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INDONESIA - CERTAIN MEASURES AFFECTING THE AUTOMOBILE INDUSTRY

REPORT OF THE PANEL

The report of the Panel on Indonesia - Certain Measures Affecting the Automobile Industry is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 2 July pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

Note by the Secretariat: This Panel Report shall be adopted by the Dispute Settlement Body (DSB) within 60 days after the date of its circulation unless a party to the dispute decides to appeal or the DSB decides by consensus not to adopt the report. If the Panel Report is appealed to the Appellate Body, it shall not be considered for adoption by the DSB until after the completion of the appeal. Information on the current status of the Panel Report is available from the WTO Secretariat.

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I. INTRODUCTION

A. Background

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1.1 On 4 October 1996, Japan requested consultations with Indonesia pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Article XXII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994") and Article 8 of the Agreement on Trade-Related Investment Measures (the "TRIMs Agreement") regarding certain measures affecting the automotive industry of Indonesia (WT/DS55/1).

1.2 On 29 November 1996, Japan requested additional consultations with Indonesia regarding the National Car Programme under Articles 1 and 4 of the DSU, Article XXII:1 of GATT 1994 and Articles 7 and 30 of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement") (WT/DS64/1).

1.3 On 5 November and 3 December 1996, Japan and Indonesia held the consultations requested on 4 October 1996. On 3 December 1996, also in Geneva, Japan and Indonesia held the consultations requested on 29 November 1996. No mutually satisfactory solution was reached.

1.4 On 17 April 1997, Japan requested the establishment of a panel, pursuant to Articles 4.7 and 6.1 of the DSU, Article XXIII:2 of GATT 1994, Article 8 of the TRIMs Agreement, and Article 30 of the SCM Agreement. Japan requested the panel to examine the consistency of various measures under the National Car Programme with Articles I:1, III:2, III:4, X:1 and X:3(a) of GATT 1994, Article 2 of the TRIMS Agreement, and Articles 3.1(b) and 28.2 of the SCM Agreement.

2. Complaint of the European Communities

1.5 On 3 October 1996, the European Communities requested consultations with Indonesia pursuant to Article 4 of the DSU, Article XXII of GATT 1994, Article 8 of the TRIMs Agreement and Articles 7 and 30 of the SCM Agreement, with respect to certain measures affecting the automobile industry (WT/DS54/1).

1.6 The European Communities and Indonesia held consultations on 6 November 1996 and on 5 December 1996. No mutually satisfactory solution was reached.

1.7 On 12 May 1997, the European Communities requested the establishment of a panel pursuant to Article XXIII:2 of GATT, Article 6 of the DSU, Article 8 of the TRIMs Agreement (to the extent that it incorporates by reference Article XXIII of GATT) and Articles 7.4 and 30 of the SCM Agreement (to the extent that Article 30 incorporates by reference Article XXIII of GATT). The European Communities requested the panel to examine the consistency of the measures identified with Articles I:1, III:2 and III:4 of GATT 1994, and Article 2 of the TRIMS Agreement. The European Communities also requested the panel to examine its complaint that the measures identified constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement which cause "serious prejudice" to the Community's interest in the sense of Article 6 of that Agreement.

1.8 The European Communities also requested, in conjunction with its request for establishment of a panel, that the Dispute Settlement Body initiate the procedure provided in Annex V of the SCM Agreement pursuant to point 2 of that Annex.

3. Complaint of the United States

1.9 On 8 October 1996, the United States requested consultations with Indonesia pursuant to Articles 1 and 4 of the DSU, Article XXII:1 of GATT 1994, Article 8 of the TRIMs Agreement (to the extent it incorporates by reference Article XXII of the GATT 1994), Articles 7 and 30 of the SCM Agreement (to the extent Article 30 incorporates by reference Article XXII of the GATT 1994), and Article 64 of the TRIPS Agreement (to the extent it incorporates by reference Article XXII of the GATT 1994) regarding certain measures affecting trade and investment in the motor vehicle sector (WT/DS59/1).

1.10 The United States and Indonesia held consultations on 4 November 1996 and 4 December 1996, but failed to reach a mutually satisfactory solution.

1.11 On 12 June 1997, the United States requested the establishment of a panel pursuant to Article 6 of the DSU, Article XXIII:2 of the GATT 1994, Article 8 of the TRIMs Agreement (to the extent it incorporates by reference Article XXIII of the GATT 1994), Articles 7.4 and 30 of the SCM Agreement (to the extent Article 30 incorporates by reference Article XXIII of the GATT 1994), and Article 64 of the TRIPS Agreement (to the extent it incorporates Article XXIII of the GATT 1994). The United States requested the panel to examine the consistency of the measures identified with Articles I:1, III:2, III:4 and III:7 of GATT 1994, Articles 3, 20, and 65 of the TRIPs Agreement, Article 28.2 of the SCM Agreement, and Article 2 of the TRIMS Agreement. The United States also requested the panel to examine its complaint that the measures identified constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement which cause "serious prejudice" to the United States' interest in the sense of Article 6 and 27 of that Agreement.

1.12 The United States also requested, in conjunction with its request for establishment of a panel, that the Dispute Settlement Body initiate the procedure provided in Annex V of the SCM Agreement pursuant to point 2 of that Annex. The United States noted that this procedure had already been invoked in the context of the European Communities' parallel request for establishment of a panel, and requested that the information-gathering process on the United States and European Communities claims be combined into a single exercise.

B. Establishment and Composition of the Panel

1.13 At its meeting on 12 June 1997, the DSB established a panel pursuant to requests by Japan and the European Communities (WT/DS55/6-WT/DS64/4, and WT/DS54/6, respectively). At its meeting of 30 July 1997, the DSB agreed to the United States' request for establishment of a panel (WT/DS59/6), and also agreed, as provided for in Article 9 of the DSU in respect of multiple complainants, that the Panel established on 12 June 1997 to examine the complaints by Japan and the European Communities would also examine the United States' complaint.

1.14 The terms of reference of the Panel are the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Japan in document WT/DS55/6-WT/DS64/4, by the European Communities in document WT/DS54/6, and by the United States in document WT/DS59/6, the matter referred to the DSB by Japan, the European Communities and the United States 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".

1.15 Pursuant to a joint request by Japan and the European Communities, and as provided for in paragraph 7 of Article 8 of the DSU, on 29 July 1997 the Director-General composed the Panel as follows:

Chairman: Mr. Mohamed Maamoun Abdel Fattah

Members: Mr. Ole Lundby

Mr. David John Walker

1.16 India and Korea reserved their rights as third parties to the dispute.

C. Information-Gathering Procedure under Annex V of the SCM Agreement

1.17 At its meeting of 12 June 1997, the DSB agreed to the European Communities' request for the initiation of the Annex V procedure, and pursuant to paragraph 4 of Annex V, designated Mr. Stuart Harbinson as its representative for purposes of that procedure.

1.18 The 60-day period for the information-gathering procedure provided for in Annex V to the SCM Agreement with respect to the European Communities' complaint began on the date of establishment of the Panel to hear the European Communities' and Japan's claims, 12 June 1997, and ended on 11 August 1997.

1.19 The United States also invoked the 60-day information-gathering procedure provided for in Annex V to the SCM Agreement. Because the United States joined the dispute as a party only on 30 July 1997, the 60-day period related to its claims was a separate, later period, which ended 22 September 1997. All parties agreed that first submissions by complainants should be due four weeks after the end of the second phase of the Annex V procedure (related to the United States' claims), so that all information developed through that procedure could be used in the preparation of the first submissions. This postponement of the deadline for first submissions, to take account of both phases of the Annex V procedure, necessitated an equal postponement of the rest of the Panel's timetable.

D. Panel Proceedings

1.20 The Panel met with the parties on 3/4 December 1997 and on 13/15 January 1998. The Panel met with the third parties on 4 December 1997.

1.21 On 11 December 1997, the Chairman of the Panel informed the DSB that the Panel would not be able to issue its report within six months of the composition and establishment of the terms of reference of the Panel. The reasons for the delay are the postponement of the schedule due to the Annex V procedure, as discussed above and set forth in WT/DS55/9-WT/DS64/7-WT/DS54/9-WT/DS59/8.

II. FACTUAL ASPECTS

2.1 This dispute concerns a series of measures maintained by Indonesia with respect to motor vehicles and parts and components thereof. The following is a summary of the factual information presented to the Panel, with respect to the tax and tariff treatment of imported motor vehicles and parts and components thereof, and with respect to the measures at issue.

A. Tax and Tariff Treatment in Indonesia of Imported Completely Built-Up Motor Vehicles

2.2 Completely Built-Up motor vehicles ("CBUs") imported into Indonesia are subject to luxury tax as set forth in Table 10 below, as well as to import duties. Indonesia's current import duty rates on CBUs are as follows:

Table 1
Import Duty Rates on CBUs

Vehicle Category	Import Duty
Motor Vehicles for the Transport of Persons Sedan (Unit)	200%
Commercial Motor Vehicles[1] Category I (Unit) Category II/III (Unit) Category IV (Unit) Category V (Unit)	80% 70% 105% 5%

B. Measures at Issue

2.3 The measures at issue are the measures comprising: (1) "the 1993 Incentive System", which was amended in 1995 and 1996 (referred to herein as the "1993 programme"), (2) "the National Car Programme", which encompasses the so-called "February 1996 programme" and "the June 1996 programme", and (3) a $US690 million loan[2] to PT Timor Putra Nasional ("PT TPN" or "TPN"). All complainants raise claims with respect to the National Car Programme, and the European Communities and the United States also raise claims with respect to the 1993 programme. In addition, the United States raises claims with respect to the $US690 million loan. These measures can be summarized as follows:

1. "1993 Programme"

2.4 In 1993, Indonesia adopted the so-called 1993 Incentive System. The 1993 Incentive System consists of:

(a) import duty relief (reductions or exemptions) on imports of automotive parts and accessories based on (1) the per cent of local content of the finished motor vehicle in which the parts are used, and (2) the type of vehicle in which the parts are used.

[1] The commercial vehicle categories are defined as follows:
I Gross Vehicle Weight up to 5 tons, with single drive-axles.
II Gross Vehicle Weight exceeding 5 tons up to 10 tons.
III Gross Vehicle Weight exceeding 10 tons up to 24 tons.
IV Gross Vehicle Weight up to 5 tons, with double drive-axles.
V Gross Vehicle Weight exceeding 24 tons.

[2] These designations are used in this report for convenience. The United States has argued that the National Car Programme is all a single programme, comprised of the February 1996 measures, the June 1996 measures and the $US690 million loan to TPN. Japan's view is that most of Government Regulation No. 20/1996 and Government Regulation No. 36/1996 are not related to "national motor vehicles" and are outside the scope of the "National Car Programme".

(b) import duty relief on imports of “subparts” used to make automotive parts and accessories based on (1) the per cent of local content of the completed part or accessory, and (2) the type of motor vehicle in which the part or accessory is used.

(c) exemption from or reduction of luxury sales tax on goods for certain categories of motor vehicles.

(a) Decree No. 114/1993

2.5 The first decree in the 1993 programme was Minister of Industry Decree No. 114/M/SK/6/1993 (June 9, 1993) (“The Determination of Local Content Levels of Domestically Made Motor Vehicles or Components”).[3] Decree No. 114/1993 defines "local components" or "local sub components" as "parts or sub parts of Motor Vehicles which are domestically made and have Local Contents at a level of more than 40 per cent for [light commercial vehicles and passenger cars] ... ".[4] The decree sets forth import duties dependent on specified local content rates for passenger cars, commercial vehicles, and automotive parts and components.

2.6 The local content rates and corresponding import duty rates applicable under this decree to parts for passenger cars are set forth below:

Table 2
Passenger Car Parts

Local Content Rates	Import Duty Rates
less than 20%	100%
20% to 30%	80%
30% to 40%	60%
40% to 60%	40%
more than 60%	0%

Thus, if the local content of a passenger car was less than 20 per cent, the importer paid an import duty of 100 per cent on imported parts, etc.

2.7 The local content rates and corresponding import duty rates applicable under this decree to parts for light commercial vehicles are set forth below:

[3] Indonesia Exhibit 8.

[4] As used herein, the term "light commercial vehicles" refers to commercial motor vehicles with a gross vehicle weight up to 5 tons with single axle drives and commercial motor vehicles with a gross vehicle weight up to 5 tons with double axle drives, including such vehicles as jeeps, vans, minivans, sports utility vehicles, etc. The term "passenger car" as used herein refers to sedans and station wagons.

Table 3
Light Commercial Vehicle Parts

Local Content Rates	Import Duty Rates
less than 20%	40%
20% to 30%	30%
30% to 40%	20%
more than 40%	0%

2.8 The local content rates and corresponding import duty rates applicable under this decree to parts for subparts for passenger cars and light commercial vehicles are set forth below:

Table 4
Subparts of Passenger Cars and Light Commercial Vehicles

Local Content Rates	Import Duty Rates
less than 20%	40%
20% to 30%	30%
more than 30% up to 40%	20%
more than 40%	0%

(b) Decree No. 645/1993

2.9 The purpose of the second decree forming part of the 1993 Programme, Minister of Finance Decree No. 645/KMK.01/1993 (June 10, 1993) ("The Relief of Import Duty on the Import of Certain Parts and Accessories of Motor Vehicles for the Purpose of Automotive Assembling and/or Manufacture"), is to authorize the incentives identified above under Decree No. 114/1993.[5]

[5] Indonesia Exhibit 36.

