60 per cent threshold category is erroneously applied to classification of parts, which in most cases should be classified under heading 87.08.[934]

7.595 **China** submits that the value of parts and components in relation to the value of the finished article is one factor that customs authorities rely upon in applying the essential character test under GIR 2(a). [935] The 60 per cent threshold criterion under Article 21(3) of Decree 125 reflects this aspect of the essential character test. China considers that a collection of imported parts and components that meets this threshold will necessarily be recognizable as a motor vehicle, and therefore have the essential character of a motor vehicle.[936]

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[926] European Communities' first written submission, paras. 276-277; second written submission, para. 116.
[927] European Communities' second written submission, para. 116, referring to China's response to Panel question No. 64. The European Communities also refers to Exhibits EC-5 to EC-11.
[928] European Communities' response to Panel question No. 117.
[929] European Communities' response to Panel question No. 218.
[930] United States' response to Panel question No. 128.
[931] Canada's second written submission, para. 48.
[932] Canada's second written submission, para. 48.
[933] Canada's second written submission, para. 54, footnote 60.
[934] Canada's response to Panel question No. 128.
[935] China's response to Panel question No. 64.
[936] China's response to Panel question No. 102.

7.596 China points out that, although Canada and the European Communities insist that the value of imported parts and components is never a relevant consideration in applying the essential character test, US Customs determinations explicitly refer to value as a factor.[937] China refers to a United States tariff classification of incomplete, unassembled pistol kits from Austria and a tariff classification of an incomplete railway car, in which, according to China, US Customs considered value as a relevant fact in determining essential character.[938]

"Value" as a criterion for the essential character determination

7.597 The **Panel** first turns to the complainants' argument that "value" is not a valid criterion for tariff classification.[939] The complainants argue that nothing in the HS, including the GIR, and Chapter 87 of China's Schedule suggests that value may be used to classify products. We agree that no reference to "value" can be found in China's Schedule, the HS, the GIR or relevant Explanatory Notes. Although we do not consider that the absence of reference to "value" as a classification criterion in the relevant classification rules proves in and of itself that value as such cannot constitute a criterion for determining the essential character of a complete good, it does cast doubt on the reasonableness of "value" as a criterion for the essential character test.[940]

7.598 China argues that the value of the incomplete article in relation to the value of the complete article is one of the factors that customs authorities apply in evaluating the essential character of an incomplete or unfinished article. To support its proposition, China points to two US Customs classification decisions in which the term "value" is mentioned.

7.599 First, China addresses a US Customs classification decision where "value" was referenced in applying the principle of GIR 2(a) to determine the essential character of a pistol.[941] We note that the US Customs indeed noted that "[t]he nature of the item, its bulk, quantity, or value may be looked to in a determination of essential character." It is not clear, however, whether the US Customs meant to imply that all these criteria were relevant altogether or individually, and how value, if at all, would be considered in determining the essential character of a complete pistol in that case. The text of the decision does not indicate that the US Customs based its classification determination on the value of the unassembled pistol kits missing one part proposed to be imported, despite its reference, among others, to value in the decision. Rather, it shows that the decision was based on the fact that the unassembled pistol kits, even absent the receiver component, constituted the aggregate of distinctive component parts that established its identity as to what it was, a complete or finished pistol.

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[937] China refers to exhibits CHI-16 and CHI-45; the European Communities' responses to Panel questions, para. 91; Canada's responses to Panel questions, p. 34.

[938] China's response to Panel question No. 117.

[939] See paragraphs 7.590-7.593 above.

[940] In this context, the Panel takes note of the statement made by Australia, a third party participant in this dispute, that the value of goods has no place in an objective international trading classification system (Australia's response to Panel question No. 19). According to Australia, because "values are subjective and can change according to factors such as seasons, fashion, exchange rates and fuel prices", this could lead to inconsistent classification of essentially the same goods from different sources.

Furthermore, we note that Annex 2 to Decree 125 ("Scope of Automobile Parts in Assemblies (systems))" provides: "This *Scope of Automobile Parts in Assemblies (systems)* is mainly intended to clarify the scope of assemblies and systems for the purpose of verifying the complete vehicles character. The scope is delimited according to the following principles: (1) *functional* independence, and (2) *distinctive and separate assembly phase*. ..." (emphasis added).

[941] US Customs and Border Protection, *Tariff Classification of Incomplete, Unassembled Pistols from Austria*, NY M83114, 10 May 2006 (Exhibit CHI-16).

7.600 We also note China's reference to another US Customs classification concerning a series of component welded together to form the front runner car body (consisting of the central box section, to which other components are fabricated), i.e. whether it should be classified as an unfinished railway or tramway freight car having the essential character of the finished railway or tramway freight car.[942] From the language of the decision, however, it is not clear whether, and if so, how value was taken into account in deciding that the imported product constituted an unfinished railway or tramway freight classifiable under the corresponding finished product. The value of the imported parts at issue (57 per cent) was mentioned as part of the description of the fact of the case: "*It is indicated* that the imported car body represents 57 per cent of the total value of the complete front runner car" (emphasis added). The decision, issued as a form of advanced classification decision upon the request of an importer, does not elaborate on the basis for its conclusion. Under these circumstances, we do not have sufficient information to conclude whether value as such was relied on by the US Customs as an independent criterion for the essential character determination as under Article 21(3) of Decree 125.[943]

7.601 Given our considerations above of the US Customs classification decisions cited by China and in light of the fact that no reference to "value" as a classification criterion can be found in the text of China's Schedule, the HS or its interpretative tools[944], it is questionable whether "value" as adopted by China for the essential character test under the measures can be considered consistent with China's obligations under its Schedule.

7.602 In this connection, determining the essential character based on "the value of the incomplete good *in relation to* the value of the complete good" as embodied in Article 21(3) of Decree 125 would necessitate specific information on "the value of a complete good", that of a complete vehicle in this dispute. This means that an importer should know at the time of importation the exact value of the complete good into which the subject incomplete article presented for classification will eventually be incorporated, with domestic and/or other imported goods, in the importing Member's territory. This would seem to be a difficult, if not impossible, task for importers. In particular, as examined in paragraph 7.362 above, the evidence before us indicates that auto parts are more standardized and thus can interchangeably be used among different vehicle models, which makes identifying a specific vehicle model into which certain auto parts will be incorporated unnecessarily trade restrictive. In fact, China itself acknowledges the difficulties associated with the implementation of the value criterion under Article 21(3) of Decree 125. In explaining the postponement of the entry into force of Article 21(3) until 2008, China submits that the reason for this delay is the difficulty encountered by Customs on how to identify the fair value of the parts.[945] Therefore, we conclude that the value criterion does not necessarily confine the essential character determination to the assessment of auto parts imported in a single shipment.[946] To that extent, the value criterion under Article 21(3) is inconsistent with the principle of GIR 2(a).

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[942] US Customs, *Tariff Classification of Railway Freight Car Body*, HQ 081691, 18 January 1989 (Exhibit CHI-45).

[943] Further, we take note of Canada's view that "value" is a notion usually associated with the rules of origin, not tariff classification.

[944] The Panel also observes that the statement by Australia, who participated in this proceeding as a third party, that 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 (Australia's oral statement, para. 24).

[945] See footnote 925 above and China's response to Panel question No. 170.

[946] See paragraph 7.524 where the Panel stated that it would examine the complainants' claim in this section on the assumption that these criteria are applied to auto parts imported in a single shipment. Accordingly, to the extent that a certain criterion for the essential character determination, by its nature, cannot

Criteria for the essential character determination under Article 21(2) and 21(3) of Decree 125

7.603 Next, we turn to the European Communities' argument that because the combinations of imported parts that will make up the 60 per cent threshold will vary from one model to another and will also vary depending on the respective evolution of the prices of auto parts in China and abroad[947], it is impossible even to begin any reasonable comparison between the examples of Chapter 87 of the HS and Article 21(3) of Decree 125 because they are based on completely different criteria the latter having nothing to do with customs rules. We agree that depending on the vehicle model, 60 per cent of a motor vehicle in value could mean different combinations of parts of that motor vehicle. China does not deny this.

7.604 China however argues that a ratio of imported parts beyond a certain value level may indicate that those parts have the essential character of the complete article.[948] According to China, a collection of imported parts and components that meets the 60 per cent threshold will *necessarily be recognizable* as a motor vehicle, and therefore have the essential character of a motor vehicle.[949] The basis for China's position is not clear to us. This is particularly so in light of China's argument on the rationale behind the criterion provided in Article 21(2) of Decree 125. China has submitted in respect of the criteria under Article 21(2) of Decree 125 that as regards machines, such as motor vehicles, a principal consideration for the essential character determination is whether the incomplete or unfinished article is *recognizable* as that type of machine *in its assembled condition*.[950] China's argument in this context implies that whether parts of a motor vehicle are "recognizable" as a complete motor vehicle is determined based on the physical appearance of the parts presented for classification. This implication drawn from China's argument finds further support from China's own statement: "China considers that the different combinations of auto parts and components set forth in Article 21 of Decree 125 all result in an incomplete article that is *plainly recognizable* as a motor vehicle".[951] We understand that for parts, in particular machines as emphasized by China itself, to be "plainly recognizable" as the corresponding complete good of parts, they must have the physical appearance of the complete good.

7.605 Furthermore, in an effort to explain the concept "recognizable", China refers to certain US Customs classification decisions concerning the essential character of incomplete goods presented.[952] These decisions also illustrate that "recognizable", relied on as a criterion for the essential character determination, refers to the physical appearance of a good when presented to customs authorities. Based on the consideration of the specific elements or parts of a good (i.e. incomplete backhoe excavators, a four-wheel drive motor vehicle missing its engine and transmission, and a centrifuge imported without the motor, valves, and the various electronic elements and controls) presented for

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be applied to auto parts imported in a single shipment, which is the assumption for the Panel's analysis in this section, such a criterion is inconsistent with the principle of GIR 2(a).

[947] European Communities' second written submission, para. 116, referring to China's response to Panel question No. 64. The European Communities also refers to Exhibits EC-5-11.

[948] China's response to Panel question No. 64.

[949] China's response to Panel question No. 102 (emphasis added). Also see paragraph 7.595 above.

[950] China's response to Panel question No. 102. Also, in response to Panel question No. 117(b), China refers to certain US Customs classification decisions where the 'recognizable' test was used (Exhibits CHI-42, CHI-43 and CHI-44). See paragraph 7.605 for the Panel's discussion on China's argument relating to these decisions.

[951] China's response to Panel question No. 117(b).

[952] China's response to Panel question No. 117(b), referring to Exhibits CHI-42, 43 and 44.

classification, the US Customs have decided whether such parts were recognizable as the complete good of parts and thus had the essential character of the complete good of the parts presented.[953]

7.606 Considered against this background, we are not convinced by China's argument that a collection of imported parts and components that meets "the 60 per cent threshold" will *necessarily be recognizable* as a motor vehicle.[954] As noted earlier, various combinations of auto parts characterized as a complete vehicle in accordance with this 60 per cent value threshold as set out in Article 21(3) would not be necessarily the same types of auto parts combinations falling within the scope of Article 21(2) of Decree 125, which China has argued constitute the types of auto parts combinations that are recognizable as a complete motor vehicle. Therefore, given that China has defined the scope of auto parts that are "recognizable" as a complete vehicle by setting out the specific physical combinations of auto parts, it logically follows that any other combination of auto parts that does not reach the level of auto parts combination as set out in Article 21(2) are not recognizable as a complete vehicle under the measures. To the extent certain sets of auto parts satisfying the 60 per cent value test under Article 21(3) of Decree 125 will not fall within the scope of the auto parts combinations specified in Article 21(2) of Decree 125, we do not consider that the 60 per cent value test under China's measures provides a valid criterion for the essential character determination in respect of auto parts.

7.607 Therefore, we find that the value test contained in Article 21(3) of Decree 125, when considered, *inter alia*, in relation to the criterion employed under the measures based on specific combinations of auto parts (i.e. Article 21(2) of Decree 125), illustrates the lack of coherency and objectivity between different criteria contained in the same measures. In reaching this conclusion, we are not suggesting that a Member cannot have more than one criterion for the essential character test. Our view is that if a Member provides for more than one criterion for the purpose of determining the essential character of a complete good, it must ensure that such criteria are logical, coherent and objective.[955]

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[953] For example, in a classification decision concerning knocked-down backhoe excavators, the US Customs reasoned: "In this instance, an incomplete or unfinished backhoe excavator would be classified as an excavator, if it has the essential character of an excavator. The incomplete or unfinished excavator must be *easily recognizable as an excavator*. ..." (emphasis added) (US Customs, *Tariff Classification of Knocked-Down Backhoe Excavators*, HQ086555, 16 April 1990) (Exhibit CHI-42). Also, in another classification decision, the US Customs found by referring to its previous classification ruling, "'For machinery, *the nature of the item* is generally determinative. For an item to have the essential character of a machine, it must be *recognizable as such a machine*.' ... Even without the equipment added in the U.S., it [a centrifuge assembly from Italy] is *recognizable as a centrifuge* hence GIR 2(a) is applicable" (emphasis added) (US Customs, *Tariff Classification of Centrifuge Assembly from Italy*, NY H80093, 4 May 2001) (Exhibit CHI-44).

[954] The Panel also observes that the notion "recognizable" as such is not mentioned in the HS, nor in its interpretive notes. Although we are not ruling on whether "recognizable" as such is a valid criterion for the essential character determination, we note Members could define the scope of the notion "recognizable" in the manner that does not correspond to the essential character of a complete good. In such a case, the application of the notion "recognizable" as a criterion could result in an arbitrary and artificial determination on the essential character of a complete good.

[955] The Panel considers that by ensuring that such criteria are logical, coherent and objective, Members would contribute to promoting the main objective and purpose of the WTO Agreement, namely "security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantially reduction of tariffs and other barriers of trade".

(iv) Criteria for Deemed Imported Assemblies under Article 22 of Decree 125

7.608 Article 22 of Decree 125 provides:

> "Article 22 Imported automobile parts shall be characterized as an assembly (system) if one of the following applies:
>
> (1) imports of a complete set of parts for the purpose of assembling assemblies (systems);
>
> (2) imports of key parts or sub-assemblies for the purpose of assembling assemblies (systems), if the quantity of the imported key parts or sub-assemblies reaches or exceeds the specified level as set forth in Annexes 1 and 2[956]; or
>
> (3) the total price of imported parts accounts for at least 60% of the total price of that assembly (system)."

7.609 The **Panel** understands that the criteria set out in Article 22 of Decree 125 are applied to determine whether the eight assemblies as defined under the measures should be considered as "Deemed Imported Assemblies", which in turn will be counted toward the thresholds for the determination on the essential character of "motor vehicles" under Article 21(2) and (3) of Decree 125. To that extent, the application of Article 21 of Decree 125 is dependent on the application of Article 22 of Decree 125, in that the criteria under Article 22, which are applied to assemblies to determine whether they are "Deemed Imported Assemblies", will eventually affect the final determination under Article 21 of Decree 125 of whether imported auto parts in a given vehicle model are "characterized as motor vehicles".

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[956] As of 1 July 2008, lower quantity thresholds will apply to those key parts identified as class A in Annex 1 to Decree 125. If those thresholds are met, the assembly will be characterized as an "imported assembly" (Note 5 of Annex I to Decree 125 and Article 19 of Announcement 4). The entry into force of this class A/B distinction was initially foreseen on 1 July 2006, but was postponed until 1 July 2008 (CGA Joint Bulletin No. 38 of 5 July 2005) (Exhibit JE-29).

Further, Article 20 of Announcement 4 provides:

> "If the imported parts accounts for more than 60% of the price of the key parts or sub-assemblies, such key parts or sub-assemblies shall be deemed as imported key parts or sub-assemblies. Manufacturers shall provide a list of price ratios of parts needed.
>
> Key parts or sub-assemblies, in principle, shall only be traced back to the secondary suppliers of the manufacturers of complete vehicles.
>
> Imported parts purchased by domestic suppliers or trading companies shall be counted as imported parts."

With respect to the class A/B distinction, which has not yet entered into force, China submits that there is nothing arbitrary about the A/B distinction or its deferral. The parts designated under Class A reflect China's consideration of which parts, by themselves, impart the essential character of the particular assembly at issue. The parts designated under Class B reflect China's consideration of the other parts of that assembly which, in the aggregate, also impart the essential character of the assembly at issue. Until the A/B distinction takes effect, China is classifying assemblies on the basis of the aggregate threshold number of parts for that assembly. With or without the class A/B distinction, China considers that the designated parts at the designated thresholds impart the essential character of that assembly (China's response to Panel question No. 26).