(c) Decree No. 647/1993

2.10 A third decree forming part of the 1993 Programme, Minister of Finance Decree No. 647/KMK.04/1993 (June 10, 1993) ("The Kinds and Types of Motor Vehicles Subject to Sales Tax on Luxury Goods") provides reduced Indonesian sales tax on luxury goods for motor vehicles with specified local content rates.[6] Specifically, passenger cars with cylinder capacities of 1600cc or less and jeeps are subject to a luxury tax of 20 per cent provided that their local content exceeds 60 per cent.[7] (An exception is made for motor vehicles used for public purposes, such as police vans, ambulances, fire-engines, etc.). If the local content is not in excess of 60 per cent, the applicable luxury tax rate is 35 per cent.

2.11 The local content rates and corresponding luxury tax rates applicable under this decree to passenger cars with cylinder capacities of 1600 cc or less and jeeps are set forth below:

Table 5
Passenger Cars < 1600 cc and Jeeps

Local Content Rates	Luxury Tax Rate
greater than 60%	20%
60% or less	35%

(d) Decree No. 223/1995

2.12 In 1995, through Minister of Finance Decree No. 223/KMK.01/1995 (May 23, 1995) ("The Improvement of Decree of the Minister of Finance Number 645/KMK.01/1993 on the Relief of Import Duty on Parts and Accessories of Motor Vehicles for the Purpose of Automotive Assembly and/or Manufacture"), Indonesia modified the schedule of import duty rates corresponding to specified local content rates.[8] The local content rates and corresponding import duty rates for imported parts used in the manufacture or assembly of passenger cars and commercial vehicles were modified as set forth below:

Table 6
Parts for Passenger Cars and Commercial Vehicles

Sedans and station wagons (HS 87.03)

Local content (%)	Import duty (%)
less than 20	65
20-30	50
30-40	35
40-50	20
50-60	10
More than 60	0

[6] Indonesia Exhibit 33.

[7] Article 3 of Decree No. 647/1993 defines "jeeps" as "multi-purpose four wheeled motor vehicles, with double differential gears, chassis, total g.v.w. of 5 (five) tons or less and capacity of transporting less than 10 (ten) people.

[8] Indonesia Exhibit 27.

Pick-ups (HS 87.04), Minibuses (HS 87.02 or 87.03) and Jeeps (HS 87.03)

Local content (%)	Import duty (%)
Less than 20	25
20-30	15
30-40	10
more than 40	0

Buses (HS 87.02) and Trucks (HS 87.04) with a total weight of more than 5 tons but not more than 24 tons

Local content (%)	Import duty (%)
Less than 20	25
20-30	15
more than 30	0

Two-wheeled motor vehicles (HS 87.11)

Local content (%)	Import duty (%)
Less than 20	25
20-30	15
30-40	10
more than 40	0

2.13 The local content rates and corresponding import duty rates for imported subparts used in the manufacture or assembly of parts and accessories for passenger and commercial vehicles were modified as set forth below:

Table 7
Subparts of Passenger and Commercial Vehicles

Sedans and Station wagons (HS 87.03), Pick-ups (HS 87.04), Minibuses (HS 87.02 or 87.03) and Jeeps (HS 87.03)

Local content (%)	Import duty (%)
Less than 20	25
20-30	15
30-40	10
more than 40	0

Buses (HS 87.02) and Truck (HS 87.04) with a total mass of more than 5 tons but not more than 24 tons

Local content (%)	Import duty (%)
Less than 10	25
10-20	15
more than 20	0

Two wheel motor vehicles (HS 87.11)

Local content (%)	Import duty (%)
less than 20	25
20-30	15
30-40	10
more than 40	0

(e) Decree No. 36/1997

2.14 Minister of Finance Decree No. 36/KMK.01/1997 (January 21, 1997) ("The Granting of Import Duty Relief to Certain Parts and Accessories of Motor Vehicles for the Assembly and or Manufacturing of Motor Vehicles")[9] reissues the schedule of import duty relief set forth in Decree No. 223/1995 in light of changes in the underlying customs statutes.

2. "The National Car Programme"

2.15 Two sets of measures have been identified by all parties under the 1996 National Car programme:

2.16 The first set of measures - the February 1996 Programme - provides for the grant of "pioneer" or National Car company status to Indonesian car companies that meet specified criteria as to ownership of facilities, use of trademarks, and technology. Maintenance of pioneer status is dependent on the National Cars' meeting increasing local content requirements over a three year period. The benefits provided are exemption from luxury tax on sales of National Cars, and exemption from import duties on parts and components.

2.17 The second set of measures - the June 1996 Programme - provides that National Cars manufactured in a foreign country by Indonesian nationals and which fulfil the local content requirements prescribed by the Minister of Industry and Trade, shall be treated the same as National Cars manufactured in Indonesia, i.e. exempt from import duties and luxury tax. In accordance with Decree 142/96, imported National Cars are deemed to comply with the 20 per cent local content requirement for the end of the first production year if the overseas producer manufacturing the National Cars "counter-purchases" Indonesian parts and components that account for at least 25 per cent of the C&F value of the imported cars.

2.18 The United States alleges a third element of the National Car Programme - a series of loans, totalling US$690 million with a maturity of 10 years, made on 11 August 1997, to TPN (the only pioneer company) for TPN to carry out the national car project. The loans allegedly were made by a consortium of state-owned and private banks at the direction of the Government of Indonesia, with the state-owned banks providing at least 50 per cent of the financing.

(a) "The February 1996 Programme"

2.19 The so-called February 1996 programme consists of a series of decrees and regulations published in February and March 1996.

(1) Presidential Instruction No. 2/1996

2.20 Presidential Instruction No. 2/1996 ("The Development of the National Automobile Industry") was issued on 19 February, 1996.[10] The purpose of Presidential Instruction No. 2/1996 is "to continue to strengthen the self-reliance of the nation, particularly in providing means of land transportation in the form of the production of a national car . . . " Presidential Instruction No. 2/1996 directs the Minister of Industry and Trade, the Minister of Finance, and the State Minister for the Mobilization of Investment Fund/Chairman of Capital Investment Coordinating Board to implement a series of "provisions."

2.21 First, Presidential Instruction No. 2/1996 directs these ministers collectively to implement "measures in close coordination to realize as fast as possible the development of the national car

[9]Indonesia Exhibit 9.
[10]Indonesia Exhibit 1.

industry, which meets the following criteria: (a) the use of a brand name of its own; (b) domestically produced; (c) the use of components which are domestically produced."

2.22 Second, Presidential Instruction No. 2/1996 directs the Minister of Industry and Trade "to foster, guide and grant facilities, in accordance with the use of provisions of laws in effect such that the national car industry: (a) uses a brand name of its own; (b) uses components produced domestically as much as possible; (c) is able to export its products."

2.23 Third, Presidential Instruction No. 2/1996 directs the Minister of Finance to "grant the following facilities in the field of taxation in accordance with regulations in force: (a) import duty exemption for importation of components produced domestically as much as possible which still need to be imported; (b) the assessment of the Value Added Tax at the rate of 10 per cent upon the delivery of the produced automobiles; (c) payment of the Sales Tax on Luxury Goods which is owed upon the delivery of the produced automobiles will be borne by the Government."

(2) Decree No. 31/1996

2.24 Also on 19 February 1996, Indonesia issued Minister of Industry and Trade Decree No. 31/MPP/SK/2/1996 ("The National Motor Vehicle").[11] Decree No. 31/1996 identifies its purpose as "to implemen[t] Presidential Instruction No.2 of 1996 on the Development of the National Car Industry ... in the framework of promoting industry ... ."

2.25 Decree No. 31/1996 sets forth the requirements for designation as a "national motor vehicle". Specifically, national motor vehicles are those which:

(a) are made domestically at production facilities owned by national industrial enterprises or Indonesian corporations, the shares of which are wholly owned by Indonesian citizens;

(b) use "a brand name of its own which has never been registered by any other party in Indonesia and which is owned by an Indonesian companies/citizen"; and

(c) are "developed with technology, construction, design and engineering based on national capability applied by stages."

The Decree also provides that "the motor vehicle industrial enterprise which produces national motor vehicles in accordance with the requirements set forth in Article 1 will be granted the status of 'Pioneer enterprise'."

2.26 Decree No. 31/1996 sets forth a schedule of local content rates to be achieved by a "national motor vehicle industrial enterprise given 'Pioneer status'":

[11]Indonesia Exhibit 2.

Table 8
Local Content Schedule for National Motor Vehicle

Time Period	Local Content Rate
end of the first year	> 20%
end of the second year	> 40%
end of the third year	> 60%

(3) Decree No. 82/1996

2.27 The third measure issued on February 19, 1996, was Decree of the Minister of Finance No. 82/KMK.01/1996 ("The Improvement of the Decree of the Minister of Finance No. 645/KMK.01/1993 on the Grant of Import Duty Relief to Certain Parts and Components of Motor Vehicles for the Assembly Purposes and/or Manufacture of Motor Vehicles as Previously Improved by the Decree of the Minister of No. 223/KMK.01/1995").[12] Decree No. 82/1996 establishes that parts and components imported by a producer/assembler of National Cars, for assembly or manufacture of National Cars fulfilling the local content rates identified above, are exempted from import duties.

(4) Government Regulation No. 20/1996

2.28 The final measure issued on February 19, 1996, was Government Regulation No. 20 ("The Amendment of Government Regulation No. 50 of 1994 Regarding the Implementation of Law No. 8 of 1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as Amended by Law No. 11 of 1994").[13] By this regulation, National Cars fulfilling the specified requirements, including local content rates, were exempted from luxury tax.

2.29 Thus, Regulation No. 20/1996 established the following luxury tax structure:

[12]Indonesia Exhibit 21.
[13]Indonesia Exhibit 20.

Table 9
Luxury Tax Rate Schedule

Type of Motor Vehicle	Luxury Tax Rate
passenger cars > 1600cc jeeps with local content ≤ 60%	35%
light commercial vehicles (other than jeeps) using diesel	25%
passenger cars ≤ 1600cc jeeps with local content > 60% light commercial vehicles (other than jeeps) using gas	20%
national motor vehicles	0%

(5) Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No. 01/SK/1996

2.30 On 27 February 1996, Indonesia issued Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No. 01/SK/1996 ("Investment Regulations Within the Framework of the Realization of the Establishment of the National Automobile Industry").[14] The decree provided that "to realise the establishment of [a] national car industry, the investment approval will be issued to the automobile industry sector with tax facilities in accordance with legal provisions enacted specifically for that purpose."

(6) Ministry of Industry and Trade Decree No. 002/SK/DJ-ILMK/II/1996

2.31 On 27 February 1996, Decree No. 002/SK/DJ-ILMK/II/1996 of the Ministry of Industry and Trade was issued.[15] This Decree designated PT Timor Putra Nasional ("TPN") as "a pioneer national motor vehicle enterprise." On 5 March 1996, Decision No. 02/SK/1996 of the State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board was issued. This decision designated TPN "to establish and produce a National Car."

2.32 The National Car, the "Timor", was to be based on the design and other technology of the Kia Sephia, model produced by Kia Motors of Korea. The Timor was to be produced initially in knock-down form in Korea by Kia Motors, for export to Indonesia, where it was to be assembled at TPN's facility at Karawang, Indonesia. (At the time that the February 1996 programme was announced, construction of this facility had not yet begun.) TPN was to gradually increase the level of local content of the Timor.

(b) "The June 1996 Programme"

2.33 The so-called June 1996 programme comprises a series of decrees issued in June 1996.

[14]Indonesia Exhibit 4.
[15]Indonesia Exhibit 41.

(1) Presidential Decree No. 42/1996

2.34 On 4 June 1996, Presidential Decree No. 42/1996 ("The Production of National Cars") was issued.[16] This Decree No. 42/1996 stated that:

> National cars which are made overseas by Indonesia workers and fulfil the local content stipulated by the Minister of Industry and Trade will be treated equally to those made in Indonesia.

In other words, National Cars in fully built-up form could be imported free of duty and luxury tax, if they were made by Indonesian personnel and fulfilled the local content requirements for the National Car.

2.35 This Decree also provided that this tax and duty exemption would be granted only once for a maximum period of one year, and would involve a total number of vehicles to be stipulated by the Minister of Industry and Trade. In Minister of Industry and Trade Decree No. 1410/MPP/6/1996 (30 June 1996)[17], TPN was authorized to import 45,000 Timors pursuant to Decree No. 42/1996.

(2) Regulation No. 36/1996

2.36 Also on 4 June 1996, Indonesia issued Government Regulation No. 36/1996 ("The Amendment of Government Regulation No. 50 of 1994 on the Implementation of Law No. 8 of 1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as Amended by Law No. 11 of 1994, as Lastly Amended by Government Regulation No. 20/1996").[18] Regulation No. 36/1996 made further revisions to the luxury tax on motor vehicles, which, as discussed, had been most recently revised on 19 February 1996, in Regulation No. 20/1996.