7.610 Therefore, under the measures, the characterization of auto parts as motor vehicles can be attributed to the application of two *consecutive* essential character determinations: first, characterization as an imported "assembly" pursuant to the criteria under Article 22 of Decree 125, which is based on the quantity of imported key parts or sub-assemblies (Article 22(2)) or on the value of imported auto parts in relation to the value of an assembly (Article 22(3)); and second, subsequently, characterization as an imported "motor vehicle" pursuant to the criteria under 21 of Decree 125, which is based on the quantity of imported "assemblies" (Article 21(2)) or on the value of auto parts in relation to the value of a motor vehicle (Article 21(3)). In our view, the criteria for the determination of the essential character of "assemblies" under Article 22, which must be applied under the measures to reach a final conclusion on whether imported auto parts have the essential character of "motor vehicles", hampers the appropriate determination of whether certain auto parts have the essential character of a "motor vehicle" in accordance with the principle of GIR 2(a). This is because the application of Article 22 of Decree 125 makes it more likely for imported auto parts to be characterized as motor vehicles under Article 21 of Decree 125.

7.611 Furthermore, as we have already found above, the application of certain aspects of Article 21 of Decree 125 will necessarily lead to the result that China violates its concessions contained in the tariff headings for auto parts. Consequently, if Article 21 of Decree 125 is proven inconsistent with the principle of GIR 2(a), this would also *a fortiori* be the case for Article 22 because it applies the criteria with the same flaws that were found in respect of Article 21. Thus, to the extent the criteria under Article 22 of Decree 125 are necessarily connected to the same aspects of the criteria under Article 21 of Decree 125, we also find that Article 22, in combination with Article 21, is inconsistent with China's obligations under its Schedule.

(c) Conclusion

7.612 The **Panel** finds that the criteria for the essential character determination under Article 21(2) and (3) and Article 22 of Decree 125, to the extent certain aspects of the criteria necessarily lead to a violation of relevant rules, are inconsistent with China's concessions contained in the tariff headings for auto parts of China's Schedule and consequently with China's obligations under Article II:1(a) and (b) of the GATT 1994.

4. China's justification of the measures under Article XX(d)

7.613 As noted in paragraphs 7.283-7.287 above, China initially did not distinguish its justification of the measures under Article XX(d) in respect of the Panel's possible finding against the measures under Article III of the GATT 1994 from that under Article II.

7.614 In response to a question from the Panel, China explained how its justification of the measures under Article XX(d) would be different depending on the specific provision under which a violation was found. In relevant part, China has responded as follows:

> "In respect of Article II, the Panel could find, for example, that there is uncertainty within the Harmonized System concerning the circumstances under which customs authorities are allowed to classify multiple shipments of parts and components as having the essential character of the complete article. Based on such a finding, the Panel might conclude that the challenged measures are not in accord with China's rights and obligations under Article II, as they do not have a clear *affirmative* basis within the rules of the Harmonized System.
>
> ...

> However, another way of viewing the presence of a known and identifiable ambiguity within the rules of the Harmonized System, and within international customs practice generally, is that China is entitled to rely upon the general exception in Article XX(d) to adopt measures that are necessary to secure compliance with its tariff provisions for motor vehicle, and to ensure that those provisions have meaningful effect. China's tariff provisions for motor vehicles reflect the tariff bindings set forth in its Schedule of Concessions, and they are therefore not inconsistent with the GATT 1994. To the extent that the rules of the Harmonized System do not provide an unambiguous legal basis for China to give effect to those provisions, this authority could be found in Article XX(d). The rules of the Harmonized System may not clearly provide for every circumstance in which customs authorities need to interpret and enforce their tariff schedules to ensure that they are undermined through the manner in which importers structure and document their imports. In these circumstances, it is consistent with the purpose of Article XX(d) to ensure that Members are nonetheless able to adopt measures that are necessary to secure compliance with their tariff provisions. ...[957]"

7.615 China's response above does not provide any explanation how the measures are justified under Article XX(d) if the measures were found to be inconsistent with Article II:1(b) of the GATT 1994. China makes an assertion without any supporting arguments or evidence that it is consistent with the purpose of Article XX(d) to ensure that Members are able to adopt measures that are necessary to secure compliance with their tariff provisions.

7.616 Therefore, the Panel finds that China has failed to prove that the measures are justified under Article XX(d). Even if China's justification of the measures under Article XX(d) in respect of their Article III violation was given consideration in respect of the measures' violation of Article II, China still has not proved that the measures are justified under Article XX(d) for the same reasons identified above under Section VII.B.5.

E. SUBSIDIES AGREEMENT

1. Arguments of the parties

7.617 The **United States** argues that China's measures exempt manufacturers from additional duties imposed on imported auto parts if they use domestic auto parts rather than imported auto parts. The United States argues that the measures therefore constitute an import substitution subsidy in breach of Articles 3.1(b) and 3.2 of the SCM Agreement.[958]

7.618 The United States argues that the reduction available for using domestic auto parts is a subsidy pursuant to Article 1.1 of the SCM Agreement. Specifically, according to the United States, China provides a financial contribution within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement by foregoing revenue otherwise due. The United States asserts that 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-

[957] China's response to Panel question No. 282 (emphasis original).
[958] United States' first written submission, para. 123.

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.[959]

7.619 The United States maintains that the "normative benchmark" that should be compared to the Chinese measure to determine whether revenue otherwise due has been foregone is the "revenue collected when the 25 per cent charge is applied, and it is the differential between the revenue collected when the 25 per cent charge is applied and the revenue collected when the 10 per cent charge is applied that, as a legal matter, represents the revenue foregone by the Chinese government."[960] Specifically, the United States argues that automobile manufacturers that use imported parts in quantities that exceed certain thresholds when assembling complete vehicles pay 25 per cent on all imported auto parts used in the assembly of a complete vehicle, while the Chinese government foregoes revenue by only requiring payment of 10 per cent on all imported parts used in the assembly of a complete vehicle in the case of automobile manufacturers that use sufficient quantities of domestic parts when assembling complete vehicles.[961] The United States contends that the appropriate normative benchmark is 25 per cent regardless of whether the application of the measure is found to be a violation of Article II and/or Article III of the GATT 1994 because "it is the rate that applies in China, i.e., under Chinese law (as determined by the Panel as a factual matter), and it is Chinese law that determines the benchmark."[962]

7.620 The United States also contends that this "financial contribution" confers a benefit 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.[963]

7.621 The United States further argues that the Chinese measures are "prohibited" within the meaning of Article 3.1(b) of the SCM Agreement because they are contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods. As such, the measures are deemed to be "specific" within the meaning of Article 2.3 of the SCM Agreement. The United States argues that because China's measures constitute a subsidy within the meaning of Article 1.1, are specific within the meaning of Article 2.3, and are "prohibited" within the meaning of Article 3.1(b) they violate Articles 3.1(b) and 3.2 of the SCM Agreement.[964]

7.622 The **European Communities** asserts its claim under Article 3 of the SCM Agreement as a claim in the alternative, only in the event that the Panel finds that the 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*. In the case that these two conditions were satisfied, the European Communities argues that the Measures would, in any case, be a prohibited subsidy pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement.[965]

7.623 The European Communities argues that the measures constitute a financial contribution within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. Under the measures, imported auto parts that satisfy the local content requirements of Article 21 of Decree 125 are charged at a rate of generally 10 per cent if they "have been verified as not being Deemed Whole Vehicles" (see Article 28 of Decree 125). The revenue "otherwise due" follows from the normative benchmark provided by

[959] United States' first written submission, para. 124.
[960] United States' response to Panel question No. 268.
[961] United States' response to Panel question No. 157(a).
[962] United States' response to Panel question No. 267(a).
[963] United States' first written submission, para. 124.
[964] United States' first written submission, paras. 125-126.
[965] European Communities' first written submission, para. 282; second written submission, para. 149.

the Chinese treatment of imported auto parts that do not satisfy the local content requirements of Article 21 of Decree 125. These parts "verified by the Center as Deemed Whole Vehicles" are charged "according to the duty rate for whole vehicles" (see Article 28 of Decree) which is typically 25 per cent. As this 25 per cent rate is explicitly foreseen for certain imported auto parts in the Chinese Measures, it is, in the words of the Appellate Body in *US – FSC*, no "entitlement in the abstract" but a "definitive, normative benchmark". By charging imported auto parts that satisfy the local content requirements "only" with a 10 per cent rate, China has, in the words of *United States – FSC*, "given up an entitlement to raise revenue that it could 'otherwise' have raised".[966.]

7.624 The European Communities disagrees with China that the 25 per cent rate for parts Deemed Whole Vehicles is not an appropriate "normative benchmark" and that this rate should rather be considered as the "revenues due under the contested measure". According to the European Communities, China does not provide any reasons for this position and simply maintains that the 25 per cent and the 10 per cent duty treatment "are not the same 'fiscal situations' for purposes of making a proper comparison".[967] As indicated above, the European Communities considers that the 10 per cent duty treatment for parts not Deemed Whole Vehicles and the 25 per cent duty treatment for parts Deemed Whole Vehicles are in fact comparable for the purposes of Article 1.1(a)(1)(ii) of the SCM Agreement.[968]

7.625 The European Communities further argues that the measures confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement. Vehicle manufacturers using imported parts that are not Deemed Whole Vehicles are financially "better off" than those using imported parts that are Deemed Whole Vehicles.[969]

7.626 Finally, the European Communities argues that the subsidies which the measures provide are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement. In particular, the benefit of the lower 10 per cent duty rate is only conferred if vehicle manufacturers satisfy the local content requirements of Article 21 of Decree 125 by using sufficient domestic parts instead of imported parts in order to stay below the relevant local content thresholds.[970]

7.627 **China** argues that the basic flaw in the reasoning of the United States and the European Communities is that it does not acknowledge the independent scope and effect of China's separate tariff provisions for auto parts and components. China has adopted measures to prevent the importation and assembly of multiple shipments of auto parts as a means of circumventing its tariff provisions for motor vehicles. The fact that China has adopted these measures, however, does not mean that it 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 vehicles.[971] For this reason, China does not forego revenue when it applies its tariff rates for auto parts to non-circumventing imports. China argues that it is not entitled under its Schedule of

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[966] Appellate Body Report on *United States – FSC*, para. 90. European Communities' second written submission, para. 150; European Communities' first written submission, paras. 285 to 288. See also European Communities' response to Panel question No. 157(a).

[967] China's response to Panel question No. 159.

[968] European Communities' second written submission, para. 151.

[969] European Communities' second written submission, para. 152; first written submission, paras. 289-292.

[970] European Communities' second written submission, para. 153; first written submission, paras. 293-298.

[971] China's first written submission, para. 177.

Concessions to collect the 25 per cent tariff rates on non-circumventing imports, and it does not do so.[972]

7.628 China recalls the Appellate Body's statement that "the term 'otherwise due' implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation."[973] The "basis of comparison must be the tax rules applied by the Member in question. … What is 'otherwise due', therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself."[974] The Appellate Body has further observed 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."[975] In making these comparisons, "panels must obviously ensure that they identify and examine fiscal situations which it is legitimate to compare."[976] According to China, the basic problem with the arguments 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."[977]

7.629 China argues that Decree 125 concerns the obligation of auto manufacturers to pay the applicable duty rates for motor vehicles when they import parts and components of motor vehicles that, in their entirety, have the essential character of a motor vehicle under GIR 2(a). These are the "revenues due under the contested measure." When auto manufacturers import auto parts and components that do not have the essential character of a motor vehicle, China classifies these imports under the applicable headings for parts, also in accordance with the rules of the Harmonized System. These are not the same "fiscal situations" for purposes of making a proper comparison. The application of GIR 2(a) to imported parts (whether one shipment of parts or multiple shipments of parts) leads to a different classification depending on whether the parts have the essential character of the complete article.[978]

7.630 China asserts that it is therefore not the case, as the United States and European Communities' arguments necessarily presume, that the benchmark rate of taxation is the duty rate that applies to complete motor vehicles. The benchmark rate of taxation depends on what is imported – parts that have the essential character of the complete article, or parts that do not have the essential character of the complete article. China therefore does not "forego revenue" when it applies the applicable duty rates for parts to imports of parts that do not have the essential character of a motor vehicle. This is, as China has explained, the "independent scope and effect of China's separate tariff provisions for auto parts and components."[979]

7.631 China argues that the proper classification of imports, and the collection of the ordinary customs duties that arise under a Member's Schedule of Concessions, cannot result in revenue foregone within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement.[980]

7.632 China concludes that the complainants have failed to demonstrate a violation of the SCM Agreement and that the Panel should reject the United States and European Communities' claims under Article 3 of the SCM Agreement.[981]

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[972] China's first written submission, para. 178.
[973] Appellate Body Report on *US – FSC*, para. 90.
[974] Appellate Body Report on *US – FSC*, para. 90.
[975] Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 89.
[976] Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 90.
[977] China's response to Panel question No. 159.
[978] China's response to Panel question No. 159.
[979] China's response to Panel question No. 159 *citing* China's first written submission, para. 177.
[980] China's second written submission, paras. 156-160; response to Panel question No. 234(b).

2. Consideration by the Panel

7.633 The United States and the European Communities each presented claims that China has violated Articles 3.1(b) and 3.2 of the SCM Agreement by providing prohibited subsidies. However, the European Communities specified that it was only claiming violations of Articles 3.1(b) and 3.2 of the SCM Agreement in the event the Panel found both that the measures impose border charges and that China is entitled to accord to the imports of auto parts the treatment it provides for vehicles in its schedule, *quod non*.[982] As noted above, the Panel has not made those two findings. Therefore, we find that the European Communities claim with respect to a violation of the SCM Agreement is not before us.

7.634 Concerning the status of the claims of the United States under the same provisions of the SCM Agreement, in an answer to a question from the Panel the United States indicated that its "claims under the SCM Agreement are not stated in the alternative – that is, they do not depend on whether or not China's charges are internal taxes or 'ordinary customs duties.'"[983] The United States also indicated in the same response, however, that insofar as the findings of the Panel are sufficient to resolve the dispute, it viewed the exercise of judicial economy in respect of its SCM claims as a matter to be left to the discretion of the Panel.[984] The United States made a similar statement in response to another question from the Panel, stating that it considers:

> "the most essential claims in this dispute as the breach of Article III:4 and/or the TRIMs Agreement, because China's measures impose a local content requirement that discriminates against all imported parts as well as administrative burdens that discourage the use of imported auto parts, and Article III:2, because China imposes an internal charge on certain imported parts in excess of any charges with no comparable charge on like domestic parts. With respect to other claims, the United States understands that questions of judicial economy are to be decided at the discretion of the panel, so long as the all [sic] findings are made that are necessary for the resolution of the dispute."[985]

7.635 In view of these statements by the complaining party, and in view of our findings above that China has acted inconsistently with Articles III:2 and III:4 of GATT 1994, we consider that we have made the findings that are necessary for the resolution of the dispute raised by the United States. In particular, bringing the measures into conformity with China's obligations pursuant to our findings under Articles III:2 and III:4 of GATT 1994 also would remove any inconsistency of those measures with Articles 3.1(b) and 3.2 of the SCM Agreement. We therefore exercise judicial economy in respect of the United States' claims under the SCM Agreement.

F. CKD AND SKD KITS

1. Complaining parties' claims

7.636 All the **complainants** agree that to the extent the importation of CKD and SKD kits is exempted by Article 2(2) of Decree 125 from the administrative procedures under the measures and subject to China's regular customs procedures, including automatic issuance of an import licence, the

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[981] China's first written submission, para. 178; second written submission, para. 160.
[982] European Communities' first written submission, para. 282; second written submission, para. 149.
[983] United States' response to Panel question No. 156.
[984] United States' response to Panel question No. 156.
[985] United States' response to Panel question No. 151.

imposition of the charge on CKD and SKD kits can be considered as an ordinary "customs duty" and thus should be addressed under Article II:1(b), first sentence of the GATT 1994.[986] The complainants claim that China's tariff treatment of CKD and SKD kits under the measures is inconsistent with China's obligation under Article II:1(a) and (b) of the GATT 1994.

7.637 In addition to their claim under Article II of the GATT 1994, the **United States** and **Canada** submit that China's imposition of the charge on CKD and SKD kits is also inconsistent with China's commitment under paragraph 93 of its Working Party Report.

7.638 The Panel will thus examine first the complainants' claim under Article II of the GATT 1994 and then the claim of the United States and Canada concerning China's commitment under paragraph 93 of the Working Party Report.[987]

2. Scope of CKD and SKD kits

7.639 The **Panel** recalls its observation above that there exists no standard definition of what constitutes a CKD and an SKD kit.[988] The measures at issue in this case, in particular Article 21(1) of Decree 125[989], do not define these product terms either.[990] The parties, however, generally agree on what should constitute a CKD or SKD kit based on the way these terms are understood in the automobile industry.

7.640 The complainants submit that at the time of China's accession to the WTO, China did not have a separate tariff line for auto parts that were either fully or partly unassembled and that were shipped together for assembly and further processed into a whole vehicle within China.[991] More specifically, according to the complainants, CKD kits ("completely knocked-down kits") are auto parts imported together in *unassembled* condition that provide the necessary parts in order to manufacture a whole vehicle.[992] CKD kits may include not only parts, but also sub-assemblies and assemblies such as engine, transmission, axle assemblies, chassis and body assemblies. China in turn submits that a CKD kit consists of all, or nearly all, of the parts and components necessary to assemble a complete vehicle.[993]

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[986] Complainants' responses to Panel question Nos. 80, 105, 192; United States' responses to Panel question Nos. 184, 192; China's response to Panel question No. 88; China's first written submission, paras. 7 and 44; China's second written submission, para. 107. Also see footnote 1102.

[987] The European Communities mentions paragraph 93 of China's Working Party Report in para. 274 of its first submission. However, the European Communities has neither included a specific claim relating to paragraph 93 of China's Working Party Report in its request for the establishment of a panel nor developed any legal and factual arguments in this relation.

[988] See paragraph 7.91.

[989] See paragraphs 7.32 for the description of Article 21 of Decree 125. Under Article 21(1) of Decree 125, auto parts or a set of auto parts that are considered as constituting a CKD or SKD kit will be characterized as complete motor vehicles. Also see paragraph 7.78 above.

[990] Noting that the HS does not use the terms CKD or SKD kits, nor are the terms in common use in customs practice, Canada submits that the terms CKD or SKD kits become relevant in this dispute only because they are used both in the Working Party Report and in the measures (Canada's response to Panel question No. 33).

[991] See Part C of the factual background section submitted jointly by the complainants.

[992] See Part C of the factual background section submitted jointly by the complainants; the complainants' responses to Panel question No. 69; Canada's response to Panel question No. 33.

[993] China's first written submission, paras. 35-36; China's response to Panel question No. 69.

7.641 The complainants consider that SKD kits ("semi knocked-down kits") refer to partially assembled combinations of parts that can be used to manufacture a whole vehicle.[994] China also considers that an SKD kit differs from a CKD kit in the extent of its prior assembly, in that unlike a CKD kit, an SKD kit includes significant parts and components that have already been *assembled*.[995] In other words, the difference between CKD and SKD kits lies in the degree of assembly as CKD kits are parts imported together in *unassembled* condition, whereas SKD kits contain *partially assembled combinations* of parts.

7.642 In respect of a kit, China submits that it refers to "a set of parts or constituents from which a thing may be assembled or made," which is a dictionary definition of the term "kit".[996] The European Communities considers that "[CKD and SKD] kits consist of all the necessary parts of a whole product packaged and imported together."[997] The United States also points out that in commercial realities, a kit is totally different from the streams of parts used in manufacturing operations.[998]

7.643 Based on the parties' understanding of the terms – CKDs, SKDs and kits – as noted above, the scope of "CKD and SKD kits" can be defined in terms of the following three elements:

(1) extent of auto parts included in a kit;

(2) package and shipment as a kit; and

(3) assembly operations in the importing country.

7.644 First, with respect to the extent of auto parts and components that need to be contained in a kit so as to constitute a CKD or SKD kit, the parties generally agree that in the automobile industry, the term is understood as referring to "all, or nearly all, of the auto parts and components necessary to assemble a complete vehicle". While sharing a similar view with the other parties that in the language of the industry, CKD or SKD kits may denote, *inter alia*, a combination of parts that make up a complete vehicle and the concepts are used in a variety of ways, the European Communities submits that in its understanding, CKD and SKD kits *under the measures* comprise *all* the parts necessary to make a complete vehicle.[999] However, the European Communities does not elaborate on why CKD and SKD kits *under the measures* consist of "all" the parts, rather than "all or nearly all the parts", necessary to assemble a complete vehicle. In the absence of an explanation from the European Communities in this relation and in light of the understanding of the term generally shared by the automobile industry as submitted by the parties, we consider that a CKD or SKD kit under the measures may be understood as consisting of "all or nearly all" the auto parts necessary to assemble a complete vehicle.[1000]

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[994] Part C of the factual background section submitted jointly by the complainants.

[995] China's first written submission, paras. 35-36; *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 1502.

[996] China's first written submission, para. 192.

[997] European Communities' first written submission, para. 267.

[998] United States' second written submission, para. 9.

[999] European Communities' first written submission, para. 267; response to Panel question No. 69. The European Communities states that "[a]lthough the measures do not provide for an exhaustive definition of what a CKD or an SKD kits consists of, it is *assumed* that such kits consist of all the parts necessary to manufacture a vehicle or an 'assembly'. In other words, such kits consist of all the necessary parts of a whole product packaged and imported together" (European Communities' first written submission, para. 267).

[1000] China, in particular, in arguing that it does not consider that a CKD or SKD kit must include "all" of the parts necessary to assemble a motor vehicle and that there is some ambiguity in how the automobile

7.645 Second, all, or nearly all, of the auto parts necessary to assemble a complete vehicle must be packaged and shipped altogether in a single shipment to constitute a CKD or SKD kit. Given that a "kit" is by definition "a set of parts or constituents from which a thing may be assembled or made", it is reasonable to understand that a CKD or SKD kit is a set of auto parts and components, either entirely unassembled or partially assembled, from which a motor vehicle may be assembled or made.[1001]

7.646 Finally, CKD and SKD kits must go through the assembly process to become a complete vehicle since auto parts constituting a CKD or SKD kit are "entirely unassembled" or "only partially assembled". As the parties submit, the nature and degree of the assembly process required for CKD and SKD kits to become a complete vehicle will vary depending on the extent to which the parts and components in a CKD or SKD kit would have been already assembled prior to their shipment to the importing country.[1002] Regardless, the parties agree that the assembly operations for CKD and SKD kits may be less complicated than the full manufacturing of vehicles from individual auto parts.[1003] At the same time, we consider that CKD or SKD kits, in particular SKD kits, are distinguished from complete motor vehicles because of the degree of assembly operations required once they are imported into the importing country. For example, if a certain SKD kit containing all or nearly all the parts necessary to assemble a motor vehicle is imported in a substantially assembled state so as not to require any further assembly operations in the importing country (for examples, motor vehicles missing only the tyres or the wiper blades)[1004], that kit might not fall within the scope of "CKD or SKD kits" as such.[1005]

7.647 In conclusion, although there is no fixed definition for CKD and SKD kits, we will consider for the purpose of this dispute that CKD and SKD kits under the measures refer to those that fall within the descriptions above.

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industry uses these terms (China's response to Panel question No. 70), refers to the following statements in *Indonesia – Autos*: the European Communities stated that CKD kits for export to Indonesia included "almost all the parts and components necessary for assembling the cars"; and the United States stated that the CKD kits for the Ford Escort would have contained all of the individual parts necessary to build a complete Escort, except for locally procured parts and components, such as oil and gasoline (China's response to Panel question No. 69, referring to the Panel Report on *Indonesia – Autos*, paras. 8.239 and 8.242 respectively). China also points to a BMW website where it states that "[i]n the CKD process, certain parts and components are packaged as kits in precisely defined assembly steps and exported for assembly in the respective countries. These kits are then supplemented with locally manufactured parts in the partner countries" (China's response to Panel question No. 69).

[1001] As described in Section VII.A.1(b), the measures at issue also cover auto parts imported in multiple shipments for the domestic assembly of motor vehicles. This aspect of the measures is addressed in Section VII.D of these reports.

[1002] Parties' responses to Panel question No. 71.

[1003] Parties' responses to Panel question No. 71; European Communities' second written submission, paras. 130-132; United States' second written submission, paras. 9-10. For example, the United States submits that "[a]n operation that assembles kits is different than a full-fledged, automobile manufacturing plant with full logistical capabilities to handle bulk shipments of parts (footnote original omitted). And most auto manufacturing plants are not in the business of assembling discrete kits" and that "[a]s a practical commercial matter, CKD and SKD kits are an inefficient production method that is limited in use by manufacturers to circumstances (1) when they are starting up a new assembly operation in a distant location with no developed supplier base; or (2) when the number of vehicles produced in a distant location is limited to only several thousand vehicles annually."

[1004] China refers to these examples in paragraph 23 of its second written submission.

[1005] They may still be classified as complete motor vehicles in accordance with general classification rules relied upon by customs authorities, such as GIR 2(a).

3. Is China's treatment of CKD and SKD kit imports under the measures consistent with Article II:1(b) of the GATT 1994?

(a) Treatment of CKD and SKD kits under China's measures

7.648 There is no separate tariff line for CKD and SKD kits in China's Schedule of Concessions.[1006] Under Articles 2 and 21(1) of Decree 125 and Article 13 of Announcement 4, China imposes an ordinary customs duty at the tariff rate applicable to complete vehicles (i.e. 25 per cent on average) on imports of CKD and SKD kits.[1007]

7.649 The **complainants** submit that China's treatment of CKD and SKD kits under the measures is inconsistent with China's tariff commitment under its Schedule and consequently with Article II:1(b) of the GATT 1994.[1008]

7.650 **China** argues that it is consistent with China's obligation under its Schedule and Article II:1(b) of the GATT 1994 to treat CKD and SKD kit imports as complete vehicles in light of the principle of GIR 2(a), which provides that a complete set of parts "presented unassembled or disassembled" (e.g., in a kit) is classified as the complete article, not as parts of that article.[1009]

7.651 The issue before the **Panel** is therefore whether imposing the tariff rates applicable to complete vehicles on CKD and SKD kits imports is consistent with China's commitment under its Schedule.

(b) Interpretation of China's Schedule of Concessions

7.652 Article II:7 of the GATT 1994 provides that the schedules annexed to the GATT 1994 are made an integral part of the GATT 1994. As observed by the Panel in *EC – Chicken Cuts*, the Appellate Body in *EC – Computer Equipment* clarified that Article II:7 means that the concessions provided in such schedules are part of the terms of the treaty, namely the GATT 1994.[1010] Paragraph 1 of Part II of China's Accession Protocol states that China's Schedule CLII annexed to China's Accession Protocol shall become the Schedule of Concessions and Commitments annexed to the GATT 1994. Thus, the content of a Member's Schedule of Concessions (i.e. China's Schedule of the Concessions in this case) is considered treaty language, which must be interpreted in accordance with customary rules of interpretation of public international law, namely the provisions of the *Vienna Convention*[1011] in accordance with Article 3.2 of the DSU.

[1006] "China's Schedule of Concessions" means China's Schedule CLII to China's Accession Protocol (Exhibit JE-2).

[1007] See paragraphs 7.71-7.77, 7.78.

[1008] European Communities' second written submission, para. 132; the United States' first written submission, paras. 118-119; Canada's first written submission, paras. 141 and 149-150. The United States and Canada refer to the arguments provided by the European Communities in Section III.D of the European Communities' first submission (United States' first written submission, footnote 145 to para. 118).

[1009] China's first written submission, para. 90.

[1010] Appellate Body Report on *EC – Computer Equipment*, para. 84; Panel Report on *EC – Chicken Cuts*, para. 7.6.

[1011] Article 31 of the *Vienna Convention* provides:

> "General rule of interpretation
>
> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

(i) Tariff term to be interpreted

7.653 The **European Communities** starts its analysis of the interpretation of the Chinese tariff schedule with a reference to the term "whole vehicles" in Article 2 of Decree 125.[1012] Article 2 states that the measures apply to the supervision and administration of imported automotive "parts" that are deemed "whole vehicles" falling within the scope of tariff headings 87.02, 87.03 and 87.04.[1013] According to the European Communities, "motor vehicles" referred to in these tariff headings can be defined as "a road vehicle powered by an internal-combustion engine" and denotes complete or whole vehicles. Thus, the terms to be interpreted pursuant to the *Vienna Convention* are "*whole* (motor) vehicle" and "*parts* of a whole vehicle (as defined in Article 21 of Decree 125)" and a proper analysis of China's tariff Schedule requires an examination of the relevant words in all relevant tariff headings starting with "parts and accessories" of motor vehicles, "chassis fitted with engines", and so forth.[1014]

7.654 The **United States** and **Canada** have not provided any specific view on the tariff term to be interpreted in the context of CKD and SKD kits.

7.655 **China** submits that the measures concerned implement China's Schedule of Concessions by interpreting and giving effect to its tariff provisions for "motor cars and other motor vehicles principally designed for the transport of persons" (i.e. tariff headings 87.02 & 87.03) and "motor vehicles principally designed for the transport of goods" (i.e. tariff heading 87.04).[1015] The measures give effect to these tariff provisions by defining the circumstances under which China will classify the importation and assembly of auto parts as equivalent to the importation of a complete motor vehicle. Thus, China considers that the interpretative issue before the Panel is whether the challenged measures are based on a valid interpretation of the term "motor vehicles".

7.656 The **Panel** observes that the position of the European Communities is slightly different from that of China to the extent that the European Communities submits that the terms to be interpreted are respectively "*whole* (motor) vehicles" and "auto parts", whereas China submits that the term at issue is "motor vehicles". We consider that the term to be interpreted is what is contained in the concerned tariff heading of China's Schedule of Concessions, not the term in China's measures. In our view, the question of whether the term "motor vehicles" is interpreted to include in its scope something other

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2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) any relevant rules of international law applicable in the relations between the parties."

[1012] European Communities' first written submission, paras. 240-248.

[1013] The European Communities also submits that it is not disputed that the "vehicles" subject to the measure at issue are those falling under tariff headings 87.02, 87.03 and 87.04 (Article 3 of Decree 125), under all of which "motor vehicles" is the common denominator.

[1014] European Communities' second written submission, footnote 83.

[1015] China's first written submission, paras. 77-78.

than whole (or complete) vehicles (i.e. CKD and SKD kits) is the very issue before us. Therefore, we consider that the tariff term to be interpreted in relation to China's measures concerning CKD and SKD kits is "motor vehicles"[1016] as indicated in tariff headings 87.02, 87.03 and 87.04.

7.657 Other relevant terms such as "auto parts", however, will also be examined as part of the context of the term "motor vehicles".

(ii) Ordinary meaning of the term "motor vehicles"

7.658 Based on the dictionary definitions[1017] of the terms "whole" ("complete, total" or "something not divided into parts; not broken up or cut into pieces; entire") and "part" ("portion or division of a whole", which is the opposite of "whole" or "complete", and "any of the manufactured objects that are assembled together to make a machine or instrument, especially a motor vehicle"), the **European Communities** argues that there is no logical or semantic basis for considering or deeming an automotive part as a complete or whole vehicle since a part of a vehicle by definition is a part or a portion or division of a whole or complete vehicle. Therefore, the classification (or "deeming") of auto parts as complete vehicles, when there are separate tariff lines for parts and whole vehicles, is not only a manifest error but a contradiction in terms of the basis of the ordinary meaning of these terms.

7.659 **China** disagrees with the European Communities on whether "a 'motor vehicle' denotes complete or whole vehicles".[1018] China does not consider that there is a clear separation between complete vehicles and the parts and components thereof. According to China, the European Communities reaches its "clear separation" principle in this case because it ignores the critical context provided by GIR 2(a), which establishes that there is never a clear separation between a complete article and the parts and components of that article. China argues that the ordinary meaning analysis is limited in this case and dictionary definitions of the term "motor vehicle" do not inform an understanding of where to draw the line between motor vehicles and parts of motor vehicles.[1019]

7.660 The tariff headings for motor vehicles under China's Schedule are as follows:

> 87.02 "*Motor vehicles* for the transport of ten or more persons, including the driver"
>
> 87.03 "*Motor cars and other motor vehicles* principally designed for the transport of persons, other than those under heading 87.02, including station and racing cars"
>
> 87.04 "*Motor vehicles* for the transport of goods"

7.661 All these three tariff headings have the term "motor cars and/or motor vehicles" in their heading descriptions. "Motor car or motor vehicle"[1020] can in turn be defined as follows:

- ***Motor Car*****:** a. (usually) four-wheeled road vehicle powered by an IC engine and designed for passengers.[1021]

[1016] References to "motor vehicles" in these reports also include the term "motor cars".

[1017] The European Communities relies on the definitions of these terms as provided in the *Shorter Oxford English Dictionary*, 2002 (5th edition), Volumes 1 and 2.

[1018] China's first written submission, paras. 79-80.

[1019] China's first written submission, para. 83.

[1020] Motor is defined as "(a) electric motor (b) engine (c) motor car" (*Dictionary of Automobile Engineering*, Peter Collin Publishing, 1997, page 156).

[1021] *Dictionary of Automobile Engineering*, Peter Collin Publishing, 1997, page 156.

- ***Motor Vehicle*:** Any automotive vehicle that does not run on rails; usually with rubber tyres; such as cars, trucks, lorries and motorcycles.[1022]

- ***Vehicle*:** (5) A means of conveyance, usu. with wheels, for transporting people, goods, etc; a car, cart, truck, carriage, sledge, etc. b. Any means of carriage or transport; a receptacle in which something is placed in order to be moved.[1023]

- ***Car*:** (6) A. usu. four-wheeled motorized vehicle for use on roads, able to carry a small number of people; an automobile.[1024]

- ***Motor*:** (3) a. A machine for producing motive power from some other form of energy, esp. electrical energy; an engine, esp. that of a vehicle. b. A motor car, a motor vehicle.[1025]

These definitions show that "motor vehicle (or car)" is a "vehicle (or car)", which is powered by engine and runs on roads, and not on rails. Although the ordinary meaning of "motor vehicle" seems to indicate a complete vehicle in that it refers to a means of transporting people or goods, the **Panel** considers it necessary to move on to examine the term "motor vehicles" in its context and in the light of its object and purpose.