2.37 Regulation No. 36/1996 established the following luxury tax schedule:

[16]Indonesia Exhibit 6.
[17]Indonesia Exhibit 13.
[18]Indonesia Exhibit 3.

Table 10
Luxury Tax Rate Schedule

Type of Motor Vehicle	Luxury Tax Rate
passenger cars ≥ 1600cc. passenger cars with local content ≦ 60%. jeeps with local content ≦ 60%. buses with local content ≦ 60%.	35%
combis, minibuses, vans and pick-ups using diesel as fuel, with local content ≦ 60%.	25%
combis, minibuses, vans and pick-ups using gasoline as fuel with local content ≦ 60%.	20%
sedans and station wagons < 1600cc manufactured in Indonesia with local content > 60%. combis, minibuses, vans and pick-ups using gasoline or diesel as fuel, manufactured in Indonesia with local content with local content > 60%. buses manufactured in Indonesia. motorcycles < 250cc manufactured in Indonesia. national motor vehicles.	0%

(3) Decree No. 142/1996

2.38 As indicated, Presidential Decree No. 42/1996 permitted the "national motor vehicle" to be produced abroad for a period of one year and still receive the duty and tax benefits of the National Motor Vehicle programme, if the local content requirements for the National Car (20 per cent local content for the first year) were met and the car was produced by Indonesian personnel.

2.39 The Decree of the Minister of Industry and Trade No. 142/MPP/Kep/6/1996, issued 5 June 1996 ("The Production of the National Cars")[19] established guidelines for meeting the local content requirement referred to in Decree 42/1996. Decree No. 142/1996 provides that "the production of national cars can be carried out overseas ... on the condition that Indonesian parts and components are used", and then states further that "[t]he procurement of Indonesian-made parts and components shall be performed through the system of counter purchase of parts and components of motor vehicles by the overseas company carrying out the production and reexporting of national cars to Indonesia." In addition, the decree states that "[t]he value of the counter purchase ... shall be fixed at the minimum of 25% (twenty-five per cent) of the import value of the national cars assembled abroad (C&F value)."

2.40 In other words, counter purchases by the overseas producer of the National Car of Indonesian motor vehicle parts and components worth at least 25 per cent of the C&F import value of the imported National Cars would satisfy the local content requirements for the National Car.

[19]Indonesia Exhibit 7.

(4) Audit of TPN's performance under Decree 142/1996

2.41 Indonesia has submitted a letter to the Panel dated January 1998, containing the results of an audit of TPN's compliance with the counterpurchase requirement of Decree No. 142/1996. The letter indicates that TPN was found in the audit not to have met the counterpurchase requirement.

3. The US$690 million loan to TPN

2.42 The United States' claims include one additional measure, which it characterizes as a further component of the National Car Programme: a loan provided on 11 August 1997. According to the United States, at the direction of the Indonesian Government a consortium of four government-owned banks and twelve private banks decided to disburse US$650 million in ten-year loans to TPN to carry out the national car project. The United States also asserts that one of the Government-owned banks involved previously had disbursed a US$40 million bridging loan to TPN, bringing the total loan amount to US$690 million. According to the United States, the loans reportedly will carry an annual interest rate of 3 per cent over the 3-6 month deposit rate, a maturity of 10 years, and a grace period of 3 years, and the four government-owned banks will provide one-half of the $650 million loan.

2.43 On 25 February 1998, Indonesia notified the Subsidies Committee that, as of 21 January 1998, it had terminated all subsidies previously granted under the National Car programme. On 2 March 1998, Indonesia notified the Panel and requested the Panel to terminate the dispute settlement proceeding, at least as it relates to the 1996 National Car programme measures.

C. Notifications by Indonesia to WTO Committees

2.44 On 23 May 1995, Indonesia made a notification with respect to the 1993 Incentive System to the TRIMs Committee under Article 5.1 of the TRIMs Agreement (G/TRIMS/N/1/IDN/1). On 28 October 1996, Indonesia notified the TRIMs Committee that it was “withdrawing” its notification related to automobiles because it considered that its programme was not a TRIM (G/TRIMS/N/1/IDN/1/Add.1); on the same day Indonesia made a notification with respect to its 1993 Incentive System and its 1996 National Car programme to the SCM Committee (G/SCM/N/16/IDN).

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES[20]

A. Japan

3.1 **Japan** requests the Panel to find that:

(a) the luxury sales tax exemption with regard to domestically produced National Cars pertaining to the February 1996 National Car Programme measures identified[21] is inconsistent with Article III:2 of GATT 1994, since imported automobiles are subject to luxury sales tax in excess of that applied to the like domestic products (i.e. National Cars);

(b) the local content requirements with regard to domestically produced National Cars pertaining to the February 1996 National Car Programme measures identified are inconsistent with Article III:4 of GATT 1994, since the requirements accord to products

[20]The descriptions in this section of the findings and recommendations requested by the parties are as they appear in the parties' submissions. These descriptions do not necessarily correspond to the parties' claims as identified in their requests for a panel.

[21]Decree Nos. 114/1993, 645/1993.

imported from Japan treatment less favourable than that accorded to like domestic products;

(c) the local content requirements and the exemption from customs tariff and luxury sales tax pertaining to the February 1996 National Car Programme measures identified are trade related investment measures as stipulated in paragraph 1(a) of the Illustrative List annexed to the TRIMs Agreement, and are therefore inconsistent with Article 2 of the TRIMs Agreement;

(d) the customs tariff exemption with regard to the import of automotive parts and components and the sales tax exemption pertaining to the February 1996 National Car Programme measures identified are inconsistent with Article I:1 of GATT 1994, since the exemptions are not accorded to the like products originating in all other members including Japan;

(e) the exemption from customs tariff and sales tax granted under the extended National Car Programme of June 1996[22] solely to the completed automobiles originating in the Republic of Korea is inconsistent with Article I:1 of GATT 1994, since the exemption is not accorded to the like products originating in other Members including Japan;

(f) the extended National Car Programme measures were not promptly published and have not been administered in a uniform, impartial and reasonable manner, thus being inconsistent with Articles X:1 and X:3(a) of GATT 1994.

3.2 **Japan** requests that the Panel recommend that Indonesia bring its measures into conformity with its obligations under GATT 1994 and the TRIMs Agreement.

B. European Communities

3.3 The **European Communities** requests the Panel to find that:

(a) Indonesia violates the provisions of Article III:2, first sentence, by exempting from the luxury sales tax the sales of the following categories of motor vehicles:

(i) domestically manufactured motor cycles with engines of 250 cc or less;

(ii) combines, minibuses, vans and pick-ups using gasoline as fuel which are manufactured domestically and have a local content of more than 60 per cent;

(iii) combines, minibuses, vans and pick-ups using diesel oil as fuel which are manufactured domestically and have a local content of more than 60 per cent;

(iv) domestically manufactured buses;

(v) domestically manufactured sedans and stations wagons of less than 1,600 cc with a local content of more than 60 per cent;

(vi) National Cars assembled in Indonesia by pioneer companies; and

[22]Presidential Decree No. 42/1996, Decree No. 142/1996.

(vii) imported National Cars.

(b) the following measures favour the "use" by Indonesian car manufacturers of domestic parts and components over "like" imported parts and components and are, accordingly, inconsistent with Article III:4 of GATT:

(i) the exemption from the luxury sales tax of locally manufactured combines, minibuses, vans and pick-ups with more than 60 per cent local content;

(ii) the exemption from the luxury sales tax of locally manufactured sedans and stations wagons of less than 1,600 cc with more than 60 per cent local content;

(iii) the exemption from the luxury sales tax of National Cars assembled in Indonesia by pioneer companies meeting certain local content requirements;

(iv) the exemption from the luxury sales tax of National Cars assembled in Korea by "overseas producers" meeting certain counter-purchasing obligations;

(v) the grant of import duty relief to parts and components used in the assembly of motor vehicles (or of other parts and components for the assembly of motor vehicles) in Indonesia based on the finished vehicles (or the parts and components) meeting certain local content requirements;

(vi) the exemption from import duties for parts and components used for the assembly of National Cars in Indonesia by pioneer companies meeting certain local content obligations.

(c) the following measures are inconsistent with Indonesia's obligations under Article I:1 of GATT:

(i) the exemption from customs duties on imports of National Cars;

(ii) the exemption from the sales tax on luxury goods for imported National Cars;

(iii) the exemption from the sales tax on luxury goods for National Cars assembled in Indonesia; and

(iv) the exemption from customs duties on imports of parts and components for the assembly of National Cars in Indonesia.

(d) the measures listed in paragraph b. above are also TRIMs inconsistent with Article III of GATT and, accordingly, that by applying those measures Indonesia is in violation of its obligations under Article 2.1 of the TRIMs Agreement.

(e) the following incentives granted to PT TPN under the National Car Programme constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement and cause "serious prejudice" to the interests of the Community in the sense of Article 5(c) of that Agreement:

(i) customs duty relief for parts and components intended for assembly into National Cars;

(ii) exemption from the luxury sales tax for National Cars;

(iii) customs duty relief for National Cars imported from Korea.

C. United States

3.4 The **United States** requests the Panel to find that:

(a) Indonesia's system of tariff and tax incentives under the 1993 Incentive System[23] and National Car programmes[24] and the government-directed $690 million loan to TPN are inconsistent with Article III:4 of GATT 1994 and are not covered by Article III:8 of GATT 1994;

(b) Indonesia's discriminatory application of the luxury sales tax is inconsistent with Article III:2, first sentence, of GATT 1994;

(c) alternatively, Indonesia's discriminatory application of the luxury sales tax is inconsistent with Article III:2, second sentence;

(d) Indonesia's exemption of CBU Kia Sephia sedans imported from Korea from import duties and the luxury sales tax violates Article I:1 of GATT 1994.

(e) Indonesia's system of tariff and tax incentives under the 1993 Incentive System and National Car programmes and the government-directed $690 million loan to TPN are inconsistent with Article 2 of the TRIMs Agreement;

(f) Indonesia's grant of "national motor vehicle" benefits only to motor vehicles bearing a unique Indonesian trademark owned by Indonesian nationals discriminates against foreign-owned trademarks and their owners and is inconsistent with Articles 3, 20 and 65 of the TRIPS Agreement;

(g) Indonesia has extended the scope of its tariff and tax subsidies in a manner inconsistent with Article 28.2 of the SCM Agreement.

(h) Indonesia's subsidies under the National Motor Vehicle Programme have caused serious prejudice to the interests of the United States within the meaning of Articles 6 and 27 of the SCM Agreement;

(i) Indonesia's subsidies under the National Motor Vehicle Programme have caused a threat of serious prejudice to the interests of the United States within the meaning of Articles 6 and 27 of the SCM Agreement.

3.5 The **United States** requests that the Panel recommend that Indonesia bring its measures into conformity with its obligations under GATT 1994, the TRIMs Agreement, the TRIPS Agreement, and the SCM Agreement.

[23]Decrees No. 114/1993, 645/1993, 647/1993, 223/1995, 36/1997, and Regulation 36/1996.

[24]Decrees No. 82/1996, 31/1996, 42/1996. 36/1996, 142/1996, Regulations 20/1996 and 36/1996, and Presidential Instruction No. 2/1996.

3.6 The **United States** also requests that the Panel recommend, pursuant to Article 7.8 of the SCM Agreement, that Indonesia take appropriate steps to remove the serious prejudice and the threat of serious prejudice or withdraw its subsidies.

D. Indonesia

3.7 **Indonesia** requests the Panel to reject the complainants' assertions and find that the 1993 incentive programme and the 1996 National Car programme are allowable subsidies under the Subsidies Agreement and do not violate any provisions of GATT 1994, the TRIMs Agreement, or the TRIPs Agreement.

IV. REQUESTS FOR PRELIMINARY RULINGS

A. Participation of Private Lawyers

4.1 On 25 November 1997, Indonesia provided to the Panel a list of its delegation to the first meeting of the Panel with the parties. On 28 November 1997, the United States, in a letter to the Chairman of the Panel, noted that Indonesia's delegation list included several private lawyers, and objected to the participation of these non-governmental employees in meetings of the Panel. On 1 December 1997 and 3 December 1997, Indonesia submitted letters to the Chairman of the Panel, responding to the objection raised by the United States. At its first substantive meeting with the parties, the Panel heard arguments of the parties and made a ruling on this issue.[25]

1. Objection of the United States

4.2 The following are the arguments of the **United States** in support of its objection:

4.3 The issue of the participation of private lawyers in panel meetings was addressed by the panel in the Bananas case (WT/DS27/R/USA, adopted 25 September 1997, para. 7.10-7.12). In that case, following the objections of the complainants, the panel limited attendance at panel meetings to members of governments. In so ruling, the panel made the following observations, among others:

- Past practice in GATT and WTO dispute settlement has been not to admit private lawyers to panel meetings if any party objected to their presence.