(iii) Context for the tariff term "motor vehicles"

What constitutes context for interpreting the tariff term "motor vehicles"?

7.662 The Appellate Body stated that the context of the term concerned in the relevant tariff heading consists of the immediate, as well as the broader, context of that term: the immediate context is the other terms of the product description contained in the tariff heading at issue and the broader context includes the other tariff headings in the relevant chapter of the member's schedule, as well as other WTO Member Schedules.[1026]

7.663 The Appellate Body also confirmed the Panel's finding in *EC – Chicken Cuts* that the Harmonized System[1027] is "context" under Article 31(2)(a) of the *Vienna Convention* for the purposes of interpreting the WTO agreements, of which [a Member's schedule] is an integral part and thus that the HS is relevant for interpreting tariff commitments in the WTO Member's Schedules.[1028] Specifically, the Appellate Body states:

> "The above circumstances confirm that, prior to, during, as well as *after* the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties to *use* the Harmonized System as the basis for their WTO Schedules, notably with respect to agricultural products. In our view, this consensus constitutes an 'agreement'

[1022] *Dictionary of Automobile Engineering*, Peter Collin Publishing, 1997, page 156.
[1023] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 2, page 3512.
[1024] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 342.
[1025] *Shorter Oxford English Dictionary*, 2002 (5th edition), Volume 1, page 1841. Definitions of "motor car" and "motor vehicle" are not provided in *Shorter Oxford English Dictionary*.
[1026] Appellate Body Report on *EC – Chicken Cuts*, para. 193.
[1027] Article 1(a) of the HS Convention provides that the HS is comprised of the headings and subheadings of the HS and their related numerical codes, the Section, Chapter and heading notes and the General Rules.
[1028] Appellate Body Report on *EC – Chicken Cuts*, para. 199.

> between WTO Members 'relating to' the WTO Agreement that was 'made in connection with the conclusion of' that Agreement, within the meaning of Article 31(2)(a) of the *Vienna Convention*. As such, this agreement is 'context' under Article 31(2)(a) *for the purpose of interpreting the WTO agreements*, of which the EC Schedule is an integral part. In this light, we consider that the Harmonized System is relevant for purposes of interpreting tariff commitments in the WTO Members' Schedules."[1029] (emphasis added)

7.664 In this regard, the United States highlights that what was at issue in *EC – Chicken Cuts* was agricultural products and a Schedule of Concessions negotiated during the Uruguay Round. Although acknowledging the relevance of the HS for the interpretation of China's Schedule in this case, the United States submits that the HS should be examined in this case as part of "supplementary means of interpretation" under Article 32 of the *Vienna Convention* rather than as context under Article 31(2)(a) of the *Vienna Convention*. This is because, according to the United States, this dispute, unlike *EC – Chicken Cuts*, does not concern agricultural products and also because the dispute does not involve a schedule negotiated during the Uruguay Round.

7.665 However, we do not consider that the Appellate Body's finding in *EC – Chicken Cuts* is necessarily limited to agricultural products or Schedules of Concessions negotiated during the Uruguay Round. While the United States only highlights two elements in the Appellate Body's reasoning which refer to agricultural products, the Appellate Body also noted several other general elements in support of its conclusion that the HS is relevant "context" within the meaning of Article 31 of the *Vienna Convention*.[1030] For example, the Appellate Body noted "the close link" between the HS and several WTO Agreements[1031], which was "particularly true" for agricultural products but not necessarily limited thereto.[1032] The Appellate Body also cited its finding in *EC – Computer Equipment*, a case not concerning agricultural products, where the HS was used as a basis for the preparation of the Uruguay Round negotiations.[1033]

7.666 Further, the Appellate Body noted that not only prior to and during but also "after" the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties to use the HS as the basis for their WTO Schedules, although notably with respect to agricultural products. At the time of China's accession to the WTO in 2001, China was already a contracting party to the

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[1029] Appellate Body Report on *EC – Chicken Cuts*, para. 199. (footnote original: "In view of this conclusion, we do not find it necessary to determine whether the Harmonized System could constitute a 'relevant rule of international law', within the meaning of Article 31(3)(c) of the *Vienna Convention*.")

[1030] The Appellate Body referred to the following elements considered by the Panel in *EC – Chicken Cuts*: the membership of the HS is extremely broad; the HS was used as a basis for the preparation of the Uruguay Round GATT schedules (e.g. *EC – Computer Equipment*); Decision by the Contracting Parties setting out guidelines and "special procedures" to facilitate wide adoption of the HS; Decision by the Contracting Parties on Procedures to Implement Changes in the Harmonized System; the reference in a number of WTO Agreements that resulted from the Uruguay Round negotiations to the Harmonized System (Appellate Body Report on *EC – Chicken Cuts*, paras. 196-197).

[1031] In its reasoning, the Appellate Body also referred to other WTO Agreements such as the *Agreement on Rules of Origin* (Article 9), the *Agreement on Subsidies and Countervailing Duties* (Article 27) and the *Agreement on Textiles and Clothing* (Article 2 and the Annex thereto). This shows, in the view of the Appellate Body, that "the close link between the Harmonized System and the WTO Agreements (...) is also clear." The Appellate Body considered that this close link between the HS and the WTO Agreements was "particularly true for agricultural products", but in our view, the Appellate Body did not limit its consideration to agricultural products (Appellate Body Report on *EC – Chicken Cuts*, paras. 197-198).

[1032] Appellate Body Report on *EC – Chicken Cuts*, para. 198.

[1033] Also see footnote 1030 above.

HS.[1034] This fact is indicated in the section on ordinary customs duties of the Working Party Report on China's accession to the WTO.[1035]

7.667 The Appellate Body's holding in *EC – Chicken Cuts* could thus be read to support that the HS is relevant "context" within the meaning of Article 31(2)(a) of the *Vienna Convention* to intepret China's Schedule rather than a supplementary means of interpretation. Moreover, the United States' argument that "China had not presented a 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" seems to contradict its own statement that "China's schedule is plainly based on the Harmonized System nomenclature."[1036] In any event, as the United States clarifies, deciding where in the *Vienna Convention* the HS should fall under would have systemic implications rather than practical implications in this case.

7.668 Therefore, the Panel will proceed to examine the context of the term "motor vehicles" to determine whether CKD and SKD kits are classified as complete vehicles.

Other terms in the tariff headings for motor vehicles and other tariff headings in Chapter 87

7.669 Other tariff terms in tariff headings 87.02, 87.03 and 87.04 describe the purpose of vehicles falling under each heading, such as the transport of persons or goods. Although a CKD or SKD kit would consist of all or nearly all auto parts necessary to assemble a motor vehicle, it would not be

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[1034] China became a contracting party to the HS in 1992.

[1035] Paragraph 89 of China's Working Party Report provides:

> "B. IMPORT REGULATION
> Ordinary Customs Duties
>
> …
>
> 89. The representative of China said that China had adopted the Harmonized Commodity Description and Coding System ("HS") as from 1 January 1992 and joined the International Convention on the Harmonized Commodity Description and Coding System in the same year. There were 21 sections, 97 chapters and 7062 eight-digit tariff headings based on the six-digit HS '96 version in the Customs Tariff for the year 2000. Tariff rates were fixed by the State Council. Partial adjustment to the duty rates was subject to deliberation and final decision by the State Council Tariff Commission. The simple average of China's import duties in 2000 was 16.4 per cent. Among the 7062 tariff headings, tariff rates for 525 headings were below 5 per cent, 1488 were between 5 per cent (inclusive) and 3027 were above 15 per cent. Information on tariff rates for specific products and import statistical data for recent years had been provided to the Working Party." (Report of the Working Party on the Accession of China (WT/ACC/CHN/49, 1 October 2001)

Canada also submits that "China is a signatory to the *Harmonized System Convention* (Exhibit JE-35). Approximately 200 countries and Customs or Economic Unions, including Canada and China, base their domestic tariff classification on the Harmonized System nomenclature (World Customs Organization, Fact Sheet, 'The Harmonized System: The Language of International Trade' (Exhibit JE-36)). The tariff commitments in China's Schedule are based on China's customs tariff, which replicates the Harmonized System up to the six-digit subheading level (It is common that all domestic tariff schedules differ after the six-digit level because the Harmonized System only classifies up to the six-digit subheading level)" (Canada's first written submission, para. 139).

[1036] United States' second written submission, paras. 30-31.

capable of fulfilling the purposes described in the headings until the auto parts included in the kit were assembled into a motor vehicle in the importing country.

7.670 The terms in the tariff headings for auto parts (e.g. tariff headings 87.06-87.08, 84.07-84.09 and 85.03)[1037] do not provide guidance either on whether CKD or SKD kits should be classified as complete motor vehicles. Based on the scope of CKD and SKD kits defined above, however, we note that a CKD and SKD kit consists of a set of auto parts, which is much more complete and ready for the assembly of motor vehicles, than individual units of auto parts falling under tariff headings for auto parts, including tariff headings 87.06 ("chassis fitted with engines") and 87.07 ("bodies (including cabs)") that cover the so-called 'intermediate products'.

7.671 Therefore, we do not find that other terms in the tariff headings concerned (87.02, 87.03, 87.04) and the terms in the tariff headings for auto parts provide useful information on whether the term "motor vehicles" is interpreted to include in its scope CKD and SKD kits.

Other Members' Schedules

7.672 Canada has provided examples of other WTO Members' Schedules under which a CKD kit is classified under the tariff headings for motor vehicles. For example, a CKD kit is classified under the tariff headings for motor vehicles, such as tariff heading 8703.2110 in Malaysia's Schedule of Concessions[1038], tariff heading 8703.2110.11 in Indonesia's Schedule of Concessions[1039], and tariff heading 8703.2131 in Vietnam's Schedule of Concessions.[1040] Also, the Schedule of Concessions of the East African Community shows that "Unassembled and Disassembled" auto parts are classified under, for example, tariff heading 8702.2010, which is a tariff heading for motor vehicles.[1041]

7.673 Overall, the evidence before us shows that in the Schedules of some WTO Members, CKD and SKD kits are classified as complete vehicles.

Harmonized System

General Explanatory Notes for Chapter 87 and GIR 2(a)

7.674 The **European Communities** submits that under Chapter 87 of the HS, "fitting" and "equipping" are important criteria of tariff classification as illustrated in the General Notes for Chapter 87.[1042] Since nothing or very little is fitted or equipped in a CKD kit, parts composing a CKD kit remain parts until they are fitted and processed together as a complete vehicle.[1043] Further, as for a SKD kit, the degree of fitting or equipping is not sufficient to make such SKD kits sufficiently similar to a complete vehicle in order to have "the essential character" of a finished vehicle.[1044]

[1037] See paragraph 7.660.
[1038] Exhibit CDA-23.
[1039] Exhibit CDA-24.
[1040] Exhibit CDA-26.
[1041] Exhibit CDA-27.
[1042] The European Communities also argues that "fitting" and "equipping" are also decisive notions for classification under tariff headings 87.06 and 87.07 of the HS (European Communities' first written submission, para. 268).
[1043] European Communities' first written submission, para. 270.
[1044] European Communities' first written submission, paras. 272-273. The European Communities acknowledges at the same time that the situation may be slightly more complex with regard to SKD kits than CKD kits. Regardless, the European Communities argues that "even if engines and bodies, which themselves

7.675 We note that the **United States** and **Canada** acknowledge that CKD and SKD kits could be classified as complete vehicles to the extent that a CKD or SKD kit can be considered as having the essential character of a complete vehicle pursuant to the principle of GIR 2(a).[1045]

7.676 **China**, on the other hand, argues that the European Communities' assertion in respect of CKD kits that even a complete set of parts remain parts until they are fitted and processed together as a complete vehicle is wrong under the second sentence of GIR 2(a).[1046] China also adds that it is surprised by the European Communities' position given that the European Communities has recognized in *Indonesia – Autos* that CKD kits for automobiles are classified as complete vehicles under GIR 2(a).[1047] China submits that the European Communities also errs in arguing based on its selective quotation of the General Explanatory Notes to Chapter 87 that there are only very exceptional situations in which an incomplete or unfinished vehicle can be classified as a complete vehicle. On the contrary, the two motor vehicle-related examples provided in the General Explanatory Notes to Chapter 87 are merely examples of how GIR 2(a) can be applied to motor vehicles.[1048]

7.677 The **Panel** will begin its analysis by considering the language of the General Explanatory Notes to Chapter 87 and GIR 2(a). The General Explanatory Notes to Chapter 87 provide:

> "An incomplete or unfinished vehicle is classified as the corresponding complete or finished vehicle provided it has the essential character of the latter (see Interpretative Rule 2(a)), as for example,
>
> (A) A motor vehicle, not yet fitted with the wheels or tyres and battery.
>
> (B) A motor vehicle not equipped with its engines or with its interior fittings.
>
> This Chapter also covers parts and accessories which are identifiable as being suitable for use solely or principally with the vehicles included therein, subject to the provisions of the Notes to Section XVII (see the General Explanatory Note to the Section)."[1049]

7.678 The General Explanatory Notes to Chapter 87 therefore make a reference to GIR 2(a) and provide two examples of incomplete or unfinished vehicles that are classified as complete vehicles in accordance with the principle of GIR 2(a).

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consist of parts falling as such under tariff line 87.08, would be packaged together with all the other necessary parts for manufacturing a complete vehicle, the engines, bodies and other parts would remain subject to their specific tariff lines and thus not classifiable as complete vehicles" (European Communities' first written submission, para. 273).

[1045] United States and Canada's responses to Panel question No. 205.

[1046] China's first written submission, para. 90.

[1047] China explains that in *Indonesia – Autos*, the European Communities invoked GIR 2(a) to explain why CKD kits for automobiles must be considered "like" assembled complete vehicles for purposes of a like product analysis under the SCM Agreement (para. 91 of China's first written submission). More specifically, in that case, the European Communities submitted that "the mere fact that those CKD kits benefit from a lower import duty rate does not necessarily mean that they are not classified within the same HS six-digit code as CBU cars. If it was confirmed that the CKD kits exported from the EC are classified by Indonesia as parts and components, rather than as passenger cars, the necessary implication would be that Indonesia does not follow General Interpretative Rule 2(a)" (Panel Report on *Indonesia – Autos*, para. 8.236).

[1048] China's first written submission, para. 92.

[1049] Exhibit JE-37.

7.679 In turn, GIR 2(a) provides:

> "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."

7.680 We understand that the text of GIR 2(a) suggests the following three situations where goods are classified under the tariff headings for complete goods:

(a) "incomplete or unfinished product" presented "assembled", provided that, as presented, the incomplete or unfinished product has the essential character of the complete or finished product;

(b) "complete or finished" product presented "unassembled or disassembled"; and

(c) "incomplete or unfinished product" presented "unassembled or disassembled", provided that, as presented, the incomplete or unfinished product has the essential character of the complete or finished product.

7.681 In our view, the two examples provided in the General Explanatory Notes to Chapter 87 could be considered as falling within the first situation foreseen under GIR 2(a) above since "a motor vehicle not yet fitted with the wheels or tyres and battery" and "a motor vehicle not equipped with its engines or with its interior fittings", presented assembled to the customs authorities, constitute the category of "incomplete or unfinished vehicles" that have the essential character of a complete vehicle.

7.682 As we noted in paragraphs 7.639-7.647, CKD or SKD kits refer to a collection of auto parts that are packaged into a kit and shipped together in a single shipment for the assembly into a motor vehicle in the importing country. These sets of auto parts are imported completely unassembled in the case of CKD kits and partially assembled in the case of SKD kits. Given that a CKD and SKD kit by definition refers to all or nearly all auto parts and components necessary to assemble a complete vehicle, the extent of auto parts comprising such a kit meets, if not exceeds, that of the incomplete or unfinished motor vehicles provided as examples in the General Explanatory Notes to Chapter 87 (i.e. a motor vehicle not yet fitted with the wheels or tyres and battery and a motor vehicle not equipped with its engines or with its interior fittings). Further, as GIR 2(a) provides that an incomplete or unfinished article presented "unassembled or disassembled" is also classified as the complete good (under the third situation above in paragraph 7.680)[1050], the fact that CKD and SKD kits are presented unassembled, namely without fixing and equipping as argued by the European Communities, does not

[1050] In response to a question from the Panel whether a collection of auto parts in the form of CKD or SKD kits as provided in Article 21(1) of Decree 125 could be considered as having "the essential character of the complete or finished vehicle" in terms of GIR 2(a), the **WCO Secretariat** comments that the HS Committee agreed that the HS should not impose a requirement that the subsequent assembly of the parts be "simple". For that reason, the HS does not limit the scope of GIR 2(a) to sets of parts for which the required assembly operation falls below a certain level of complexity. The WCO Secretariat further mentions that absent guidance from the nomenclature (i.e. legal provisions) or the Committee (i.e. interpretation of the nomenclature), it is within the purview of national customs administrations to interpret these provisions (WCO's letter of 20 June, page 4).

necessarily make such kits falling outside the scope of GIR 2(a).[1051] As China submits and we noted above, the two examples provided in the General Explanatory Notes for Chapter 87 illustrate how the first sentence of GIR 2(a) operates, namely an "incomplete or unfinished" vehicle presented "assembled" is classified as the corresponding complete or finished vehicle provided it has the essential character of the latter. We do not find in the text of these two examples that "fixing and equipping" are important criteria of tariff classification as the European Communities submits.