- Because private lawyers may not be subject to disciplinary rules such as those that applied to members of governments, their presence in panel meetings could give rise to concerns about breaches of confidentiality.

- The admission of private lawyers to panel meetings, if it became a common practice, would not be in the interest of small Members as it could entail disproportionately large financial burdens for them.

- The panel had concerns about whether the presence of private lawyers would change the intergovernmental character of WTO dispute settlement proceedings.

- Limiting attendance at panel meetings to members of governments would not in any respect adversely affect the right of parties or third parties to meet and consult with their private lawyers in the course of panel proceedings, nor to receive legal or other advice in the preparation of written submissions from non-governmental experts.

[25] See Findings, section XIV.A.1, for this ruling.

4.4 These observations of the Bananas panel are equally applicable to this Autos dispute. Moreover, while the Appellate Body ruled that private lawyers could participate in the Appellate Body hearing in Bananas, the Appellate Body carefully limited its ruling to proceedings of the Appellate Body, not panels, and took pains to note that it was not dealing with an appeal of the panel's ruling in Bananas concerning the participation of private lawyers in panel meetings. (WT/DS27/AB/R, adopted 25 September 1997, para. 11). While the United States does not agree with the Appellate Body's limited ruling, that ruling is distinguishable from the present case in that the entire Appellate Body process is a new process for which prior GATT practice, arguably, does not provide an appropriate guide.

4.5 However, the panel process is not new, and there is no basis at this time for the WTO to change its established practice in this area. If a change is to be made in WTO dispute settlement practice, such a change must be negotiated and agreed in the context of the review of the WTO dispute settlement rules and procedures scheduled to be completed by the end of 1998. A change of this magnitude would entail a fundamental alteration of the premises underlying WTO dispute settlement and its operation, and would erode the control of governments over what has been a well-functioning government-to-government process for the peaceful settlement of disputes.

4.6 Moreover, the fact that the private lawyers in question attended the consultations in the Autos dispute is neither relevant nor dispositive for purposes of this panel proceeding. Indonesia conditioned its agreement to consult on the presence of these individuals. Even then, however, there was an understanding between the United States and Indonesia that the private lawyers would not address the United States delegation, and that should they do so, the United States delegation would not respond. As a result, the private lawyers were limited to the role of communicating with their client.

4.7 Therefore, the United States objects to the participation of non-governmental employees in meetings of the Panel in the Autos dispute and requests the Panel to make a finding with respect to this matter prior to the 3 December 1997, meeting of the Panel with the parties.

2. Response of Indonesia

4.8 In its letter dated 1 December 1997, **Indonesia** made the following arguments:

4.9 The Government of the Republic of Indonesia has the sovereign right to determine the composition of its delegations to, and select its spokesmen at, all meetings of WTO bodies and organs. This sovereign right is based on the customary international law principle of the sovereign equality of states.

4.10 Moreover, it is recognized in the practice of international dispute tribunals, including the Appellate Body of the WTO. In upholding the right of Saint Lucia to include non-government legal counsel on its delegation for the Appellate Body hearing and to allow counsel to speak at the hearing in the EU Bananas proceeding, the Appellate Body stated:

4.11 On 15 July 1997, the Appellate Body notified the participants and third participants in this appeal of its ruling that the request by Saint Lucia would be allowed. The Appellate Body said the following:

> ... we can find nothing in the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), the DSU or the Working Procedures, nor in customary international law or the prevailing practice of international tribunals, which prevents a WTO Member from determining the composition of its delegation in Appellate Body proceedings. Having carefully considered the request made by the Government of Saint Lucia, and the responses dated 14 July 1997 received from Canada; Jamaica; Ecuador; Guatemala; Honduras;

> Mexico and the United States, we rule that it is for a WTO Member to decide who should represent it as members of its delegation in an oral hearing of the Appellate Body.
>
> * * * * *
>
> We note that there are no provisions in the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), in the DSU or in the Working Procedures that specify who can represent a government in making its representations in an oral hearing of the Appellate Body. With respect to GATT practice, we can find no previous panel report which speaks specifically to this issue in the context of panel meetings with the parties. We also note that representation by counsel of a government's own choice may well be a matter of particular significance - especially for developing country Members - to enable them to participate fully in dispute settlement proceedings.
>
> WT/DS27/AB/R (9 September 1997) at paras. 10 and 12.

4.12 Thus, the Appellate Body fully rejected the bases and logic of the underlying panel report, upon which the United States bases its objection. In this regard, my Government wishes to reiterate, first, that the individuals in question are retained by the Government of the Republic of Indonesia and, obviously, are completely subject to its direction, not the other way around. Thus, the "intergovernmental character" of the panel process will not be disturbed by their participation. Indeed their participation is required to preserve the "intergovernmental character" of the process by helping to ensure that my Government is able to achieve its goals in the process. Second, as the United States well knows, these individuals are subject to the strict confidentiality requirements set forth under the United States legal system. Moreover, they are contractually bound to my Government to maintain the confidentiality of the proceeding. Will any of the other participants in the proceeding be so bound? If anything, the inclusion of respected private attorneys will reduce the breaches of confidentiality that occur in panel proceedings. Third, the Government of the Republic of Indonesia is perfectly capable of making independent financial decisions regarding contracting legal or other experts and any attempt by the United States to insert itself into this area is insulting and misplaced. This point, in particular, highlights the inappropriateness of the United States, as Indonesia's opponent in this proceeding, having any say whatsoever in Indonesia's composition of its defence team. Finally, the decision of the Appellate Body emphasizes the importance of full - not partial - participation by accredited counsel.

4.13 The United States ignores the logic of this decision and attempts to avoid its application to the instant proceeding, even though every rationale noted by the Appellate Body applies here in full. Moreover, the Appellate Body noted that the issue of private counsel participation before the Panel had not been appealed by a party to the EU Bananas dispute because the Member state which included the private attorney in its delegation, Saint Lucia, was a third party to the dispute and the issue had not been directly appealed by the Respondent. (The respondent in the EU Bananas dispute was, in any case, the European Communities which, like the United States and Japan, maintains an army of attorneys with WTO expertise and thus has no need for private assistance to defend its interests before the WTO.) The decision of the Appellate Body in the EU Bananas proceeding therefore should guide the Panel in rejecting the United States' objection.

4.14 The right to determine the composition of delegations to meetings with the Panel in dispute settlement proceedings is particularly important for developing countries like Indonesia. These WTO members do not have at their disposal specially trained and highly experienced corps of WTO legal experts. The only way Indonesia can obtain full and effective representation in this dispute is by retaining outside legal experts, which it has done. Effective legal representation, chosen by the party participating in the dispute is as necessary for the legitimacy of the WTO dispute settlement process as it

is for the legitimacy of any dispute settlement process. The United States' arguments to the contrary are absurd.

4.15 The United States cannot deny that under customary international law Indonesia has the sovereign right to compose its delegation to panel meetings in this dispute. The United States does not and cannot cite anything in the Marrakesh WTO Agreement, the DSU or the Working Procedures of this Panel that limits this sovereign right. Nor does or can the United States cite to any Panel decision or recommendation that limits the right and permits challenges to the credentials or qualifications of accredited delegates. All that the United States can do is to point to past GATT practice. The mere fact that previously no country has formally maintained its opposition to challenges to its sovereign right to compose its delegation cannot be the basis for extinguishing Indonesia's insistence on the exercise of that right now. This is particularly true because, unlike the old GATT regime, decisions by Panels (and the Appellate Body) under the DSU are legally binding and the basis for retaliation if not implemented. In short, Members did not deem the right to counsel so important when they could simply block a negative panel decision and be done with it.

4.16 In its letter dated 3 December 1997, **Indonesia** made the following arguments:

(a) General principles of international law support Indonesia's sovereign right to select counsel of its choice and organize and present its defence

4.17 The principle of "sovereign equality of states" provides that all states are free to choose representation of their choice before international adjudicatory bodies or subsidiary organs of international organizations. This principle is an accepted rule of customary international law. Thus, Indonesia has an absolute right to compose its own delegations to meetings of international organizations, including WTO dispute settlement proceedings.

4.18 The United Nations International Law Commission (the ILC) expressly recognized the importance of the principle of sovereign equality of states in technical proceedings such as WTO dispute settlement. In his Fifth Report on Relations Between States and International Organizations, the Special Rapporteur explains the rationale for this principle as follows:

> [T]he sending State should have a wider freedom of choice with respect to the members of its delegations to organs of international organizations and to conferences convened by such organizations [as compared with members of permanent missions]. One of the salient features of present-day international relations is the increasing number of subsidiary organs set up by international organizations to deal with very specialized matters of highly technical character which require the enlisting of the services of experts possessing the necessary training and experience ... . For these reasons it is highly desirable, if not indispensable, that the sending States should enjoy the widest possible freedom in the choice of the members of its delegations to such organs and conferences.[26]

4.19 The Report recognizes that a country may need to include outside experts in its delegation in order to deal effectively with the increasingly specialized nature of subject matters addressed by international fora. WTO dispute settlement proceedings are exceedingly specialized and complex proceedings that involve a wide range of technical trade, economic and legal issues that must be litigated under highly technical procedural rules and requirements. This is exactly the type of proceeding where the ILC declared that specialized expertise is indispensable.

[26]See Yearbook of the International Law Commission, 1970, Vol. II, p. 19 (emphasis added).

(b) Practice before international adjudicatory bodies confirms Indonesia's right

4.20 The principle of sovereign equality of states is fully consistent with the practice of every major international dispute settlement tribunal and international organization. These practices support Indonesia's right to include outside private attorneys in its delegation to the WTO. Each of the following international dispute settlement tribunals and international organizations permits states complete freedom in composing their delegations:

Dispute resolution tribunals

- International Court of Justice;
- International Centre for Settlement of Investment Disputes;
- Permanent Court of Arbitration;
- European Court of Human Rights;
- Inter-American Court of Human Rights;
- United Nations Compensation Commission; and
- Iran-United States Claims Tribunal

Other international organizations

- United Nations;
- Food and Agriculture Organization;
- International Labour Office;
- International Telecommunication Union;
- United Nations Conference on Trade and Development;
- World Intellectual Property Organization; and
- Organization of American States.

4.21 In sum, no tribunal or organization (other than North American Free Trade Agreement in certain proceedings) limits in any way a state's decision to accredit outside counsel as members of its delegation. Nor does any limit the degree of counsel's involvement in a dispute proceeding. The absence of restrictions in all the major dispute resolution tribunals and other organizations is consistent with the general principle of customary international law that recognizes the sovereign right of countries to accredit representatives of their choosing to represent them in international fora.

(c) The WTO Appellate Body supports Indonesia's right

4.22 On 15 July 1997, the Appellate Body in the EU Banana Regime proceeding allowed outside counsel for the ACP States, not only to attend the oral proceedings but also to present the ACP States' legal case. The Appellate Body disagreed with the Panel's reasoning in denying outside counsel's participation in the Panel proceeding and concluded:

> ... we can find nothing in the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), the DSU or the Working Procedures [of the Panel], nor in customary international law or the prevailing practice of international tribunals, which prevents a WTO Member from determining the composition of its delegation in Appellate Body proceedings ... we rule that it is for a WTO Member to decide who should represent it as members of its delegation in an oral hearing of the Appellate Body.[27]

[27]Report of the Appellate Body in the EU Banana Regime, para. 10.

4.23 In addition, we note that the Appellate Body recognized the importance of representation by counsel of a government's own choice not only in the Appellate Body proceedings, but also during the entire dispute settlement proceeding, including the Panel proceeding. Moreover, the Appellate Body emphasized the crucial nature of this right for developing countries, such as Indonesia, in particular. According to the Appellate Body:

> We also note that representation by counsel of a government's own choice may well be a matter of particular significance - especially for developing-country Members - to enable them to participate fully in dispute settlement proceedings. Moreover, given the Appellate Body's mandate to review only issues of law or legal interpretation in panel reports, it is particularly important that governments be represented by qualified counsel in Appellate Body proceedings.[28]

4.24 The Appellate Body recognizes that each WTO Member may freely compose its delegation to the Appellate Body. We believe that the Appellate Body finding applies to Panel proceedings as well because nothing in the WTO agreements restricts a Member's right to compose its delegation in Panel proceedings.

(d) GATT past practice does not and cannot circumvent Indonesia's sovereign right

4.25 In earlier dispute settlement proceedings under the GATT, delegations were, in virtually every instance, composed solely of government representatives. This practice does not circumvent Indonesia's right to include outside counsel as accredited members of its dispute settlement delegation. The fact that in the past developing countries chose not to include outside counsel in their delegations (or were bullied by complainants such as the United States not to do so) does not block Indonesia from exercising its rights under international law to choose its representatives to the dispute proceeding. This right would be lost only if the WTO Agreement or the DSU limited who could be members of a delegation. As noted by the Appellate Body in the passage from the Bananas case quoted above, there is no such limitation. Further, as also recognized by the Appellate Body, customary international law and the practice of other international dispute settlement tribunals uniformly support a country's right to select the representatives of its choice. As a matter of international law, then, past GATT practice does not prevent Indonesia from accrediting outside counsel as members of its delegation.