Explanatory Note (VII) to GIR 2(a)

7.683 The **European Communities** further claims that Articles 2 and 21(1) of Decree 125 and Article 13(a) of Announcement 4 are *as such* in violation of Article II of the GATT 1994 because they require China's customs authorities to "always and automatically" classify CKD and SKD kits as complete vehicles and hence subject them to the higher duty.[1052] The European Communities submits that China's measures are inconsistent with the principle of GIR 2(a) since China classifies CKD and SKD kits as complete vehicles even when their assembly into complete vehicles includes working operations such as painting and curing of the body, which are not assembly operations.[1053] On that basis, the European Communities argues that since the manufacturing processes to make a complete vehicle using CKD or SKD kits in China usually requires further working operations in the form of painting and curing of the body, which exceed the boundary of assembly operations within the meaning of Explanatory Note (VII) to GIR 2(a), it is inconsistent to always and automatically classify such CKD and SKD kits as complete vehicles. According to the European Communities, different kits intended to become complete vehicles may need different further working operations depending on the level of high technology electronics in the final vehicle and thus the classification of a kit must always be made on a case-by-case basis and not generally as China does unless the member's schedule provides for tariff lines for different kind of kits.[1054]

7.684 **China**, on the other hand, argues that whatever its state of prior assembly, both CKD and SKD kits are assembled by means of the types of assembly operations specified in Explanatory Note (VII) to GIR 2(a).[1055] According to China, no party has disputed that CKD and SKD kits can be assembled into a complete vehicle by means of the assembly methods detailed in Explanatory Note VII and this is supported by the fact that national customs authorities routinely classify CKD and SKD kits for motor vehicles as "motor vehicles" in accordance with GIR 2(a).[1056] China submits that the word "working" in "working operations" in Explanatory Note VII to GIR 2(a) should be presumed to mean "making, manufacture, construction; the manner or style in which something is made," and that if the components must be subjected to an additional "working operation" (i.e. a manufacturing

[1051] In response to Panel question No. 218, the European Communities submits that "as presented" and "presented unassembled or disassembled" in the first and second sentences of GIR 2(a) denote the same meaning in time and that the second sentence of GIR 2(a) addresses the question of assembly. The European Communities further elaborates that the two sentences of GIR 2(a) have separate Explanatory Notes that guide their interpretation. According to the European Communities, Chapter 87 contains a *lex specialis* in the form of an Explanatory Note under GIR 2(a), and under this *lex specialis*, the conditions of GIR 2(a) are clearly more likely fulfilled in an individual case if the goods are presented in an advanced stage of assembly since the notion of "fitting" is used in the examples. In sum, the European Communities' arguments relating to "fixing and equipping" appear to be based on the Explanatory Notes to the second sentence of GIR 2(a), which are addressed in the following section.

[1052] European Communities' second written submission, para. 132.

[1053] European Communities' second written submission, para. 130, referring to China's response to Panel question No. 71.

[1054] European Communities' response to Panel question No. 47.

[1055] China's response to Panel question No. 71.

[1056] China's response to Panel question No. 62.

operation) before they can be assembled into the complete article, then the components cannot be classified as the complete article in accordance with GIR 2(a).[1057]

7.685 The **Panel** notes that the European Communities' claim in this respect concerns two different, but related, issues. First, the European Communities submits that China's measures are as such inconsistent because they always and automatically classify CKD and SKD kits as complete vehicles even though there are situations where certain CKD and SKD kits should not be classified as complete vehicles. Second, most CKD and SKD kits imported into China go through the types of operations that exceed the scope of assembly operations because they involve painting and curing of the body. We will consider these two issues in turn.

7.686 First, regarding whether China's measures are as such inconsistent because they always and automatically classify CKD and SKD kits as complete vehicles even though there are situations where certain CKD and SKD kits should not be classified as complete vehicles, the European Communities, as the party asserting a claim, bears the burden to prove that under the measures, China's customs authorities "always and automatically" classify CKD and SKD kits imports as complete vehicles even though certain shipments of CKD and SKD kits do not qualify to be classified as complete vehicles. In order to show that the measures are as such in violation of China's WTO obligations with respect to CKD and SKD kits, the European Communities must demonstrate the mandatory nature of the measures at issue – i.e. under the measures, China's customs authorities have no discretion to determine whether certain shipments of auto parts and components constitute CKD and SKD kits and thus should be classified as complete vehicles. The European Communities has not proved that is the case.

7.687 As examined above, the measures do not provide any standard definition for CKD and SKD kits. However, we were able to define the scope of CKD and SKD kits based on the general understanding of these product terms in the automobile industry.

7.688 Under Article 21(1) of Decree 125, China's customs authorities must classify auto parts presented for classification, once categorized as a "CKD and SKD kits", as motor vehicles. This means that China's customs authorities must first determine whether a given shipment of auto parts and components presented for classification fits the scope of a CKD or SKD kit. Once the customs authorities decide, based on the content of each shipment, that the auto parts presented constitute a CKD or SKD kit, then they must classify the parts as motor vehicles under the measures.

7.689 In this connection, the European Communities argues that China's customs authorities do not have discretion in making an initial decision whether a certain shipment of auto parts and components fits the scope of a CKD or SKD kit. We do not find any support for such a position. Rather, what makes the measures at issue mandatory in respect of CKD and SKD kits is the fact that once the auto parts presented for classification are determined to constitute a CKD or SKD kit, the customs authorities must classify them as complete vehicles without any discretion. This question, which is before us, is distinguished from the question whether China's customs authorities' decision in a given case that a shipment of auto parts constitutes a CKD or SKD kit is consistent with China's obligations. The latter concerns whether the measures, "as applied" to a specific situation, are consistent.

7.690 Second, the European Communities submits a factual claim that most CKD and SKD kits imported into China go through the operation processes that exceed the scope of assembly operations indicated in Explanatory Note (VII) to GIR 2(a). The European Communities' claim is based on

[1057] China's response to Panel question No. 62.

China's response that the assembly operations of CKD and SKD kits involve, *inter alia*, painting and curing of the body.

7.691 Explanatory Note (VII) to GIR 2(a) provides:

> "For the purposes of this Rule, 'articles presented unassembled or disassembled' means articles the components of which are to be *assembled either by means of fixing devices (screws, nuts, bolts, etc.) or by riveting or welding*, for example, provided *only assembly operations* are involved.
>
> No account is to be taken in that regard of the complexity of the assembly method. However, the components shall not be subjected to any further working operation for completion into the finished state." (emphasis added)

7.692 We first note that the text of Explanatory Note (VII) to GIR 2(a) provides some examples, not an exhaustive list, of the qualifying assembly processes under GIR 2(a). While agreeing that the processes such as fixing with screws, nuts and bolts, riveting and welding are within the scope of assembly processes, the European Communities contends that painting and curing of the body are not assembly operations within the meaning of GIR 2(a).

7.693 With respect to a question from the Panel concerning the kind of manufacturing processes involved to make a complete vehicle using CKD and SKD kits, the parties were generally of the view that it is difficult to give a general answer as the level of fitting and equipping will vary depending on the circumstances and the content of the kit.[1058] In other words, the more assembled auto parts are prior to their importation, the less operations will be required in their assembly into a complete vehicle. The parties also seem to agree that although the manufacturing of a complete vehicle using CKD or SKD kits may not be considerably different from the general manufacturing process, the assembly operations using CKD or SKD kits will be less complicated than those using parts in general. In particular, we find the observation by the United States relevant in this regard. The United States submits:

> "An operation that assembles kits is different than a full-fledged, automobile manufacturing plant with full logistical capabilities to handle bulk shipments of parts (footnote omitted). And most auto manufacturing plants are not in the business of assembling discrete kits" and that "[a]s a practical commercial matter, CKD and SKD kits are an inefficient production method that is limited in use by manufacturers to circumstances (1) when they are starting up a new assembly operation in a distant location with no developed supplier base; or (2) when the number of vehicles produced in a distant location is limited to only several thousand vehicles annually."

7.694 We further note the complainants' view on how the assembly processes required for CKD and SKD kits are different from those for regular auto parts. For example, the European Communities states in its response to a Panel question that CKD and SKD kits are imported because sometimes there is no manufacturing capacity in the country of destination and essentially the necessary investment is yet to be made for building up cars from bulk shipment of parts. According to the European Communities, to move to imports of parts in bulk, it is necessary to have in the place of destination the assembly and manufacturing plants together with a sufficiently developed informatics system and people able to manage thousands of parts to be used in different models.[1059] Canada also

[1058] Parties' responses to Panel question No. 70.
[1059] European Communities' response to Panel question No. 255.

considers that a vehicle manufacturer does not need a full, dedicated assembly line to assembly CKD kits into a complete vehicle.[1060]

7.695 Further, China's explanation[1061] of the automobile assembly process relates to the general automobile assembly process, and is not necessarily limited to the assembly of CKD and SKD kits.[1062] In any event, we have not been presented with evidence supporting the view that painting and curing the body are assembly operations. Therefore, we are not in the position to pronounce ourselves that painting and curing of the body are processes necessary for the assembly of CKD or SKD kits imported into China.

7.696 In this regard, our finding above is for the sole purpose of the present dispute based on the evidence before us. Therefore, we are not determining whether, and if so, how the principle of GIR 2(a) should be applied to a certain shipment of CKD or SKD kits based on the assembly operations that such kits would require in the importing country.

7.697 In these circumstances, the **Panel** finds that the context of the term "motor vehicles", in particular GIR 2(a), suggests that CKD and SKD kits could in principle be classified as complete vehicles.

(iv) Object and purpose

7.698 We now consider whether interpreting the tariff term "motor vehicles" to include in its scope CKD and SKD kits would undermine the object and purpose of the treaties concerned, namely the WTO Agreement and the GATT 1994.

7.699 In this connection, the Appellate Body in *EC – Chicken Cuts* has provided clarification on the scope of the object and purpose of the WTO Agreement and the GATT 1994 within the meaning of Article 31(1) of the *Vienna Convention*. The Appellate Body considered that although the starting point for ascertaining "object and purpose" is the treaty itself in its entirety, Article 31(1) of the *Vienna Convention* does not necessarily exclude taking into account the object and purpose of a particular treaty term (a tariff term contained in a tariff heading of the European Counities' Schedule of Concessions in that case), if doing so assists the interpreter in determining the treaty's object and purpose on the whole.[1063] At the same time, the Appellate Body cautioned against interpreting WTO

[1060] Canada's response to Panel question No. 255.

[1061] China's response to Panel question No. 71.

[1062] In response to a question from the Panel on the difference, if any, between "manufacturing" and "assembling" with respect to CKD and SKD kits, China submits that the scope of GIR 2(a), second sentence, is defined by the reference to the types of assembly operations specified in Explanatory Note (VII) to GIR 2(a) and that the relevant consideration, in respect of the scope of GIR 2(a), is whether the unassembled parts and components can be assembled into the complete article by means of the specified assembly operations (China's response to Panel question No. 62). China also submits that no party has disputed that CKD and SKD kits can be assembled into a complete motor vehicle by means of the assembly methods detailed in Explanatory Note (VII) to GIR 2(a). According to China, this conclusion follows from the fact that national customs authorities routinely classify CKD and SKD kits as motor vehicles in accordance with GIR 2(a).

[1063] Appellate Body Report on *EC – Chicken Cuts*, para. 238, referring to Sir Ian Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd edition (Manchester University Press, 1984), pages 130-135, which was referenced in the Panel Report on the same dispute (Panel Report, footnote 153 to para. 7.105). Thus, according to the Appellate Body, to the extent that one can speak of the "object and purpose of a treaty provision", it will be informed by, and will be in consonance with, the object and purpose of the entire treaty of which it is but a component (Appellate Body Report on *EC – Chicken Cuts*, para. 238, referring to the Appellate Body Report on *Argentina – Textiles and Apparel*, where the Appellate Body states that "a basic object and purpose of the

law in the light of the purported "object and purpose" of specific provisions, paragraphs or subparagraphs of the WTO agreements, or tariff headings in Schedules, in isolation from the object and purpose of the treaty on the whole.[1064] In particular, the Appellate Body shared the Panel's view that "one Member's unilateral object and purpose for the conclusion of a tariff commitment cannot form the basis" for an interpretation of that commitment, because interpretation in the light of Articles 31 and 32 of the *Vienna Convention* must focus on ascertaining the *common* intention of the parties.[1065]

7.700 One of the objects and purposes of the WTO Agreement and the GATT 1994 is the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade. When considered against its context as examined above, including some other Members' schedules, the tariff term "motor vehicles" would seem to be interpreted to include in its scope CKD and SKD kits imports. The complainants themselves have not denied that certain collections of auto parts, which would fall within the scope of CKD and SKD kits, imported and presented to customs together in a single shipment could be classified as complete vehicles. Therefore, interpreting "motor vehicles" to include CKD and SKD kits would not seem to undermine the security and predictability of the reciprocal and mutually advantageous arrangements between the Members. Although we are mindful that the overall objective of the WTO Agreement and the GATT 1994 is directed to the "substantial reduction of tariffs and other barriers to trade", tariff commitments reflected in a Member's Schedule are the "reciprocal and mutually advantageous arrangements", which include a committing Member's interest in how specific commitments are arranged in its Schedule.

7.701 We now continue with our analysis of the term "motor vehicles" in light of other interpretative tools under Article 31 of the *Vienna Convention*.

(v) Subsequent practice

7.702 Article 31(3)(b) of the *Vienna Convention* states:

> "3. There shall be taken into account, together with the context:
>
> (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation."

7.703 As the Appellate Body observed in *EC – Chicken Cuts*, "'subsequent practice' in the application of a treaty may be an important element in treaty interpretation because 'it constitutes objective evidence of the understanding of the parties as to the meaning of the treaty'."[1066] In light of

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GATT 1994 [was] reflected in Article II" (Appellate Body Report on *Argentina – Textiles and Apparel*, para. 47)).

[1064] Appellate Body Report on *EC – Chicken Cuts*, para. 239.

[1065] Appellate Body Report on *EC – Chicken Cuts*, para. 239, referring to the Appellate Body Report on *EC – Computer Equipment*, para. 84; and Sinclair, pages 130-131, as referred to in the Panel Report on *EC – Chicken Cuts* (footnote 536 to para. 7.236). In *EC – Chicken Cuts*, the European Communities argued that the notion of "long-term preservation" characterizes the four processes mentioned in heading 02.10, that is, "salted", "in brine", "dried", and "smoked". In conclusion, the Appellate Body did not find an error with respect to the Panel's finding that an interpretation of the term "salted" in the tariff commitment under heading 02.10 of the EC Schedule, as including the criterion of long-term preservation, "could undermine the object and purpose of security and predictability", which underlie both the WTO Agreement and the GATT 1994.

[1066] Appellate Body Report on *Chicken Cuts*, para. 255, citing *Yearbook of the International Law Commission* (1966), Vol. II, page 219, para. (6).

this principle, the Appellate Body in that case clarified various issues arising from a treaty interpreter's examination of "subsequent practice".

7.704 First, regarding the question of "what" may qualify as practice, the Appellate Body stated that although *not each and every party* must have engaged in a particular practice for it to qualify as a "common" and "concordant" practice, it would be *difficult* to establish a "concordant, common and discernible pattern" on the basis of acts or pronouncements of *one, or very few parties to a multilateral treaty*, such as the WTO Agreement.[1067] The Appellate Body further found that if only some of WTO Members have actually engaged in a certain practice, that circumstance may reduce the availability of such "acts and pronouncements" for purposes of determining the existence of "subsequent practice" within the meaning of Article 31(3)(b).

7.705 Furthermore, in addressing the question of "whose practice" is relevant to establish agreement on the interpretation of the relevant provision, the Appellate Body found in *EC – Chicken Cuts* that although the issue in that dispute concerned the scope of a tariff commitment contained in the WTO Schedule specific to the European Communities, the relevant headings are common to all WTO Members and thus exclusive reliance on the importing Member's classification practice as constituting subsequent practice cannot be justified.[1068]

7.706 Accordingly, on the basis of the guidance provided as above by the Appellate Body on the assessment of subsequent practice for interpreting a treaty provision (China's commitments under its Schedule), the Panel will consider how China has been classifying CKD and SKD kits since its accession to the WTO as well as how the complainants and other WTO Members have been classifying such kits.

China's practice since its accession to the WTO

7.707 The **complainants** submit that China has been treating CKD and SKD kits as parts by applying the lower tariff rates applicable to parts since its accession to the WTO.[1069] The

[1067] Appellate Body Report on *EC – Chicken Cuts*, para. 259.

[1068] Appellate Body Report on *EC – Chicken Cuts*, paras. 259-260, 265-266. The Appellate Body states in the relevant part of its report on *EC – Computer Equipment*:

> "[t]he fact that Members' Schedules are an integral part of the GATT 1994 indicates that, while each Schedule represents the tariff commitments made by *one* Member, they represent a common agreement among *all* Members" (emphasis in original, para. 109).
>
> "The purpose of treaty interpretation is to establish the *common* intention of the parties to the treaty. To establish this intention, the prior practice of only one of the parties may be relevant, but it is clearly of more limited value than the practice of all parties. ..." (emphasis in original, para. 93).

The Appellate Body also clarified the question of "what product range" is relevant for purposes of establishing "subsequent practice". The Appellate Body viewed that the relevant product range included *the "entire" range* of the products *classifiable under the tariff heading concerned* in that case as well as *other relevant alternative tariff headings*, and not only the classification practice relating to the subset of such products covered by the measures challenged in that dispute (Appellate Body Report on *EC - Chicken Cuts*, paras. 267-270).

[1069] Complainants' responses to Panel question No. 254. See also footnote 1101.

complainants, however, have not been able to provide documentary evidence to support such a practice by China.[1070]

7.708 On the contrary, **China** argues that it has classified CKD and SKD kits as motor vehicles and assessed CKD and SKD kits at the applicable duty rates for motor vehicles both prior and subsequent to its accession to the WTO.[1071] To support its position, China provides an import declaration form in which a CKD kit import by Shanghai GM in 2004 was classified as motor vehicles and assessed the duty rate applicable for motor vehicles.[1072]

7.709 The **Panel** first notes a subtle difference in the terms used by the parties in their respective arguments: the complainants refer to how China has been *treating* CKD and SKD kits, whereas China submits that it has always *classified* CKD and SKD kits as motor vehicles and assessed them at the applicable duty rates for motor vehicles.

7.710 In response to a question from the Panel whether tariff treatment is always linked to tariff classification, the complainants submit that tariff classification is normally[1073], generally[1074], or always[1075] related to tariff treatment.

7.711 China submits that tariff treatment – i.e. the applicable duty rate – is always linked to tariff classification. According to China, tariff classification of a good precedes the determination of the duty rate that applies since it is impossible to determine the correct rate of duty without first determining the classification of the good.[1076]

7.712 We also understand that *interpreting* a Member's Schedule of Concessions in order to determine the Member's tariff commitment contained in a tariff heading is linked to tariff classification because the Member's Schedule is structured in the form of nomenclature, which in turn is governed by classification rules. In respect of the complainants' claim under Article II of the GATT 1994 on China's tariff treatment of CKD and SKD kits under the measures, we must *interpret* China's Schedule to determine China's tariff commitment with respect to such kits. This requires us to examine first whether CKD and SKD kits are *classified* as motor vehicles under China's Schedule.

7.713 Turning now to China's practice since its accession to the WTO, we are not presented with evidence showing that China has been *classifying* CKD and SKD kits as parts. The only evidence of China's classification practice in this regard is the import declaration form submitted by one importer – Shanghai GM – as presented by China.[1077] According to this declaration form, a CKD kit imported by Shanghai GM was classified as a motor vehicle under tariff heading 8703.2334.90, which is a subheading at the ten digit level under tariff heading 87.03 for "motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading No. 87.02), including station wagons and racing cars". Under these circumstances, we do not have sufficient evidence to conclude that China has been classifying CKD and SKD kits as parts since its accession to the WTO, as argued by the complainants.

[1070] Complainants' responses to Panel question No. 254.
[1071] China's response to Panel question No. 254.
[1072] China's response to Panel question No. 254, referring to Exhibit CHI-48.
[1073] European Communities' response to Panel question No. 259(d).
[1074] United States' response to Panel question No. 259(d).
[1075] Canada's response to Panel question No. 259(d).
[1076] China's response to Panel question No. 258.
[1077] Exhibit CHI-48.

Complainants' practice since China's accession to the WTO

7.714 All the complainants submit that they do not use the terms or have a tariff line for "CKD and SKD kits" in their Schedules.[1078] Rather, classification of goods is conducted in the condition of goods as imported on a case-by-case basis.

7.715 Specifically, the **European Communities** considers that an SKD kit would appear more likely to fulfil the conditions to be classifiable as a complete vehicle as the parts would be presented to the customs with a certain degree of "fitting and equipping" and that a CKD kit that consists of all the parts necessary to assemble a complete vehicle may in some circumstances be classified as the complete vehicle provided that no working operation beyond assembly for completion into the complete vehicle is necessary in accordance with Explanatory Note (VII) to GIR 2(a).

7.716 The **United States** submits that to the extent the United States understands the terms "CKD or SKD kits" as defined by China under Decree 125, it classifies merchandise in its condition as imported. If a group of components are entered together that may form an assembly, it would be classified under the heading that describe that assembly. If a group of components do not constitute an assembly, they are individually classified.

7.717 **Canada** submits that what is relevant for tariff classification is the application of GIR 2(a) and that certain collection of parts may only properly be described as CKD or SKD kits where all or nearly all of the parts necessary to construct a whole vehicle are presented to customs together in one shipment.[1079] Canada further argues that China's customs officials have the discretion either to classify CKD or SKD kits as parts, or to classify them at the six-digit level as a whole vehicle.[1080]

7.718 **China** submits that consistent with GIR 2(a), customs authorities routinely classify CKD kits (for autos and other articles) as the complete article.[1081] China refers to instances where the complainants have classified CKD and SKD kits as complete vehicles by application of GIR 2(a): Canada Border Services Agency classified unassembled kits consisting of all the parts necessary to assemble a complete motor vehicle as a complete motor vehicle[1082]; and the European Communities classified, through its Binding Tariff Information (BTI), completely disassembled Bentley Mark VI sports car as a motor vehicle.[1083]

7.719 The **Panel** thus notes that the evidence provided by China shows that the complainants have also classified CKD and SKD kits as complete motor vehicles. In fact, the complainants themselves do not deny that a collection of auto parts constituting all or nearly all the parts necessary to assemble a motor vehicle could be classified as a motor vehicle in accordance with the principle of GIR 2(a), if they are imported and presented to customs together in a single shipment.

[1078] Complainants' responses to Panel question No. 47.

[1079] Canada's response to Panel question No. 33.

[1080] Canada submits that if China classifies CKD or SKD kits at the six-digit level as a complete vehicle, there should be a further classification at the seven- or eight-digit level to show that it is a whole vehicle in unassembled form, and therefore subject to a 10 per cent duty.

[1081] China's first written submission, para. 90, footnote 65. China also refers to a classification decision by the United States in which the US Customs and Border Protection classified unassembled pistol kits missing one part as complete pistols based on the principle of GIR 2(a) (NY M83114, *Tariff classification of incomplete, unassembled pistols from Austria* (10 May 2006) (CHI-16)).

[1082] Memorandum D10-14-45, *Tariff Classification of Kit Cars* (9 March 2007) (Exhibit CHI-17).

[1083] BTI GB115951081 (16 November 2006) (Exhibit CHI-18).

Other WTO Members' practice since China's accession to the WTO

7.720 As the **Panel** observed above in paragraphs 7.672, some WTO Members have separate tariff lines for CKD and SKD kits under the tariff headings for motor vehicles in their Schedules. Canada points out that these countries, except for Australia and the Philippines[1084], charge lower tariff rates for CKD and SKD kits imports than for complete motor vehicles.[1085] In our view, however, charging lower tariff rates for CKD and SKD kits than for motor vehicles does not change the fact that these Members *classify* them under the tariff headings for motor vehicles. Specific tariff commitments contained in the tariff headings of these Members' Schedules are the results of the specific negotiations between the subject Member and other Members. Overall, the evidence indicates that at least some other WTO Members, such as Malaysia, Indonesia, Vietnam, the East African Community, Australia and the Philippines, classify CKD and SKD kits as "motor vehicles", and that the tariff treatment these Members accord to CKD and SKD kits may vary.

7.721 In conclusion, the **Panel** finds, based on the available evidence before it, that the classification practices of at least some WTO Members show that CKD and SKD kits are classified as motor vehicles.[1086]

(vi) Supplementary means of interpretation

7.722 Article 32 of the *Vienna Convention* states:

> "Supplementary means of interpretation
>
> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:
>
> (a) leaves the meaning ambiguous or obscure; or
>
> (b) leads to a result which is manifestly absurd or unreasonable."

7.723 In *EC – Chicken Cuts*, the Appellate Body stated that the purpose of its analysis under Article 32 in that case was to ascertain whether WTO Members have agreed on the criterion

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[1084] Australia and the Philippines impose tariffs on CKD and SKD kits at largely the same rate as that for assembled vehicles (Canada's response to Panel question No. 256).

[1085] Canada's response to Panel question No. 256.

[1086] The Panel is aware of the Appellate Body's finding that previous panel reports are not "subsequent practice" within the meaning of Article 31(3)(b) of the *Vienna Convention*. Nonetheless, we note that the Panel in *Indonesia – Autos* found that CKD kits are "like" assembled complete cars in the context of the Subsidies Agreement. The Panel stated: "We do not consider that an unassembled product *ipso facto* is not a like product to that product assembled. Recalling the view of the Appellate Body that tariff classification may be a useful tool in like product analysis (*Alcoholic Beverages* (1996), op. cit., Appellate Body Report, page 21 (original footnote 743)), we note that, under the General Rules for the Interpretation of the Harmonized System: 'Any reference in a heading to an article shall be taken to include a reference to that article complete or unfinished, provided that, as presented, the incomplete or unassembled article has the essential character of the complete or unfinished article.' We think that a comparable approach to the relation between assembled and unassembled products makes good sense in the context of this dispute. It appears that, in order to avoid paying 200 per cent duties on CBU passenger cars, EC and US car producers ship to Indonesia virtually complete CKD kits that are effectively 'cars in a box.' Accordingly, we believe that they can properly be considered to have characteristics closely resembling those of a completed car" (Panel Report on *Indonesia – Autos*, para. 14.197).

("preservation") for the term "salted" advanced by the European Communities with respect to the tariff commitment under the tariff heading of the EC Schedule at issue (i.e. tariff heading 02.10).

7.724 Following the same logic, the purpose of the Panel's analysis under Article 32 is to confirm whether WTO Members have agreed on including CKD and SKD kits in the scope of China's tariff commitment under the tariff headings for motor vehicles of China's Schedule.

7.725 Regarding the scope of supplementary means of interpretation to which an interpreter may have recourse under Article 32, the Appellate Body stated that Article 32 does not define it exhaustively and thus that an interpreter has a certain *flexibility* in considering relevant supplementary means in a given case so as to assist in ascertaining the common intentions of the parties.[1087] More specifically, regarding the question of what types of events, or acts, and other instruments may be taken into account as circumstances of conclusion under Article 32, the Appellate Body considered that customs classification practice prior to the conclusion of a treaty could form part of the circumstances of the conclusion of a treaty, and that in this connection, even documents published, events occurring, or practice followed subsequent to the conclusion of a treaty could give an indication of what were, and what were not, the "common intentions of the parties" at the time of the conclusion.[1088]

7.726 Therefore, we will examine China's classification practice for CKD and SKD kits prior to as well as at the time of its accession to the WTO as part of the circumstances of the conclusion of China's accession to the WTO.

7.727 The **European Communities** submits that prior to joining the WTO, China imposed substantially lower tariff rates on CKDs and SKDs than on imported whole vehicles[1089] and that at the time it joined the WTO, China did not have a separate tariff line for auto parts that were either fully or partly unassembled and were shipped together for assembly and further processing into a whole vehicle within China. The European Communities notes that China committed to a Schedule of Concessions that, by 1 July 2006, imposed a bound tariff rate on most auto parts at 10 per cent or lower, and on most vehicles at 25 per cent. Furthermore, according to the European Communities, China agreed that if it did introduce a separate tariff line for CKD and SKD kits, the tariff rate would be no more than 10 per cent.[1090]

[1087] Appellate Body Report on *EC – Chicken Cuts*, para. 283. More specifically, the Appellate Body recalled its statement in a previous case that the "circumstances of [the] conclusion" of a treaty includes, "in appropriate cases, the examination of the historical background against which the treaty was negotiated" (Appellate Body Report on *EC – Chicken Cuts*, para. 284, citing its report on *EC – Computer Equipment*, para. 86). Further, the Appellate Body clarified that an "event, act or instrument" may be relevant as supplementary means of interpretation not only if it has actually influenced a specific aspect of the treaty text in the sense of a relationship of cause and effect, but also if it helps discern what the common intentions of the parties were at the time of the conclusion with respect to the treaty or specific provision. Thus, it found that not only "multilateral" sources, but also "unilateral" acts, instruments, or statement of individual negotiating parties may be useful in ascertaining "the reality of the situation which the parties wished to regulated by means of the treaty" and, ultimately, for discerning the common intentions of the parties (Appellate Body Report on *EC – Chicken Cuts*, para. 289).

[1088] Appellate Body Report on *EC – Chicken Cuts*, paras. 304-305.

[1089] The European Communities refers to this fact in Exhibit JE-25, page 189.

[1090] European Communities' first written submission, para. 274. The European Communities refers to paragraphs 93 and 342 of China's Working Party Report (Exhibit JE-26), and Part I:1.2 of the Accession Protocol (Exhibit JE-1).

7.728 The **United States** submits that China did maintain separate tariff lines for CKD and SKD kits from 1992 to 1995. According to the United States, these tariff lines were the same as the scheduled tariff rates applicable to motor vehicles.[1091] However, instead of applying these rates, China negotiated the applicable tariff rates for CKD and SKD kits with an individual auto manufacturer, which resulted in the tariff rates for CKD and SKD kits substantially below those for motor vehicles for certain auto manufacturers.[1092] After 1995, China eliminated the tariff lines for CKD and SKD kits, but still did *not* apply the tariff rates applicable to motor vehicles for CKD and SKD kits and continued to apply tariff rates for CKD and SKD kits (and parts) that were negotiated between an individual auto manufacturer and the Chinese authorities, as it did in the period from 1992 to 1995. In the view of the United States, China continued these tariff practices through the time of China's accession to the WTO and post-accession until China began to implement the measures at issue in this dispute.[1093]

7.729 **Canada** submits that in China's 1995 Customs Tariff, parts to manufacture certain vehicles could be classified as unassembled (i.e. CKD), which would result in the payment of lower duties than for an assembled vehicle.[1094] According to Canada, starting in 1996, references to CKDs were removed from China's customs tariff, and China's evidence on how CKD kits were treated after this point is contradictory. China asserts without evidence either that CKD and SKD kits were prohibited from importation, or that they were classified as whole vehicles. However, Canada argues that

[1091] United States' comments on China's response to Panel question No. 2, referring to Exhibit CHI-30.

[1092] United States' comments on China's response to Panel question No. 3. The United States submits that the key factors in the negotiation were the amount of the auto manufacturer's investment in China and the extent to which the auto manufacturer used local content in the assembly of its vehicles, both at the time of negotiation and under the auto manufacturer's future plans. According to the United States, "normally, an auto manufacturer with a larger amount of investment and a larger percentage of local content would be able to negotiate a lower tariff rate than would an auto manufacturer with a smaller amount of investment and a smaller percentage of local content. Particularly for the auto manufacturers that the Chinese authorities viewed as committed to China based on these factors, the negotiated tariff rates for CKDs and SKDs were substantially below the tariff rates for motor vehicles. In addition, the Chinese authorities would normally apply the same negotiated tariff rates for parts, as the negotiated tariff rates were often also below the tariff rates for parts set forth in China's tariff schedule."

[1093] United States' comments on China's responses to Panel question Nos. 2, 254, also referring to Exhibit JE-25, page 189; Response to Panel question No. 254. The United States considers that China's tariff practices relating to CKD and SKD kits (and parts) during the period from 1992 until China's accession to the WTO at the end of 2001 help to explain why paragraph 93 of the Working Party Report accompanying China's Protocol of Accession reads the way it does [Paragraph 93 of the Working Party Report: "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. If China created such tariff lines, the tariff rates would be no more than 10 per cent."]: "When negotiating this provision in the years leading up to China's WTO accession, WTO Members, including the United States, knew that China had separate tariff lines for CKD and SKD kits that scheduled tariff rates that were the same as those for motor vehicles from 1992 to 1995, and that China eliminated these tariff lines effective 1 January, 1996. WTO Members also knew that the Chinese authorities had nevertheless been applying substantially lower tariffs for CKD and SKD kits (and parts) than for motor vehicles, both when China had separate tariff lines for CKD and SKD kits and when it did not. In negotiating paragraph 93, therefore, WTO Members wanted to ensure that China would continue to treat CKD and SKD kits essentially as parts for tariff purposes after acceding to the WTO and that China would be unable to re-establish separate tariff lines for CKDs and SKDs, at higher rates, if its policy focus changed as its domestic auto industry evolved."