4.26 Also, the change in the nature of GATT/WTO dispute settlement undercuts the importance of past GATT practice. Under the GATT, panel decisions (indeed, all stages of a proceeding) could be blocked by either party, including the losing party. Dispute settlement was viewed principally as part of the "diplomatic" process. Due largely to the insistence of the United States, the diplomatic process was replaced by a "judicial" process, in which the losing party cannot block a panel (or Appellate Body) decision.

4.27 Having expert counsel in a binding, "judicial" WTO proceeding is infinitely more important than it was in non-binding GATT proceedings. Because of the radical change in the dispute settlement system, prior GATT practice is not relevant. Thus, for practical reasons as well as under principles of international law, Indonesia's sovereign right to include outside counsel on its delegation is not affected by past GATT practice.

[28]See Report of the Appellate Body in the EU Banana Regime, para. 12.

(e) Practical and equitable considerations mandate that Indonesia not be denied its right

4.28 As the Appellate Body has recognized, in order to participate on equal terms with Complainants and other countries with large corps of trade lawyers, Indonesia must be allowed to select its counsel for WTO dispute settlement proceedings. USTR, the European Communities and Japan each have a cadre of attorneys with substantial experience in WTO matters. In contrast, Indonesia has only a few attorneys with experience in trade disputes before the WTO. The language barrier adds another burden to Indonesia's effective representation because the WTO proceeding will be conducted in English, both with regard to written submissions and oral presentations.

4.29 The WTO will not be a meaningful and fair forum in which countries can resolve trade disputes unless the interests of all parties to the disputes are represented efficiently and effectively and in 4accordance with their wishes. Without the support of outside counsel, Indonesia's interests will not be adequately represented in this proceeding.

4.30 We refer the Panel and complainants to the writings of the eminent WTO scholars William Davey, John Jackson and Alan Sykes. In regard to what these three experts describe as the "basic problems" of developing countries in WTO dispute settlement proceedings, they conclude that developing countries such as Indonesia "clearly are not as able to use the dispute settlement system as developed countries".

4.31 Principles of international law and practices of all the major international dispute settlement tribunals and international organizations, including the WTO Appellate Body, support Indonesia's position to have counsel of its choice to represent its interests during the WTO proceedings. Complainants' objections to Indonesia's inclusion of outside counsel in its delegation to the WTO are groundless and contravene principles of international law and practices of international organizations and the spirit of equity in the WTO. Moreover, the objections comprise a litigation strategy designed to disadvantage Indonesia in the WTO proceeding. In this regard, complainant United States, in particular, employs the very device it states excluding outside counsel will preclude.

4.32 The Panel should ignore complainants' objections and recognize Indonesia's sovereign right to counsel. Any other decision, including any compromise, will taint the proceeding and, indeed, completely undermine the legitimacy of the WTO as a body for resolving disputes between developed nations with substantial WTO expertise and significant political and economic power and developing countries lacking such expertise and power.

4.33 At the first substantive meeting, **Japan** made the following arguments before the Panel:

4.34 Regarding the issue of the participation of private lawyers, Japan has some systemic concerns, in particular the following two:

i) First, dispute settlement proceedings under the auspices of GATT/WTO have been supposed to be intergovernmental. The presence of private lawyers would change this intergovernmental character.

ii) Second, since private lawyers may not be subject to disciplinary rules such as those applied to members of governments, Japan has some concerns about the breaches of confidentiality.

4.35 In this regard, Japan prefers the non-participation due to the preceding concerns, but Japan understands that it is the Panel who should decide on this issue. However, Japan believes that it would be essential for the Panel to ensure the observance of the general rules applied to the participants of the Panel, including confidentiality, in case the Panel allows their participation.

B. Preliminary Objection to the United States' Claims Regarding the $US690 Million Loan to TPN

4.36 Indonesia raised a preliminary objection to the United States' claims with respect to the $US690 million loan to TPN, on the basis that this loan was not within the Panel's terms of reference. On 3 December 1997, the Panel heard arguments and made a ruling on this issue.[29]

1. Objection by Indonesia

4.37 The following are **Indonesia's** arguments in support of this objection.

4.38 As a preliminary matter, Indonesia asks the Panel to rule that it will not examine the $690 million loan discussed at great length by the United States. In its first submission, the United States argues that an August 1997 loan of $690 million to Timor Putra Nasional is inconsistent with Article III:4 of the General Agreement and Article 2 of the TRIMs Agreement and is a specific subsidy that causes serious prejudice. The August 1997 loan should not be examined by the Panel because it was not raised in the 12 June 1997 request of the United States for the establishment of a panel (WT/DS59/6) or in the Panel's terms of reference.

(a) First, the loan was not raised in the Panel request or the Panel's terms of reference

4.39 Article 6.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the DSU) states that "[t]he request for the establishment of panel ... shall identify the specific measures at issue." In European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (9 September 1997) (para. 143 at p. 64), the Appellate Body examined Article 6.2 and stated:

> Article 6.2 of the DSU requires that the claims ... must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending party and any third parties to know the legal basis of the complaint.

4.40 The terms of reference in the present dispute are the standard terms of reference in which the definition of the matter is supplied by Complainants' requests for establishment of a panel. Neither the United States, which now belatedly seeks to inject the loan into this proceeding, nor the other Complainants, identify the loan in their panel requests. The panel in United States-Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway, ADP/87 (27 April 1994) (at para. 336), concluded that:

> a matter, including each claim composing that matter, could not be examined by a panel under the [General] Agreement unless that same matter was within the scope of, and had been identified in, the written statement or statements referred to or contained in its terms of reference.

(b) Second, the loan arose after the Panel was established

4.41 The Panel in United States-Restrictions on Imports of Sugar (22 June 1989), BISD 36S/331, concluded that a matter arising after the establishment of a panel is not within the scope of the panel proceeding. The Panel stated:

> Since the matter raised by Australia [complainant] had arisen only after the establishment of the Panel by the Council ... , contracting parties had no reason to

[29] See Findings, section XIV.A.2, for this ruling.

> expect that the reallocation of sugar quotas among Caribbean countries [the matter] would be an issue before the Panel. The Panel therefore decided that this reallocation was not part of its mandate.[30]

Furthermore, in United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (para. 3.5.), the panel concluded that "its terms of reference [did] not permit it to examine 'any new measure which may come into effect during the Panel's deliberations'." Id. at para. 3.5.

(c) Third, the United States cannot "cure" its omission of the loan from its Panel request by discussing the loan in its first submission

4.42 In European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (9 September 1997), the Appellate Body stated that:

> If a claim is not specified in the request for the establishment of a panel, then a faulty request cannot be subsequently "cured" by a complaining party's argumentation in its first written submission to the panel or in any other submission or statement made later in the panel proceeding.[31]

As did the United States here, in United States-Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil (19 June 1992), BISD 39S/128, Brazil made arguments in its first submission concerning issues not raised in consultations or in its request for the establishment of a Panel. The Panel rejected Brazil's arguments and concluded that the terms of reference were "limited to the matters raised by Brazil in its request for the establishment of this Panel".[32]

4.43 For the foregoing reasons, the Panel should rule that it will not examine any claim by the United States regarding the August 1997 loan.

2. Response of the United States

4.44 Indonesia argues that the Panel should not consider the $690 million government-directed loan because it was not raised in the United States request for a panel. It is true that the loan was not identified in the United States request, because the loan had not yet been made.

4.45 However, there is precedent for panels taking a more flexible and dynamic approach to disputes than the rigid straitjacket advocated by Indonesia. In India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/R (issued 5 September 1997) ("Indian Mailbox") the panel rejected an Indian request to bar a United States claim because the claim had not been included in the United States request for a panel. Because the new claim of the United States in that case addressed the same "problem" identified in the United States request for a panel, the panel concluded that the new claim was within the panel's terms of reference.

4.46 Here, the United States clearly indicated in its request for a panel that the "problem" was the National Car Programme, which resulted in, among other things, the discriminatory treatment of imported auto parts and subparts and subsidies that caused serious prejudice to the interests of the United States. The $690 million government-directed loan is merely the most recent component of the National Car Programme, a component that exacerbates the problem previously identified in the United States' request for a panel.

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[30] At para. 5.8 (emphasis added).
[31] At 64, para. 143 (second emphasis added).
[32] At para. 6.2.

4.47 This Panel demonstrated that it would not be bound by the mainstream of GATT dispute settlement practice when it decided to allow Indonesia's private counsel to participate in the meetings of the Panel. With respect to the admissibility of the $690 million government-directed loan to TPN, the Panel should show similar flexibility by following the lead of the Indian Mailbox panel.

4.48 In the recent report in Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, the panel declined to make a preliminary ruling on a jurisdictional issue similar to the issue raised by Indonesia. Contrary to Indonesia's assertion, this was not because the panel lacked guidance on the issue, but because it is standard panel practice to defer decisions on such issues to the final panel report. These types of issue are not procedural, but instead are substantive. To resolve these issues, a panel is required to make findings of fact.

4.49 In this case, to resolve the issue raised by Indonesia, the Panel will have to make findings as to whether or not the $690 million government-directed loan is merely one aspect of a single measure, the National Car Programme, or whether it is a separate measure in itself. This question implicates many other issues raised in this dispute, because Indonesia's defence concerning several claims of the Complainants is based on the proposition that the National Car Programme can be divided up into individual "programmes", some of which allegedly have expired.

4.50 The United States submits that the Panel should not prejudge the outcome of these issues one way or another by making a ruling on a preliminary objection, especially when standard practice is to defer such rulings to the final panel report.

C. Business Proprietary Information

4.51 Indonesia requested the Panel to require the United States to submit, prior to the first substantive meeting of the Panel with the parties, certain information characterized by the United States in its first submission as "business proprietary". The United States indicated in its first submission that it had further information in its possession that was relevant to its serious prejudice claims but that the information was "business proprietary" and the United States was reluctant to provide it to the Panel in the absence of "adequate procedures" to protect such information. At its first meeting with the parties, the Panel heard arguments and made a ruling with respect to this issue.[33]

1. Request of Indonesia

4.52 The United States refers obliquely to confidential data in its possession which it claims would demonstrate serious prejudice and threat thereof if only the Panel process could be trusted with the data, which then would allow the United States to present it. (See Section VIII.B.) This presentation is inadequate. The United States has the burden of establishing serious prejudice on the basis of positive evidence and it cannot hide behind the claimed sensitivity of its “data.”

4.53 The United States tactic raises issues of fairness, as well. The goal of the United States, apparently, is to allow itself to be “forced” to present the data in its second submission, to which, of course, the Government will have no opportunity to respond in its second submission.

4.54 This gamesmanship undermines the legitimacy of the Panel proceeding. The United States is well aware that the WTO - like the United States International Trade Commission and the United States Department of Commerce - has procedures to protect confidential data. Article 18.2 of the DSU designates all written submissions to the Panel as “confidential.” According to Article 18.2:

[33]See Findings, section XIV.A.3, for this ruling.

> Members shall treat as confidential information submitted by another Member to the Panel or the Appellate Body which that Member has designated as confidential.

Article 18.2 also provides that, on request, a Member submitting confidential data shall "produce a non-confidential summary of the [confidential] information" contained in its written submission.

4.55 The United States, however, treats this proceeding as no-holds-barred litigation and, to secure an advantage, pretends that Article 18 does not exist, acting as though this is the first time the issue of confidentiality has arisen. The Panel should not countenance this attempt by a developed, experienced, sophisticated WTO Member to gain an unfair advantage over Indonesia. Rather, the Panel should require the United States to submit its confidential data immediately, prior to the 3-4 December 1997 hearing. The data should be available for review and comment by the legal experts hired and accredited by Indonesia and informative non-confidential summaries should be given to the Indonesian delegation. Moreover, Indonesia must be given an opportunity to review and respond fully to the data and to any additional United States argumentation based on it.

2. Response of the United States

4.56 The issue raised by Indonesia is much ado about nothing. Regarding business proprietary information, in its first submission the United States noted that it had additional information in its possession documenting the plans and projections of General Motors, Ford, and Chrysler with respect to the Indonesian motor vehicle market. The United States indicated that it was reluctant to provide such information to the Panel unless the Panel first established adequate procedures to protect such information. Indonesia claims that this legitimate desire to ensure the protection of business proprietary data constitutes an unfair tactic and that the protection of business proprietary data is adequately ensured by Article 18.2 of the DSU.

4.57 Article 18.2 of the DSU merely recognizes that confidential information should be treated as confidential, but in itself does not establish procedures for ensuring the protection of such information. Therefore, the United States was justified in being cautious with the information supplied to it by private companies.

4.58 Be that as it may, while the United States reserves its right to submit additional factual information in this proceeding, at this point, the United States does not intend to submit the business proprietary information we have been discussing. The information in question relates to the plans of United States auto-manufacturers to enter, or expand their presence in, the Indonesian passenger car market, plans that were cancelled in light of the introduction of the National Car Programme. The information included in the first United States submission summarizes that information in a non-confidential manner, and Indonesia has not disputed the accuracy of this data or the existence of the United States manufacturers' plans. Indeed, an attachment to Indonesia's first submission to the Panel corroborates this information and the existence of these plans. Therefore, there is no present need to submit this information, because the points that this information would corroborate are uncontested by Indonesia.

4.59 At no place in Indonesia's first written submission to the Panel does Indonesia contest the existence of the United States manufacturers' plans to enter, or expand their presence in, the Indonesian passenger car market. At the first meeting of the Panel, Indonesia announced, for the first time, that it does, indeed, contest the existence of these plans. If Indonesia plans to revise its defence by submitting rebuttal information of its own, then the United States, of course, reserves its own right to counter that information with information of its own.

4.60 Moreover, the United States notes the following statement of the Appellate Body in its report in the Bananas case: "There is no requirement in the DSU or in GATT practice for arguments on all

claims relating to the matter referred to the DSB to be set out in a complaining party's first written submission to the panel." (para. 145).

D. Request from Indonesia for Termination of the Panel with Respect to the National Car Programme

4.61 On 26 February 1998, **Indonesia** officially submitted to the Panel a copy of a letter from Indonesia to the Chairman of the SCM Committee, which letter Indonesia requested the Chairman of the Committee to consider as a formal modification of its notification of subsidies granted to the National Automobile Industry (G/SCM/N/16/IDN). This notification, to which were attached copies of the referenced decrees and regulations issued on 21 January 1998, states the following:

4.62 On 21 January 1998, the Government of Indonesia took the following actions:

- Presidential Decree No. 20/1998[34] revoked Presidential Decree No. 42/1996 (4 June 1996) and declared Presidential Instruction No. 2/1996 (19 February 1996) obsolete, thereby terminating the authority for further import duty and luxury tax exemption subsidies to producers of a national car.

- Minister of Industry and Trade Decree No. 19/MPP/Kep/1/1998[35] revoked (effective 2 February 1998) Minister of Industry and Trade Decree No. 31/MPP/SK/2/1996(19 February 1996) and all departmental regulations issued pursuant to it to implement Presidential Instruction No. 2/1996.

- Minister of Industry and Trade Decree No. 20/MPP/Kep/1/1998[36] revoked (effective 2 February 1998) Minister of Industry and Trade Decree No. 142/MPP/Kep/6/1996 (5 June 1996), which had authorized production of national cars to be carried out overseas for a one-year period, in implementation of Presidential Decree No. 42/1996. (This decree already had terminated by its own terms.)

- Government Regulation No. 14/1998[37] amended Government Regulation No. 50/1994 (28 December 1994), as previously amended by Government Regulation No. 20/1996 (19 February 1996) and by Government Regulation No. 36/1996 (14 June 1996), so as to eliminate (effective 2 February 1998) the exemption of national cars from payment of the luxury sales tax.

- Minister of Finance Decree No. 19/KMK.01/1998[38] revoked (effective 2 February 1998) Minister of Finance Decree No. 404/KMK.01/1996 (7 June 1996), which had exempted national cars produced overseas (during the one-year period specified in Minister of Industry and Trade Decree No. 142/MPP/Kep/6/1996) from payment of the customs import duty. (This decree already had terminated by its own terms.)

- Minister of Finance Decree No. 20/KMK.01/1998[39] amended Minister of Finance Decree No. 36/KMK.01/1997 (21 January 1997) to delete (effective 2 February 1998) the authority to exempt parts and components for assembly or manufacture of national cars from payment of the customs import duty.

[34]Indonesia Exhibit 51.
[35]Indonesia Exhibit 52.
[36]Indonesia Exhibit 53.
[37]Indonesia Exhibit 54.
[38]Indonesia Exhibit 55.
[39]Indonesia Exhibit 56.

4.63 On 27 February 1998, the Panel sent a communication to all parties concerning this subsidy notification received from Indonesia. The Panel asked Indonesia to inform the Panel what action, if any, Indonesia requested the Panel to take on the basis of the notification, and what Indonesia believed to be the legal implications of the notified revocations for the panel process. The Panel asked the complainants to respond to Indonesia's comments.

1. Request from Indonesia

4.64 **Indonesia** responded to the Panel as follows:

4.65 The Government of Indonesia believes that, given the actions it took on 21 January 1998 (as set out in our 25 February letter), the dispute settlement proceeding should be terminated, at least as it relates to the measures originally promulgated in 1996 to promote the National Car Programme.[40] We would hope that the three complaining parties would choose to withdraw their complaints. If they do not, though, the Panel should terminate the proceeding and issue a report limited to declaring that the matter was resolved through the abolition of the measures at issue.

4.66 As set out in Indonesia's letter of 25 February, the decrees and regulations issued by the Indonesian Government on 21 January revoked or amended all of the decrees, instructions and regulations implementing measures to promote the National Car Programme which allegedly were inconsistent with Indonesia's obligations under the General Agreement, the SCM Agreement, the TRIMs Agreement and the TRIPs Agreement. (In the two instances in which decrees were amended rather than revoked, the amendment abolished all measures in the decree that previously had benefited the National Car Programme.) All of the decrees, instructions and regulations cited in each of the complaining parties' request for establishment of a panel (at least, regarding the National Car Programme) were revoked (or amended in relevant part), and all of the measures to promote the National Automobile Industry which were thereby implemented ceased to be in effect.

4.67 Article 19.1 of the DSU provides that:

> [w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. (Footnote omitted.)

4.68 Article 3.7 of the DSU confirms that this forward-looking remedy - elimination of an inconsistent measure - is the only WTO-consistent remedy. Therefore, even if the measures to promote the National Automobile Programme had been inconsistent with a provision of the WTO (which Indonesia does not accept), there is nothing further to remedy. Under such circumstances, it would be inappropriate for the Panel to do more than note the termination of the measures and declare that no determination is warranted as to the claimed WTO inconsistency of them.

4.69 Prior Panel decisions support the refusal to rule on an expired measure, as previously set out by Indonesia (See section VII.D(c)). In Thailand-Restrictions on Importation of and Internal Taxes on Cigarettes (7 November 1990), BISD 37S/200, prior to the panel's decision, Thailand issued regulations eliminating the discriminatory elements of two taxes. Even though the underlying authority to reimpose discriminatory taxes remained in effect, the panel concluded that the current regulations were consistent with Thailand's GATT obligations.

4.70 In the 1989 dispute regarding EEC-Restrictions on Imports of Dessert Apples (22 June 1987), BISD 36S/93, the EEC measures lapsed prior to the Panel's decision. Chile urged the panel to rule that

[40]See Findings, section XIV.A.4, for the Panel's ruling on this request.

the EC should offer compensation since a ruling that the measures should be withdrawn would be meaningless. The panel refused to do so.

4.71 These prior panel decisions support the conclusion that, since the measures promoting the National Car Programme and their underlying legal authority have expired, the Panel should declare that no decision on the merits of the alleged inconsistency with WTO agreements is appropriate.

2. Response of Japan

4.72 **Japan** responded to the Panel as follows:

4.73 The Government of Indonesia expressed its hope that the complaining parties would withdraw the complaints. In addition, Indonesia argued that, if the complaining parties do not do so, the Panel should nevertheless terminate the proceeding and issue a report limited to declaring that the matter was resolved through the abolition of the measures at issue.

4.74 The Government of Japan finds it difficult to share the view of Indonesia. Japan still does not believe that a mutually satisfactory solution has been achieved. Unless such a mutually satisfactory solution is obtained between the parties, a panel is obliged to submit its findings to the DSB as described in Article 12:7 of the DSU. Article 12 of the DSU requires a panel to follow the procedures and not to unilaterally terminate the proceeding. In this regard, there are three elements Japan would particularly like to point out.

(a) It is still not clear whether the National Car Programme has been fully terminated

4.75 First, some parts of the decrees issued by the Indonesian Government are still unclear in their implications. For example, the decrees did not explicitly revoke the Presidential Decree No. 2/1996, which Japan believes is the most important basis for the National Car Programme, while declaring it "obsolete" instead.

4.76 Second, and more importantly, the Government of Japan has not been convinced that all the exemptions of import duties and luxury taxes have been terminated. As we all can recall, at the second Panel meeting, Indonesia explained that the Indonesian Government would request PT Timor to return the benefits already given to it, since it failed to meet the requirements of the June 1996 programme and the first year requirements of the February 1996 programme. Despite this statement, however, Japan has been informed that favourable treatment under the Programme in question might continue for Timor cars remaining stock, including unsold Korean made National Cars.

4.77 Japan is trying to gather further information from the Indonesian Government regarding these factual matters.

(b) The Government of Indonesia has not provided any assurances that it will not introduce the measures of the same nature as the National Car Programme, i.e. discriminatory measures to benefit specific domestic products

4.78 It should be noted that Indonesia in its letter of 2 March still denies the inconsistency of the National Car Programme with its obligations under the relevant provisions of the WTO Agreements. This, together with unclarity regarding the termination of the Programme makes it difficult for Japan to judge, at this stage, whether the Government of Indonesia has decided against introducing programmes of the same kind in the future.

(c) Even if measures are eliminated, a panel can and should rule on them

4.79 The Government of Japan is of the view that even if measures are eliminated, a panel still can and should rule on them. In fact, Japan has already discussed this issue before this Panel.

4.80 As already described more fully by Japan (See section X.B.3 and 4), Japan believes that it has been the usual practice of GATT/WTO panels to rule at least on measures that were effective at the time the panel's terms of reference were fixed, even if such measures later became ineffective before the panel rendered its ruling. "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system", as described in Article 3:2 of the DSU. In this respect, if a panel should not rule on this kind of occasion, a WTO Member might easily evade the WTO reviews.

4.81 Japan sincerely hopes that the Panel will continue to review this case.

3. Response of the European Communities

4.82 The **European Communities** responded to the Panel's request as follows:

4.83 For the reasons set out below, the European Communities disagree with Indonesia's demand and respectfully request the Panel to rule on all the claims within its terms of reference, including those concerning the 1996 National Car Programme.

4.84 The legal consequences of the measures enacted by Indonesia on 21 January 1998 are far from clear. For instance, Presidential Instruction No. 2/1996 has not been revoked but merely declared "obsolete" by Presidential Decree Number 20/1998. The precise implications of a declaration of "obsolescence" by what appears to be a norm of inferior rank are unclear. It is also unclear to the European Communities how, if at all, the measures of 21 January 1998 will apply to those cars imported from Korea which have not been sold yet.

4.85 In the European Communities' view, there is no good reason for the Panel to take any decision as regards these and other similar issues precipitately and on the basis of the limited information which has been made available by Indonesia. We consider that the Panel should complete its report in the normal fashion, and that the issues raised by Indonesia should be clarified and decided within the framework provided by Article 21 of the DSU. If the measures taken on 21 January 1998 already constitute appropriate implementation of the DSB recommendations in this case, Indonesia will find itself in the enviable position of not having to adopt any further implementing measures. On the other hand, if it was established in accordance with Article 21 of the DSU that such is not the case, the complainants would have access to the mechanisms provided in the DSU in case of non-compliance with the recommendations of the DSB.

4.86 Furthermore, it must be noted that the measures taken on 21 January 1998 do not provide for the reimbursement of the benefits already granted under the National Car Programme. As a result, those subsidies will continue to benefit future sales of National Cars. Accordingly, whether or not the measures adopted on 21 January 1998 are considered to have revoked effectively the National Car Programme, the Panel will be required to rule on the compatibility of those subsidies with the SCM Agreement.

4.87 Similarly, as admitted implicitly by Indonesia, the measures adopted on 21 January 1998, do not effect the 1993 Programme. Thus, again, the Panel, will in any event have to issue a report ruling on the claims regarding the 1993 Programme, whether or not the 1996 National Car Programme is deemed to have been effectively revoked.

4.88 Contrary to Indonesia's arguments, past practice supports the European Communities' request that the Panel rule on all the claims within its terms of reference. Under GATT 1947, several panels[41] considered measures that were no longer in force in cases where, as in the present dispute, the measures were still in force at the time the Panel was established.

4.89 This practice has continued under the WTO Agreement. In US - Standards for Reformulated Gasoline[42], the Panel decided not to rule on a discontinued measure, but only because the measure had been terminated before the terms of reference were established and was unlikely to be renewed. In US -°Measures affecting imports of Woven Wool Shirts and Blouses from India, the Panel decide that:

> "in the absence of an agreement between the parties to terminate the proceedings, we think that it is appropriate to issue our final report regarding the matter set out in the terms of reference of this Panel in order to comply with our mandate [....] notwithstanding the withdrawal of the US restraint"[43],[44]

4.90 For the reasons set out above, the European Communities respectfully request the Panel to reject Indonesia's demand and to rule on all the claims within its terms of reference, including those relating to the 1996 National Car Programme.

4. Response of the United States

4.91 The **United States** responded to the Panel's request as follows:

4.92 The United States does not concur in Indonesia's request.[45]

4.93 By way of background, by letter dated 25 February 1998, Indonesia informed the Chairman of the SCM Committee that Indonesia purportedly "had terminated all subsidies previously granted to the National Automobile Industry." Notwithstanding the fact that the deadline for submitting information and argument in this dispute closed on 30 January 1998, Indonesia provided copies of this letter, and the attachments thereto, to the Panel, the Chairman of the Dispute Settlement Body, and the complainants in this dispute.