[1094] Canada refers to Exhibit CHI-30, subheadings 8704.1010 and 8704.1020.

evidence shows that parts imported into China as CKDs and SKDs were not charged the whole vehicle rate, but were classified as parts.[1095]

7.730 **China** submits that in 2001, immediately prior to its accession to the WTO, the average applied tariff rate for "motor vehicles" was 63.6 per cent and the average *applied* tariff rate for "auto parts" was 24.7 per cent. According to China, there were no separate tariff lines for "CKD and SKD kits" in China's Tariff Code and CKD and SKD kits were classified as complete vehicles according to GIR 2(a) and were assessed at the tariff rates identical to those applicable to the corresponding complete vehicle model. In 2002, right after China's accession to the WTO, the average *bound* tariff rate for "motor vehicles" was 49.4 per cent, and the average *bound* tariff rate for "auto parts" was 20.4 per cent. There were no separate tariff lines for "CKD and SKD kits" in China's Tariff Code, and these were classified as motor vehicles in accordance with GIR 2(a).[1096] China has classified CKD and SKD kits as motor vehicles and assessed CKD and SKD kits at the applicable tariff rates for motor vehicles both prior[1097] and subsequent to its accession to the WTO.[1098]

7.731 The **Panel** notes from the parties' arguments as well as the evidence before us that China maintained separate tariff lines for CKD and SKD kits in its Schedule from 1991 to 1995 under the tariff headings for motor vehicles. The complainants do not dispute this fact, but argue that China still charged lower tariff rates for CKD and SKD kits than for motor vehicles.

7.732 For the period from 1996 to 2001 (China's accession to the WTO), all the parties agree that separate tariff lines for CKD and SKD kits ceased to exist in China's Schedule. In fact we find language in the text of 1994 China's Automobile Policy Order that prohibits CKD and SKD kits imports.[1099] Regardless of the prohibition of CKD and SKD kits imports, China does not deny that such kits were still imported. The complainants and China however dispute how China in fact "treated" CKD and SKD kits during this period: the complainants submit that regardless of whether China maintained separate tariff lines for CKD and SKD kits in its Schedule, China normally applied

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[1095] Canada refers to China's first written submission, paras. 40, 184; the factual background section jointly submitted by the complainants; Canada's first written submission, footnote 36; Canada's response to Panel question No. 61(a).

[1096] China's response to Panel question No. 2. The average *applied* tariff rate for "motor vehicle" was 42.2%, and the average tariff rate for "auto parts" was 18.1% in 2002.

[1097] China explains, however, that prior to its accession to the WTO, China:

> "… maintained policies that allowed a limited number of auto manufacturers to obtain temporary reductions in the duty rates for *motor vehicles* that would ordinarily apply to the importation of CKD/SKD kits. These reduced rates for a limited number of auto manufacturers were not the rates for parts, and were not based on a classification of CKD/SKD kits as parts. After the expiration of these reductions in the applicable duty rate, these manufacturers would revert to paying the applicable *motor vehicle* rate for CKD/SKD imports, in accordance with the ordinary classification of CKD/SKD kits. …" (China's comments on complainants' responses to Panel question No. 254).

[1098] China's response to Panel question No. 254. In support of its submission, China puts forward two specific CKD import entries: one from 2001, before China acceded to the WTO (CHI-47), and one from 2004, after China had joined the WTO (Exhibit CHI-48).

[1099] Article 43 of China's 1994 Policy Order (Exhibit JE-24) provides:

> "Article 43 An automobile enterprise shall not engage in assembly through import of semi-knocked-downs (SKD) or completely knock-downs (CKD)".
>
> Also see footnote 172 and paragraph 7.3 above.

tariff rates substantially lower than those for complete motor vehicles to CKD and SKD kits based on the negotiations China reached with individual automobile manufacturers in China, whereas China submits that it always classified CKD and SKD kits imports as complete motor vehicles and applied the corresponding tariff rates to CKD and SKD kits.[1100]

7.733 The complainants' argument is therefore that China normally "treated" CKD and SKD kits imports with substantially lower tariff rates than complete motor vehicles since 1996 and prior to China's accession to the WTO. However, the complainants have not been able to provide specific evidence that can support their position, not to mention any evidence indicating how China "classified" CKD and SKD kits during this period.[1101]

7.734 On the other hand, China has provided us with a copy of an import declaration form showing that a CKD kit import was "classified" as and assessed at the tariff rate for a complete motor vehicle prior to its WTO accession.

7.735 In sum, the evidence before us (i.e. China's tariff schedule from 1991 to 1995 and an import declaration form classifying a CKD kit as a motor vehicle prior to China's accession) demonstrates that prior to and at the time of China's accession to the WTO, China classified CKD or SKD kits as motor vehicles. Therefore, in our view, China's classification practice in respect of CKD or SKD kits prior to and at the time of China's accession confirms our conclusion above that CKD and SKD kits could fall within the scope of China's commitment under the tariff headings for motor vehicles of its Schedule of Concessions.

[1100] See, however, footnote 1097 above, containing China's explanation that prior to its accession to the WTO China "allowed a limited number of auto manufacturers to obtain temporary reductions in the duty rates for *motor vehicles* that would ordinarily apply to the importation of CKD/SKD kits."

[1101] In this regard, we note that the complainants refer to two articles – one on "Market and Institutional Regulation in Chinese Industrialization, 1978-94" (Exhibit JE-25) and another on "Different Strategies of Localization in the Chinese Auto Industry: The Cases of Shanghai Volkswagen and Tianjin Daihatsu" (Exhibit CDA-28) – to support their position that China has been treating CKD and SKD kits imports with lower tariff rates than complete motor vehicles. In our view, however, these articles do not define the term "CKD or SKD kits" and use the term more in a general sense without necessarily confining its scope to a particular collection of auto parts that could be considered as falling within the scope of a CKD or SKD kit as discussed in this dispute. According to these articles, imported parts could be considered as constituting CKD or SKD kits even if the final assembled vehicle would consist of 40 per cent of domestic parts and 60 per cent of imported parts. However, we recall our finding above in paragraph 7.644 that the term CKD and SKD kit is understood as referring to "all, or nearly all, of the auto parts and components necessary to assemble a complete vehicle". For this reason, it is not clear to us whether these articles are referring to imported CKD and SKD kits as defined in these reports.

We also have taken note of Canada's argument based on the import statistics for motor vehicles from Canada (Exhibit CDA-32) that CKD kits imports from Canada could not have been classified as motor vehicles unless they were valued at US$12 each, because 23,000 CKD kits were imported to China in 1999 when the value of imports of motor vehicles (HS headings 87.02 to 87.05) from Canada in 1999 was only US$279,000. However, Exhibit CDA-32 shows that the sum of imported motor vehicles falling under HS heading 87.02 to 87.05 amounts to more than US$5 million. Due to the inaccuracy of the data referred to by Canada, we cannot draw any conclusion from this specific evidence on how China classified CKD kits in 1999.

Finally, Canada has not provided any documentary evidence regarding China's treatment of CKD and SKD kits after its accession in its response to Panel question No. 61(b).

At the same time, we note China's explanation that prior to its accession to the WTO China "allowed a limited number of auto manufacturers to obtain temporary reductions in the duty rates for *motor vehicles* that would ordinarily apply to the importation of CKD/SKD kits" (see footnote 1097 above).

(c) Conclusion

7.736 For the reasons set forth above, the **Panel** considers that the term "motor vehicles" under relevant tariff headings of 87.02, 87.03 and 87.04 does not preclude CKD and SKD kits from its scope under China's Schedule. Therefore, we find that the complainants have not proved that China's tariff treatment of CKD and SKD kits under Article 2(2) of Decree 125 and Article 13(a) of Announcement 4 is inconsistent with China's obligation under Article II:1(b) of the GATT 1994.

4. Is China's treatment of CKD and SKD kit imports under the measures consistent with China's commitment under paragraph 93 of China's Working Party Report?

7.737 As noted above in paragraph 7.648, under the measures, China accords CKD and SKD kits the tariff rate applicable to motor vehicles (i.e. 25 per cent on average).

7.738 The **United States** and **Canada** submit that China's tariff treatment of CKD and SKD kits under the measures is inconsistent with its commitment under paragraph 93 of China's Working Party Report.[1102]

7.739 **China** argues that it has not violated its commitment under paragraph 93 of the Working Party Report since the condition underlying China's commitment under paragraph 93 has not occurred.

7.740 All parties agree that China's commitments under its Working Party Report are enforceable in WTO dispute settlement proceedings.[1103] The Accession Protocol is an integral part of the WTO Agreement pursuant to Part I, Article 1.2 of the Accession Protocol. In turn, paragraph 342 of China's Working Party Report incorporates China's commitments under its Working Party Report, including paragraph 93, into the Accession Protocol. Therefore, China's commitment in paragraph 93 of the Working Party Report is also an integral part of the WTO Agreement.[1104]

7.741 Accordingly, the Panel will interpret China's commitment under paragraph 93 of the Working Party Report in accordance with the interpretative rules of the *Vienna Convention* to determine whether China has acted inconsistently with commitments under paragraph 93 of the Working Party Report.

(a) What is China's commitment under paragraph 93 of the Working Party Report?

7.742 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

[1102] While referring to paragraph 93 of China's Working Party Report in support of its argument under Article II:1 of the GATT 1994 in respect of CKD and SKD kits, the European Communities has not made a separate claim under paragraph 93 of the Working Party Report. (European Communities' first written submission, para. 274). Also, see the European Communities' request for the establishment of a panel (WT/DS339/8). See also footnote 987 above.

[1103] Parties' responses to Panel question No. 154.

[1104] United States' first written submission, paras. 119, 120; Canada's first written submission, paras. 75-77, 149. China considers it appropriate for dispute settlement panels to take into account the context of a commitment made in a working party report, and to exercise special care in interpreting these commitments (China's first written submission, para. 189).

> 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." (emphasis added)

7.743 Under paragraph 93 of China's Working Party Report, therefore, China is committed to the application of the "tariff rates" of no more than 10 per cent to CKD and SKD kits, if China creates separate tariff lines for such kits. In other words, China's commitment is conditioned upon the creation of separate tariff lines for CKD and SKD kits, which did not exist at the time of China's accession to the WTO. To determine whether China has violated its commitment under paragraph 93, we will first consider whether the condition underlying China's commitment under paragraph 93 has been satisfied.

(b) Has China created tariff lines for CKD and SKD kits?

7.744 All the parties have initially agreed that China has not created separate tariff lines for CKD and SKD kits in its Schedule in the sense that China has not formally created separate tariff lines by amending its Schedules.[1105]

7.745 The **United States** and **Canada** have nevertheless claimed that China has created a tariff line for CKD and SKD kits by introducing the measures at issue. According to the United States and Canada, the measures do in effect specify a tariff line for CKD and SKD kits that imposes a 25 per cent customs duty and thus they have *de facto* created a tariff line for CKD and SKD kits.[1106]

7.746 **China** submits that a Member cannot create a new tariff line *de facto* and that the process of creating a new tariff line involves amending the Member's Schedule to include the new tariff line.[1107] Specifically, China has explained that under China's domestic law, the Ministry of Finance issues a revised tariff schedule each year, which reflects China's Schedule of Concessions.[1108] If China were to introduce a new tariff line, it would include the new tariff line in the next tariff schedule issued by the Ministry of Finance. The Chinese Finance Ministry has not issued any revised tariff schedule with a new tariff line for CKD and SKD kits. China argues that, by its ordinary meaning, paragraph 93 contains a premise and a conditional commitment: namely at the time of accession, China did not

[1105] Parties' response to Panel question No. 61(a). Specifically, regarding whether China has created tariff lines for CKD and SKD kits, the parties have provided the following responses: **China** has responded, "No. China has not created separate tariff lines for CKD and SKD kits"; the **European Communities** has responded, "No, the European Communities is not aware of any formal tariff line created by China for CKD and SKD kits. ..."; the **United States** has responded, "the United States is not aware of any tariff lines in China's tariff schedule for CKD or SKD kits. ... "; and **Canada** has responded, "China does not have a formal tariff line for either CKDs or SKDs. However, in its customs tariff for 1995, China did have separate tariff lines differentiating between certain whole vehicles and CKDs at the eight-digit level, while other descriptions of a particular tariff line included the term 'CKD' in their description. ..."

[1106] United States' first written submission, para. 121; Canada's first written submission, para. 150. The United States submits that 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 CKDs and SKDs that imposes a 25 per cent tariff, rather than a 10 per cent tariff as required under the Working Party Report. Canada submits that the Working Party Report makes it clear that China committed to charging no more than 10 per cent for parts imported as CKD kits and SKD kits. Since 10 per cent is the tariff rate for the vast majority of parts, whereas the rate for whole vehicles is 25 per cent, the necessary interpretation is that China would continue to treat CKD and SKD kits as parts, charging no more than 10 per cent. China's failure to do so violates its obligations under *the WTO Agreement*.

[1107] China's responses to Panel question Nos. 137 and 259(b).

[1108] China's response to Panel question No. 259.

maintain separate tariff lines for CKD and SKD kits, and that if China were to create separate tariff lines for CKD and SKD kits after accession, the tariff rates would be no more than 10 per cent. On the basis of this interpretation, China argues that since it has not created separate tariff lines for CKD and SKD kits, whether through the challenged measures or otherwise, the condition underlying the commitment made in paragraph 93 of the Working Party Report has not occurred.[1109]

7.747 In its comments on China's response to a Panel question after the second substantive meeting, however, **Canada** submits that China has, for the first time, provided evidence of its classification and duty assessment of CKD kits in response to a question from the Panel and that this evidence establishes that China in fact created separate tariff lines for CKD and SKD kits:[1110] China's own evidence from December 2004 (Exhibit CHI-48) shows that the shipment in question was classified under a separate tariff line (8703.2334.90) – "CKD for Buick 2800cc cars". Introducing tariff lines at the "national level" (i.e. beyond the six-digit level) is precisely how WTO Members create separate tariff lines for unassembled vehicles. Therefore, according to Canada, paragraph 93 of China's Working Party Report requires China to apply a 10 per cent duty rate for those tariff lines. Moreover, Canada submits that to confirm that China's introduction of tariff lines for CKD kits was not limited to 2800cc cars, Canada has obtained a copy of China's Customs Tariff for 2005, which shows that 10-digit tariff lines ending in ".90" are generally for CKD and SKD kits (or "complete sets of assemblies", as they are described in the tariff).[1111]

7.748 First, the **Panel** notes that the condition giving rise to China's obligation in paragraph 93 is the "creation" of tariff lines, not modification of a Member's Schedule of Concessions.[1112] To determine whether China has created tariff lines for CKD and SKD kits, we will begin our analysis by describing tariff lines in Members' Schedules.

7.749 The majority of the WTO Members, including China, are also contracting parties to the HS Convention.[1113] In this context, although no legal definition of "tariff lines" appears to exist in the HS Convention, those Members who are HS contracting parties are required to respect the HS codes at the six-digit level in accordance with Article 3 of the HS Convention.[1114] Member countries are

[1109] China further submits that the complainants' effort to establish China's pre-accession practice of classifying CKD and SKD kits as parts and assessing these entries at the tariff rates for parts is fundamentally irrelevant – in no event is it possible to interpret paragraph 93 as committing China to continue something that it was already doing, and in no event is it possible to read the express conditionality of the commitment out of paragraph 93 (China's comments on the complainants' responses to Panel question No. 254). China argues that as irrelevant as it is, the complainants have not, in fact, presented any evidence of this alleged practice.

[1110] Canada's comments on China's response to Panel question No. 254.

[1111] Canada's comments on China's response to Panel question No. 254, referring to "Customs Import and Export Tariff of the People's Republic of China, 2005, Economic Science Publishing House" (Exhibit CDA-48).

[1112] Modification of a Member's Schedule is addressed in Article XXVIII of the GATT 1994. Article XXVIII:1 provides:

> "1. On the first day of each three-year period, ... a contracting party ... may, by negotiation and agreement with any contracting party with which such concession was initially negotiated and with any other contracting party determined by the CONTRACTING PARTIES to have a principal supplying interest ..., and subject to consultation with any other contracting party determined by the CONTRACTING PARTIES to have a Substantive interest in such concession, modify or withdraw a concession included in the appropriate schedule annexed to this Agreement."

[1113] See paragraph 7.665 above.

[1114] Article 3(1)(a) of the HS Convention provides:

however allowed to create their own headings and subheadings beyond the six-digit level. Canada also submits that it is common customs practice to have separate tariff lines beyond the six-digit level.[1115] In addition, according to the HS Classification Handbook, further subdivisions of the HS nomenclature have to be introduced at the national level since the goods or categories of goods referred to in the national Customs tariff often do not coincide with the HS categories.[1116] Therefore, for the purpose of our analysis of China's commitment under pargraph 93 of China's Working Party Report, we understand "a tariff line" to mean a horizontal line in a tariff schedule that provides a specific heading number, regardless of the number of digits (i.e. be it at the eight-digit or ten-digit level), and a specific tariff rate for the product described under that heading.