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[41]See for instance the Panel Report on European Communities - Restrictions on Imports of Dessert Apples, Complaint by Chile, adopted on 22 June 1989, BISD 36S/93; the Panel Report on EEC - Restrictions on Imports of Apples, Complaint by the United States, adopted on 22 June 1989, BISD 36S/135; the Panel on United States - Prohibition of Imports of Tuna and Tuna Products from Canada, adopted on 22 February 1982, BISD 29S/91; the Panel Report on EEC - Restrictions on Imports of Apples from Chile, adopted on 10 November 1980, BISD 27S/98; and the Panel Report on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49.

The panel reports invoked by Indonesia do not support its position, as already demonstrated by Japan in its second submission to the Panel (see Section X.B.4).

[42]Panel Report on United States - Standards for Reformulated Gasoline, WT/DS2/R, adopted on 20 May 1996, para. 6.19.

[43]Panel Report on United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, adopted on 23 May 1997, WT/DS33/R, para.6.2.

[44]In Argentina - Certain measures affecting Imports of Footwear, Textiles, Apparel and Other Items (WT/DS56/R, at pp.83-86, on appeal) the Panel decided not to rule on a measure which was revoked after the circulation of the request for the establishment of a Panel but before the DSB agreed to the establishment of the Panel.

[45] The United States also does not concur in any termination of this proceeding with respect to the 1993 Programme, and notes that the measures notified by Indonesia to the SCM Committee do not affect the 1993 Programme.

4.94 In a communication dated 27 February 1998, the Panel requested that Indonesia inform the Panel by 2 March as to "what action, if any, it requests the Panel to take on the basis of this notification and why, and what it believes to be the legal implications of these revocations for the panel process." The Panel also requested the complainant parties in this dispute to respond to Indonesia's comments by 6 March.

4.95 At the outset, the United States must express some dismay that the Panel even has considered Indonesia's untimely submission. Having said that, however, the United States appreciates being afforded the opportunity to comment on Indonesia's request. For the reasons set forth below, the United States does not concur in Indonesia's request.

(a) The Measures at Issue Are Within the Panel's Terms of Reference

4.96 Indonesia's request relates only to "the measures to promote the National Automobile Programme."[46] Indonesia does not dispute that these measures are within the Panel's terms of reference. The only question is whether a Panel is free, notwithstanding its terms of reference, to decline to make a finding on measures within its terms of reference at the request of the responding party. The United States submits that a Panel may not.[47] The fact that the responding party claims that the measures have been withdrawn does not change this legal conclusion.

(b) Established GATT and WTO Panel Practice Is to Make Findings on Measures that Are Withdrawn Subsequent to the Establishment of a Panel's Terms of Reference

4.97 Even assuming, for purposes of argument, that the measures comprising the National Car Programme have been revoked and have ceased to have any legal or operational effect, Indonesia is not entitled to a termination of this dispute absent agreement by the complaining parties. Prior GATT and WTO practice dictates that a panel should make findings on discontinued measures covered by its terms of reference in situations where, as is the case here, a measure was in force at the time the panel was established.[48] This practice was most recently reaffirmed in United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/R, Report of the Panel, as modified by the Appellate Body, adopted on 23 May 1997, para. 6.2.

4.98 Indonesia's references to Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, DS10/R, Report of the Panel adopted on 7 November 1990, BISD 37S/200, and EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile, L/6491, Report of the Panel adopted on 22 June 1989, BISD 36S/93, are inapposite. With respect to Thai Cigarettes, Japan previously has demonstrated how that report does not support Indonesia's position.[49] Moreover, even if the Panel should not accept Japan's demonstration, Thai Cigarettes is an aberration from the mainstream of GATT and WTO practice.

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[46] See page 2 of 2 March 1998 letter from Indonesia to the Panel.

[47] Note that the Appellate Body has also spoken on the failure of a panel to make a finding on a measure within its terms of reference. In Japan - Taxes on Alcoholic Beverages (WT/DS8/AB/R), the Appellate Body stated that:

We note that the Panel's conclusions on "like products" and on "directly competitive or substitutable products" contained in paragraphs 7.1(i) and (ii), respectively, of the Panel Report fail to address the full range of alcoholic beverages included in the Panel's Terms of Reference. ... We consider this failure to incorporate into its conclusions all the products referred to in the Terms of Reference, consistent with the matters referred to the DSB in WT/DS8/5, WT/DS10/5 and WT/DS11/2, to be an error of law by the Panel. (Page 26)

[48] The parties previously have addressed this issue in connection with Indonesia's argument that the complainants' claims concerning the June 1996 measures are moot. (See section VII.E.3 and X.C).

[49] See Section X.B.4.

4.99 As for Dessert Apples, it directly contradicts Indonesia's position. In that case, the panel did make findings of GATT inconsistency with respect to measures that had expired after the panel's establishment. What the panel declined to do, and properly so, is recommend, as requested by Chile, that the EEC provide compensation.

(c) It Is Not Established that the Measures Have, in Fact, Expired

4.100 Assuming, for purposes of argument, that a panel may ignore its terms of reference and decline to make findings with respect to a measure that has expired subsequent to the panel's establishment, Indonesia has failed to establish that the measures that comprise the National Car Programme have expired. At best, the status of these measures remains unclear.

4.101 Looking at the measures from one perspective, and taking Indonesia at its word, the measures still have legal and operational effect with respect to products imported and sold prior to the revocation of those measures. According to Indonesia, the local content requirements of these measures, and TPN's failure to satisfy those requirements, continue to constitute the basis for seeking repayment by TPN of previously forgiven duties and taxes.[50] These measures will be the governing legal instruments should TPN challenge any Government demand for repayment of duties and taxes.

4.102 Looking at the measures from a different perspective, it is questionable whether the benefits conferred by the various legal instruments (as opposed to the legal instruments themselves) really have been withdrawn. Notwithstanding Indonesia's assurances to the Panel and the complainants, it was reported in February that TPN had requested that the Government of Indonesia provide a tax exemption for those Timor Kia Sephias that remain unsold.[51] The Government apparently was willing to consider TPN's request, because Indonesia's Minister of Industry and Trade was quoted as stating: "I am having discussions with the finance minister over whether these 15,000 cars will be exempted from the taxes like those imported with them."[52] It now appears that the Government, did, indeed, grant TPN's request, deciding "that the remaining 15,000 cars could maintain their tax exemptions."[53]

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[50] In a question to Indonesia, the United States described Indonesia's position as follows: "[A]ccording to Indonesia, TPN will have to reimburse the Government of Indonesia for import duties and luxury taxes that were exempted under Decree No. 42/96." Questions from the United States to Indonesia, 15 January 1998, page 1. The United States asked Indonesia to confirm whether this description was accurate. Id. Indonesia confirmed that this description was accurate. Answers of Indonesia to the 15 January 1988 Questions of the United States. Indonesia also stated to the Panel that the relevant Customs District Office "will issue a letter to TPN demanding payment of the customs import duties and luxury sales tax due by virtue of TPN's failure to satisfy the criteria of the National Car Programme for the first year." Importation, Enforcement and Effect of TPN's Non-Fulfillment, submitted by Indonesia on 30 January 1998.

[51] "Timor Car Project Has 'Moral Obligation' to Continue," Asia Pulse (19 Feb. 1998) (US Exhibit 41, p. 1).

[52] "Minister Asks Indonesian 'National Car' Maker to Evaluate Viability," Agence France Presse (19 Feb. 1998) (US Exhibit 41, p.2).

[53] "Indonesia Chief Falls Short on Promised Economic Reforms", New York Times (5 March 1998) (US Exhibit 41, pp. 3-5); see also "Indonesia Defends Car Tax Break," *AP Online* (5 March 1998) (US Exhibit 41, pp. 6-7); "Indonesia Dodging IMF Reform Demands...Again, Say Analysts", Agence France Presse (3 March 1998) (US Exhibit 41, pp. 8-10); and "Several IMF Conditions Go Unheeded in Indonesia", The Boston Globe (3 March 1998) (US Exhibit 41, pp. 11-14).

4.103 Moreover, in the statement quoted in the preceding paragraph, the Minister of Industry and Trade describes the issue as "whether these 15,000 [unsold] cars will be exempted from the taxes like those imported with them [*i.e.*, the previously sold cars]." (Emphasis added). This suggests that, notwithstanding its prior assurances to the Panel and the complainants, Indonesia did not require TPN to reimburse the Government for luxury taxes owed on those cars that had been sold prior to the completion of the local content audit. In addition, it is now entirely unclear what has happened with respect to the forgone import duties owed on those cars that were sold and those that remain unsold.

4.104 Finally, it must be emphasized that none of the measures notified by Indonesia to the SCM Committee provides for the reimbursement of the subsidies already conferred under the National Car Programme. As previously demonstrated by the United States, these subsidies constitute "non-recurring" subsidies that will benefit future sales of cars produced by TPN, a point that Indonesia did not seriously dispute.[54] Thus, whether or not the measures notified by Indonesia to the SCM Committee can be considered as revoking the legal instruments that make up the National Car Programme, the Panel will be required to consider the subsidies conferred by these legal instruments in connection with the US and EC claims under the SCM Agreement.

(d) A Termination of the Dispute Would Diminish US Rights Under the DSU

4.105 It is axiomatic that rulings of panels "cannot add to or diminish the rights and obligations provided in the covered agreements." Article 19.2, DSU. Pursuant to Article 1 and Annex 1 of the DSU, the DSU itself is a "covered agreement." In the context of this case, under Article 21 of the DSU, the United States has the right to ensure that the National Car Programme is withdrawn and stays withdrawn or otherwise is brought into conformity with Indonesia's WTO obligations. Under Article 22 of the DSU, the United States has the right to compensation or retaliation if these conditions are not fulfilled.

4.106 If the Panel were to grant Indonesia's request and terminate the dispute settlement proceeding with respect to the National Car Programme, the Panel effectively would be depriving the United States of its rights under Articles 21 and 22 of the DSU. Because the Panel would not have made any findings that the measures were inconsistent with Indonesia's WTO obligations, Indonesia arguably would be free at that point to reintroduce these measures, and the United States would have to commence an entirely new dispute settlement proceeding.

4.107 The evidence suggests that such a scenario is highly plausible. Newspaper reports indicate that subsidization of the National Car is continuing.[55]

4.108 Finally, the facts developed in this proceeding should make the Panel extremely sceptical of any claims by Indonesia that the discrimination against imports from the complainants and the subsidization of TPN under the National Car Programme have ended. Consider the following:

- The history of the National Car Programme, particularly the manner in which TPN was selected to be the producer of the National Car;[56]

[54] See Sections VIII.B.2(b) and VIII.B.4(c).

[55] "IMF Effort Not Working, Suharto Tells Clinton", The Washington Post (17 Feb. 1998) (US Exhibit 41, pp. 15-18). "Indonesia Chief Falls Short on Promised Economic Reforms", New York Times (5 March 1998) (US Exhibit 41, pp. 3-5). "Indonesian Forest Fund Used for National Car: Camdessus", Agence France Presse (21 Jan. 1998) (US Exhibit 41, p. 19).

[56] First Submission of the United States, 20 October 1997, paras. 34-80.

- The obvious contradiction between Indonesia's denial that the joint venture between TPN and Kia Motors was to be the producer of the National Car and all of the evidence to the contrary, including the third-party submission by Korea;[57]

- The obvious contradiction between Indonesia's assertion that the Government of Indonesia played no role in the provision of the $690 million loan to TPN and all of the evidence to the contrary and the fact that the IMF required *the Government* to revoke special credit privileges for the National Car Programme;[58]

- The obvious contradiction between Indonesia's assurance that TPN would be required to reimburse the Government for foregone customs duties and luxury taxes due in connection with the CBU Sephias imported from Korea and the evidence (described above) that the Government is *not* requiring reimbursement;

- The fact that Presidential Decree No. 20/1988 declares Presidential Instruction No. 2/1996 "obsolete" rather than "revoked"; and

- The fact that even in its letter of 2 March 1998, Indonesia continues to insist that the National Car Programme was not inconsistent with its WTO obligations. This indicates that Indonesia feels free to resurrect the measures in question when it determines that the time is ripe.

In short, the status of the National Car Programme remains unclear, and it is not (nor should it be) the Panel's task to predict the future based on the incomplete information available at this time. Instead, these are matters that are properly dealt with under Article 21 of the DSU. If it should turn out that the measures in question constitute adequate implementation of the recommendations by the DSB, Indonesia will have fulfilled its WTO obligations. However, should it be established under Article 21 that the measures in question do not constitute adequate implementation, the United States and the other complaining parties would still have their rights under Article 22.

(e) Conclusion

4.109 Both before and after this Panel was established, the United States sought a mutually acceptable solution with Indonesia of this matter. Indonesia refused, preferring to let the dispute settlement process run its course. It is now inappropriate for Indonesia to seek a termination of this dispute after the case has been fully briefed and argued.