7.750 As noted above, all the parties do not dispute that China did not have separate tariff lines for CKD and SKD kits in its Schedule of Concessions at the time of accession to the WTO.[1117] Canada has however presented a copy of China's Customs Import and Export Tariff for 2005 in which separate tariff headings at the ten-digit level are included for "complete sets of assemblies" for motor vehicles.[1118] For example, under tariff heading 87.03 ("Motor cars and other motor vehicles

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> "(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".

[1115] Canada's second written submission, para. 67.

[1116] Exhibit CDA 16 (*HS Classification Handbook*, Part II, Chapter 4, page II/27). Canada's second written submission, para. 67, footnote 79; Canada's response to Panel question No. 259(d). Also see Panel Report on *EC – Chicken Cuts*, para. 7.11.

[1117] A copy of China's Schedule of Concessions, submitted as attachment to the complainants' first written submissions (Exhibit JE-2), confirms the absence of separate tariff lines for CKD and SKD kits at the time of China's accession to the WTO.

[1118] Exhibit CDA-48 (Customs Import and Export Tariff of the People's Republic of China, 2005, Economic Science Publishing House) (Canada's comments on China's response to Panel question No. 254, footnote 135). After the second substantive meeting, the Panel sent out a second set of written questions to the parties. The parties submitted their responses to this second set of questions on 26 July 2007, and were given an opportunity to provide their comments on each others' responses to Panel questions by 9 August 2007 in accordance with the Panel's timetable in this dispute. It is in its comments on China's response to Panel question No. 254 that Canada submitted a copy of Customs Import and Export Tariff of the People's Republic of China, 2005 published by the Economic Science Publishing House, as Exhibit CDA-48. Afterwards, the Panel posed one additional question to the parties (Panel question No. 304) on 6 August 2007. The parties provided their responses to this additional question by 31 August 2007 and their comments on each others' responses by 10 September 2007. China has not provided the Panel with any comments on the status or content of Exhibit CDA-48 since Canada provided a copy of Exhibit CDA-48 on 9 August 2007.

The Panel further notes that paragraph 13 of the Panel's working procedures provides:

> "The parties shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to factual evidence necessary for purposes of

principally designed for the transport of persons"), there are tariff headings at the ten-digit level such as 8703.2130.90 and 8703.2334.90 with the description code indicating "complete sets of assemblies". Considering that the same tariff heading 8703.2334.90, which is shown in the import declaration form mentioned in the following paragraph, is described as "CKD for Buick 2800cc cars", we consider it reasonable to understand that the description "complete sets of assemblies" in China's Customs Import and Export Tariff for 2005 refers to CKD and SKD kits.

7.751 We also recall China's acknowledgment that it has been classifying CKD and SKD kits as complete vehicles since the entry into force of the measures. This is evinced by an import declaration form submitted by an automobile manufacturer in China, in which the shipment was classified under the tariff line 8703.2334.90 as "CKD for Buick 2800cc cars".[1119]

7.752 In light of the available evidence above, therefore, we consider that China has created separate tariff lines for CKD and SKD kits in its tariff schedule at the ten-digit level and thus has met the condition under paragraph 93.

7.753 Furthermore, even setting aside the evidence showing China's creation of tariff lines for CKD and SKD kits, the United States and, initially, Canada also argued that China's measures *de facto* created tariff lines for CKD and SKD kits. What the complainants argue in this context is that China has "in fact" created tariff lines for CKD and SKD kits, which did not exist at the time of China's accession to the WTO, by implementing the measures at issue.

7.754 As examined in paragraph 7.648 above, CKD and SKD kits are classified as motor vehicles under China's measures, namely Article 21(1) of Decree 125, which consequentially leads to the imposition on such kits of the tariff rates applicable to motor vehicles.[1120] In this respect, the question is therefore whether a tariff line can be deemed created when a Member introduces a measure through which it effectively classifies a good under a specific tariff line and applies a tariff rate under that tariff line, which deviates from the commitment it made at the time of accession.

7.755 We consider that the answer is positive, as under the measures, China mandates its customs to classify CKD and SKD kits under tariff lines for motor vehicles. Specifically, Article 21(1) of Decree 125 provides that imports of CKD or SKD kits for the purpose of assembling vehicles must be characterized as complete vehicles. In turn, under the measures, "auto parts characterized as complete vehicles" are subject to the tariff rates for motor vehicles.[1121] Moreover, China has itself explained that an automobile manufacturer who declares imports of CKD or SKD kits as auto parts characterized as complete vehicles under Article 2(2) of Decree 125 pays the duty at the tariff rates

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rebuttals, answers to questions or comments on answers provided by others. Exceptions to this procedure will be granted upon a showing of good cause. In such cases, the other parties shall be accorded a period of time for comment, as appropriate."

Therefore, it would seem that China could have invoked this provision to provide its comment, if any or necessary, on the status and/or content of this evidence (a copy of Customs Import and Export Tariff of the People's Republic of China, 2005) submitted by Canada. In any event, in the absence of any contention by China on this evidence submitted by Canada, we see no reason to question the validity of the content of this evidence.

[1119] Exhibit CHI-48.

[1120] China's comments on the complainants' responses to Panel question No. 259(b). China points to Canada's statement that it does not believe that there is a legal concept of *de facto* creating a new tariff line (Canada's response to Panel question No. 259(b)).

[1121] Article 28 of Decree 125 provides that the customs shall *classify* "imported auto parts characterized as complete vehicles" as motor vehicles and *base* the tariff on rates applicable to complete vehicles.

applicable to complete vehicles at the time of importation.[1122] We also recall China's statement that the legal obligation of auto manufacturers to pay the applicable customs duties on imports of auto parts that have the essential character of a motor vehicle is set forth in Decree 125.[1123] Therefore, we are of the view that under the circumstances surrounding the measures at issue in this dispute, a tariff line for CKD and SKD kits can be deemed created through the measures since China effectively classifies such a kit under specific tariff lines and applies the tariff rates applicable under such tariff lines under the measures.

7.756 In this connection, we note China's argument that it has not created tariff lines for CKD and SKD kits because it has not *amended* its Schedule as required under China's domestic law to create new tariff lines. What is at issue in the present dispute is however China's commitment under the WTO Agreement, not whether China has satisfied its domestic procedures for creating new tariff lines. As China submits, satisfaction of the condition underlying the commitment in paragraph 93 rests with China as it is up to China to decide whether it wants to create tariff lines for CKD and SKD kits, which did not exist at the time of accession. However, once China has decided to initiate an action by enacting the measures at issue in 2004 and 2005 (3-4 years later from its accession to the WTO in 2001), through which it systematically gives CKD and SKD kits imports certain tariff lines, that very action, in our view, effectively creates tariff lines for CKD and SKD kits. Interpreting otherwise would render meaningless China's commitment contained in paragraph 93 of China's Working Party Report since China will always be able to resort to its domestic legal system to argue that it has never amended its Schedule and thus no tariff lines have been created. Given that the manner in which to create new tariff lines is something entirely within the discretion of China under its domestic legal system, we consider that the substantive effect of China's measures must be taken into account in assessing the realization of the condition underlying China's commitment in paragraph 93. Therefore, we are not persuaded by China's argument in this respect.

7.757 In light of the foregoing, therefore, we find that by creating separate tariff lines for CKD and SKD kits in its tariff schedule and by enacting the measures at issue, China has fulfilled the condition underlying China's obligation in paragraph 93 to apply no more than 10 per cent of tariff rates to CKD and SKD kits.[1124]

(c) Conclusion

7.758 For the reasons set forth above, the **Panel** finds that China has violated its commitment under paragraph 93 of China's Working Party Report, which is an integral part of the WTO Agreement[1125], that it will apply tariff rates of no more than 10 per cent to CKD and SKD kits if China creates tariff lines for CKD and SKD kits.

[1122] China has also stated that since its adoption of the measures, all imports of CKD and SKD kits have been made under Article 2(2) of Decree 125. Also see paragraph 7.72 above and China's response to Panel question No. 15.

[1123] China's response to Panel question No. 48.

[1124] In this connection, we recognize that whether separate tariff lines for CKD and SKD kits can be deemed created through the introduction of the measures within the meaning of paragraph 93 is a separate question from how China classifies CKD and SKD kits (i.e. either as "motor vehicles" or as "auto parts"). As we noted earlier, China's commitment concerned is the tariff treatment of no more than 10 per cent for CKD and SKD kits if China creates tariff lines for such kits, regardless of how China classified such kits.

[1125] See paragraph 7.740.

G. OTHER CLAIMS

7.759 In this section, the Panel addresses the remaining claims brought by the complaining parties.

1. European Communities (DS339)

7.760 The European Communities claims that China has acted inconsistently with its obligations under the WTO Agreement, as set out in Part I, paragraphs 1.2, 7.2 and 7.3 of China's Accession Protocol, by introducing measures that are inconsistent with Article III of the GATT 1994 and the TRIMs Agreement. Having found that the measures concerned in this dispute are inconsistent with Article III:2 and III:4 of the GATT 1994 and having exercised judicial economy with respect to the European Communities' claim under the TRIMs Agreement, the Panel does not consider it necessary to rule on the European Communities' claims concerning China's obligations under the Accession Protocol.

2. United States (DS340)

7.761 The United States claims in its request for the establishment of a panel that to the extent that the measures impose a charge on the importation of auto parts, China has acted inconsistently with Article XI:1 of the GATT 1994. However, in response to a question from the Panel, the United States has clarified that it does not pursue this claim in this proceeding.[1126]

7.762 The United States also claims that China has acted inconsistently with its obligations under the WTO Agreement, as set out in Part I, paragraphs 1.2, 7.2 and 7.3 of China's Accession Protocol, by introducing measures that cannot be justified under Article III of the GATT 1994 and the TRIMs Agreement. Having found that the measures are inconsistent with Article III:2 and III:4 of the GATT 1994 and having exercised judicial economy with respect to the United States' claim under the TRIMs Agreement, the Panel does not find it necessary to rule on the United States' claims concerning China's obligations under the Accession Protocol.

3. Canada (DS342)

7.763 Canada claims that China has acted inconsistently with Part I, paragraphs 1.2, 7.2 and 7.3 of China's Accession Protocol, through measures inconsistent with Article III of the GATT 1994 and the TRIMs Agreement. Having found that the measures concerned in this dispute are inconsistent with Article III:2 and III:4 of the GATT 1994 and having exercised judicial economy with respect to Canada's claim under the TRIMs Agreement, the Panel does not consider it necessary to rule on Canada's claims under China's Accession Protocol.

7.764 Furthermore, given that the Panel has found with respect to CKD and SKD kits that the measures are inconsistent with China's obligations under paragraph 93 of the Working Party Report, it is not necessary for the Panel to examine Canada's conditional claim that the measures constitute a non-violation nullification and impairment under Article XXIII:1(b) of the GATT 1994.

VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 The Panel recalls the United States' request pursuant to paragraph 18 of the Panel's Working Procedures that the Panel issue its findings in the form of a single document containing three separate reports with common sections on the Panel's conclusions and recommendations for each complaining

[1126] United States' response to Panel question No. 165.

party.[1127] The European Communities and Canada were in agreement with the Untied States' request.[1128] In accordance with the requests by the complaining parties, we therefore provide three separate sets of conclusions and recommendations.

A. COMPLAINT BY THE EUROPEAN COMMUNITIES (DS339): CONCLUSIONS AND RECOMMENDATIONS OF THE PANEL

(a) With respect to imported auto parts in general, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:2, first sentence of the GATT 1994 in that they subject imported auto parts to an internal charge in excess of that applied to like domestic auto parts;

(ii) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:4 of the GATT 1994 in that they accord imported auto parts less favourable treatment than like domestic auto parts; and

(iii) Policy Order 8, Decree 125 and Announcement 4 are not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with laws or regulations which are not inconsistent with the GATT 1994.

(b) *In the alternative*, assuming that the measures fall within the scope of the first sentence of Article II:1(b) of the GATT 1994, with respect to imported auto parts in general, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article II:1(a) and Article II:1(b), first sentence of the GATT 1994 in that they accord imported auto parts treatment less favourable than that provided for in the appropriate Part of China's Schedule of Concessions; and

(ii) Policy Order 8, Decree 125 and Announcement 4 are not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with laws or regulations which are not inconsistent with the GATT 1994.

(c) with respect to CKD and SKD kits, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are not inconsistent with Article II:1(b) of the GATT 1994.

8.2 With respect to the European Communities' claims that Policy Order 8, Decree 125 and Announcement 4 are inconsistent with the TRIMs Agreement and Article III:5 of the GATT 1994, the Panel has decided to exercise judicial economy.

[1127] See Section II.D above.

[1128] European Communities' comments on the draft descriptive part of the Panel Report (4 October 2007); Canada's comments on the draft descriptive part of the Panel Report (4 October 2007).

8.3 Under Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. The Panel concludes that, to the extent that the measures listed above are inconsistent with the GATT 1994, they have nullified or impaired benefits accruing to the European Communities under those agreements.

8.4 Accordingly, the Panel recommends that the Dispute Settlement Body request China to bring these inconsistent measures as listed above into conformity with its obligations under the GATT 1994.

B. COMPLAINT BY THE UNITED STATES (DS340): CONCLUSIONS AND RECOMMENDATIONS OF THE PANEL

(a) With respect to imported auto parts in general, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:2, first sentence of the GATT 1994 in that they subject imported auto parts to an internal charge in excess of that applied to like domestic auto parts;

(ii) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:4 of the GATT 1994 in that they accord imported auto parts less favourable treatment than like domestic auto parts; and

(iii) Policy Order 8, Decree 125 and Announcement 4 are not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with laws or regulations which are not inconsistent with the GATT 1994.

(b) *In the alternative*, assuming that the measures fall within the scope of the first sentence of Article II:1(b) of the GATT 1994, with respect to imported auto parts in general, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article II:1(a) and Article II:1(b), first sentence of the GATT 1994 in that they accord imported auto parts treatment less favourable than that provided for in the appropriate part of China's Schedule of Concessions; and

(ii) Policy Order 8, Decree 125 and Announcement 4 are not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with laws or regulations which are not inconsistent with the GATT 1994.

(c) with respect to CKD and SKD kits, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are not inconsistent with Article II:1(b) of the GATT 1994; and

(ii) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with China's commitment under paragraph 93 of China's Working Party Report, which is an integral part of the WTO Agreement.[1129]

8.5 With respect to the United States' claims that Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:5 of the GATT 1994, TRIMs Agreement and SCM Agreement, the Panel has decided to exercise judicial economy.

8.6 Under Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. The Panel concludes that, to the extent that the measures listed above are inconsistent with the GATT 1994 and China's commitment under its Working Party Report, they have nullified or impaired benefits accruing to the United States under those agreements.

8.7 Accordingly, the Panel recommends that the Dispute Settlement Body request China to bring these inconsistent measures as listed above into conformity with its obligations under the GATT 1994 and the WTO Agreement.[1130]

C. COMPLAINT BY CANADA (DS342): CONCLUSIONS AND RECOMMENDATIONS OF THE PANEL

(a) With respect to imported auto parts in general, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:2, first sentence of the GATT 1994 in that they subject imported auto parts to an internal charge in excess of that applied to like domestic auto parts;

(ii) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:4 of the GATT 1994 in that they accord imported auto parts less favourable treatment than like domestic auto part; and

(iii) Policy Order 8, Decree 125 and Announcement 4 are not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure compliance with laws or regulations which are not inconsistent with the GATT 1994.

(b) *In the alternative*, assuming that the measures fall within the scope of the first sentence of Article II:1(b) of the GATT 1994, with respect to imported auto parts in general, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article II:1(a) and Article II:1(b), first sentence of the GATT 1994 in that they accord imported auto parts treatment less favourable than that provided for in the appropriate part of China's Schedule of Concessions; and

(ii) Policy Order 8, Decree 125 and Announcement 4 are not justified under Article XX(d) of the GATT 1994 as measures that are necessary to secure

[1129] See paragraphs 7.740 and 7.758 above.
[1130] See paragraphs 7.740 and 7.758 above.

compliance with laws or regulations which are not inconsistent with the GATT 1994.

(c) with respect to CKD and SKD kits, the Panel concludes:

(i) Policy Order 8, Decree 125 and Announcement 4 are inconsistent with China's commitment under paragraph 93 of China's Working Party Report, which is an integral part of the WTO Agreement.[1131]

8.8 With respect to Canada's claims that Policy Order 8, Decree 125 and Announcement 4 are inconsistent with Article III:5 of the GATT 1994 and the TRIMs Agreement, the Panel has decided to exercise judicial economy.

8.9 Under Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. The Panel concludes that, to the extent that the measures listed above are inconsistent with the GATT 1994 and China's commitment under its Working Party Report, they have nullified or impaired benefits accruing to Canada under those agreements.

8.10 Accordingly, the Panel recommends that the Dispute Settlement Body request China to bring these inconsistent measures as listed above into conformity with its obligations under the GATT 1994 and the WTO Agreement.[1132]

[1131] See paragraphs 7.740 and 7.758 above.
[1132] See paragraphs 7.740 and 7.758 above.