4.110 Accordingly, for the foregoing reasons, the United States respectfully requests that the Panel deny Indonesia's request to terminate this dispute with respect to the National Car Programme.

[57]See, e.g., Second Submission of the United States, 23 December 1997, Attachment A, para. 36, note 7.

[58]See, e.g., section VIII.A.2 (footnote 423); and IMF News Brief No. 98/2 (15 Jan. 1998) (US Exhibit 41, pp. 20-22).

V. CLAIMS UNDER ARTICLE III OF GATT 1994

A. Claims Under Article III:2, First Sentence of GATT 1994

1. Claims Raised by Japan

5.1 **Japan** claims that the National Car Programme of February 1996 violates Article III:2, first sentence of GATT 1994. (See Section III.A). The following are **Japan's** arguments in support of this claim:

5.2 One of the essential elements of Indonesia's National Car Programme is the discriminatory exemption from the sales tax on luxury goods (luxury tax) which would otherwise be levied on sales of National Cars. This privilege results in imposition of an internal tax on imported "like" automobiles in excess of that applied to domestically produced National Cars, thus violating Article III:2, first sentence of GATT 1994.

(a) Article III:2, first sentence requires that sales of imported products not be taxed at rates in excess of rates imposed on like domestic products

5.3 The first sentence of GATT Article III:2 provides that imported products:

> "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."

Under the recent GATT/WTO precedents, Article III:2, first sentence has been applied in a straightforward manner:

> "[T]he words of the first sentence require an examination of the conformity of an internal tax measure with Article III by determining, first, whether the taxed imported and domestic products are 'like' and, second, whether the taxes applied to the imported products are 'in excess of' those applied to the like domestic products."[59]

The National Car Programme meets both of these criteria.

(b) Luxury tax is an internal tax

5.4 According to Indonesia's relevant laws and regulations, the sales tax on luxury goods is applicable to both domestically manufactured and imported automobiles.[60] The tax is collected from either domestic manufactures or importers, as the case may be.[61]

(c) National Cars are domestic products

5.5 Under the relevant regulations[62], National Cars (or National Motor Vehicles) must be "domestically produced by using facilities owned by national industrial companies or Indonesian statutory bodies with total share belonging to Indonesian citizens". The very language of the decree thus makes it clear the National Cars are domestic products. (See Section II.B.2).

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[59]Report of the Appellate Body on Japan-Taxes on Alcoholic Beverages ("Japan-Alcoholic Beverage II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted on 4 October 1996 pp.18-19.

[60]Government Regulation No.36/1996 (Japan Exhibit 25). (See also Section II.B.2.)

[61]Decree of Minister of the Finance No.272/KNK.04/1995 (Japan Exhibit 24); Decree of the Ministry of Finance No. 647/KMK.04/1993 (Japan Exhibit 23).

[62]Decree of Minister of the Industry and Trade No.31/MPP/SK/2/1996 (Japan Exhibit 28).

(d) National Cars and imported automobiles are "like" products

5.6 Regarding the legal test for determining "like" products, recent Appellate Body reports have repeatedly affirmed that:

> "a determination of 'like products' for the purpose of Article III:2, first sentence, must be construed narrowly, on a case-by-case basis, by examining relevant factors including:
>
> (i) the product's end-uses in a given market,
> (ii) consumers' tastes and habits and
> (iii) the product's properties, nature and quality."[63]

5.7 However, in this present case, it is almost meaningless to discuss "likeness", because, even if vehicles identical in all aspects (including the end-uses, properties, nature and quality) with National Cars are manufactured abroad (for example, in Japan) and imported, they would still be treated differently from National Cars.

5.8 Moreover, foreign brand "like" products of National Cars (the Timor S515) actually are sold in the Indonesian auto market. As shown by the Table 11 below, the National Car - Timor Sephia sedans (1500cc) - are no different from other competitive products imported or assembled by other automakers in Indonesia. First, their common end-use in the Indonesian market is passenger transportation. Second, although consumers' brand preferences may exist, the products themselves are generally recognized to belong to the same "sedan" category. Indonesia may contend that the mere fact that the former vehicles are manufactured abroad makes them different (or that Indonesian consumers prefer domestic products, and thus, imported products are not regarded as "like" products of such domestic products). However, these arguments cannot prevail, since it would deny the fundamental principle of Article III.[64]

[63]Report of the Appellate Body on Canada-Certain Measures Concerning Periodicals ("Canada - Periodicals"), WT/DS31/AB/R, adopted on 30 June 1997, pp. 19-20. Report of the Appellate Body on Japan-Alcohol Beverages II, p.19. See also Working Party Report on Border Tax Adjustment ("Border Tax Adjustment"), L/3464, adopted on 2 December 1970 (BISD 18S/97) para.18.

[64]In this connection, a panel report on Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages,adopted on 10 November 1987 L/6216,(BISD 34S/83),stated that, [even if consumers prefer traditional Japanese shochu to vodka]"the traditional Japanese consumers habits with regard to shochu provided no reason for not considering vodka to be a 'like' product," since "the aim of Article III:2... could not be achieved if differential taxes could be used to crystallize consumer preferences for traditional domestic products." See para .5.7 of the Panel Report. Of course, it would be difficult to assume any wider difference between domestic automobiles and imported automobiles for Indonesian consumers than the difference between shochu and vodka for Japanese consumers.

Table 11
Like Products

Company	P.T. Timor	Toyota	Mitsubishi	Honda	Suzuki
Brand	Timor S515i	Corolla	Lancer	Civic	Baleno SY 416
Category	Sedan	Sedan	Sedan	Sedan	Sedan
Engine displacement	1,500cc	1,600cc	1,600cc	1,600cc	1,600cc
Luxury Tax	0%	35%	35%	35%	35%
Price (1,000Rp) (March 1997)	36,400-36,900	68,300-71,800	65,000-72,000	71,160-74,860	44,750

(e) Imported products are taxed less favourably than "like" domestic products

5.9 As noted earlier, the category, or the concept of, "National Cars" consists, in principle, of domestic products. The regulation at issue accords the luxury tax exemption to this category of domestic products, thereby creating more favourable terms than imported products. In fact, paragraph (4) of Article 23 of Government Regulation No. 50/1994 on the Implementation of Law No.8/1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as amended by the Government Regulation No.20/1996 provides as follows:

> "(4) National motor vehicles which are *domestically produced* by using trade marks created by relevant industrial companies themselves ... shall be granted government borne sales tax on luxury goods on their delivery." (*Italics* added.)[65]

On the other hand, under the February 1996 Programme, no imported motor vehicles qualify as the "National Cars" and all imported sedans are subject to 35 per cent luxury tax. [(See **Chart-3**)]**

5.10 This mechanism deprives imported automobiles of an opportunity for tax exemption, which is available for domestic automobiles, precisely because they are imported products. To this extent, this case presents the same issue as a Panel faced in United States - Measures Affecting The Importation, Internal Sale and Use of Tobacco.[66]

5.11 In that case, all imported tobacco was subject to an internal tax (the Budget Deficit Assessment of "BDA"), but not all domestic tobacco was subject to the tax. The Panel found that "the BDA, as currently applied, provided less favourable treatment to imported tobacco than to like domestic tobacco."[67]

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[65]Government Regulation No.20/1996 (Japan Exhibit 26); Government Regulation No.36/1996 (Japan Exhibit 25) which amended the former regulation but without relevant substantive changes.

[66]United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco ("United States - Tobacco"), DS44/R, adopted on 4 October 1994.

[67]Id. para.90. This panel further found that "an internal regulation which merely exposed imported products to a risk of discrimination ... constitutes, by itself, a form of discrimination, and therefore less favourable treatment within the meaning of Article III." (paras. 92-93, 95-98).

Quite similarly, at issue in this proceeding is tax exemption which is available for some domestic products (i.e., National Cars) but from which no imported products may benefit. Accordingly, imported like products are taxed less favourably than domestic products.

(f) Insignificant market share for imported sedans is not a defence

5.12 For various reasons, imported assembled sedans have earned only a fraction of the Indonesian market. The share of foreign passenger vehicles in the market was 0.28 per cent in 1994, 2.58 per cent in 1995 and 0.29 per cent in 1996.[68] However, previous Panels consistently have rejected a defence based on the insignificant economic consequence of imported products[69], and there is no reason for this Panel to diverge from that clear precedent.

5.13 Indonesia admits all the facts necessary to establish a violation of GATT Article III:2. The first sentence of Article III:2 prohibits a WTO Member from subjecting imported goods to internal taxes in excess of those applied to like domestic products. Indonesia admits that:

(1) "The Indonesian luxury tax is an internal tax"; and

(2) "Under the February 1996 national car programme, the Government excuses [PT Timor] from payment of the luxury tax on the 1500cc Timor S515 ... while imposing the non-subsidized rate of 35 per cent on imports of like products." (See Section V.D.)

Therefore, Indonesia itself admits that it applies greater taxes on imported cars than it applies on like domestic products. No more need be said to establish a *prima facie* violation of the first sentence of Article III:2.

5.14 The Government of Japan continues to submit that the February 1996 Programme also violates the second sentence of Article III:2 (See Section V.B.1), but it considers that this point requires no more argumentation in light of Indonesia's admissions that it discriminates between National Cars and imported "like" automobiles.

5.15 Having admitted a *prima facie* violation of Article III:2, Indonesia raises as its only defence a series of related arguments intended to show that Article III:2 does not apply - despite its plain language - to tax discrimination of this kind. (See Section V.D.) Those arguments are meritless and should be rejected by the Panel. (See Section V.E.1.). Therefore, the February 1996 Programme violates Article III:2.

2. Claims Raised by the European Communities

5.16 The **European Communities** claims that Indonesia has violated its obligations under Article III:2, first sentence, by exempting from the Sales Tax on Luxury Goods the sales of the following categories of motor vehicles (See Section III.B):

(1) domestically manufactured motor cycles with engines of 250 cc or less;

(2) combines, minibuses, vans and pick-ups using gasoline as fuel which are manufactured domestically and have a local content of more than 60 per cent;

[68]Motor Vehicle Market Share 1992-1997 (Japan Exhibit 60).

[69]United States - Taxes on Petroleum and Certain Imported Substances, L/6175 adopted 17 June 1987, BISD 34S/136, para.5.1.9; United States - Tobacco, paras. 99-100.

(3) combines, minibuses, vans and pick-ups using diesel oil as fuel which are manufactured domestically and have a local content of more than 60 per cent;

(4) domestically manufactured buses;

(5) domestically manufactured sedans and stations wagons of less than 1,600 cc with a local content of more than 60 per cent;

(6) National Cars assembled in Indonesia by Pioneer companies; and

(7) imported National Cars.

5.17 The following are the **European Communities'** arguments in support of this claim:

5.18 GATT Article III:2, first sentence, provides that:

> The products of the territory of any contracting 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.

5.19 As confirmed by the Appellate Body in Japan - Alcoholic Beverages[70] and Canada - Certain Measures concerning Periodicals[71], in order to establish whether an internal tax is applied in violation of Article III:2, first sentence, it is necessary to make two determinations:

- first, whether the taxed imported and domestic products are "like"; and
- second, whether the taxes applied to the imported products are "in excess of" those applied to the like domestic products.

5.20 Before making those two determinations, however, it must be ascertained whether the taxes in question constitute an "internal tax".

(a) The Sales Tax on Luxury Goods is an "internal tax"

5.21 The Sales Tax on Luxury Goods is levied on the sale of both domestic and imported motor vehicles and not just "on" or "in connection" with the importation of motor vehicles, even if some categories of domestic motor vehicles are subsequently exempted therefrom. Accordingly, the Sales Tax on Luxury Goods has to be considered as an "internal tax" in the terms of Article III:2, and not as an import charge within the purview of GATT Articles II and VIII.

(b) Imported products are "like" the domestic products exempted from the tax

5.22 The term "like product" is not defined in the GATT 1994. In Japan - Alcoholic Beverages[72] and Canada - Certain Measures concerning Periodicals[73] the Appellate Body endorsed the basic approach set out in the 1970 Report of the Working Party on Border Tax Adjustment:

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[70]Appellate Body Report on Japan - Alcoholic Beverages, WT/DS 8/AB/R, WT/DS 10/AB/R, WT/DS 11/AB/R, adopted 1 November 1996, pp. 18-19.

[71]Appellate Body Report on Canada - Certain Measures concerning Periodicals, WT/DS 31/AB/R, pp. 22-23.

[72]Appellate Body Report on Japan - Taxes on Alcoholic Beverages, WT/DS 8/AB/R, WT/DS 10/AB/R, WT/DS 11/AB/R, adopted 1 November 1996, p.20.

> ... the interpretation of the term [like product] should be examined on case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a similar product. Some criteria were suggested for determined, on a case-by-case basis, whether a product is "similar": the product's end uses in a given market; consumers' tastes and habits, which change from country to country; the products properties, nature and quality.[74]

5.23 The tax exemptions provided by the measures in dispute are not based on any factor which affects of itself the properties, nature or quality of the products concerned or their end uses, nor consequently prevent the exempted products from being "like" the non-exempted products.

5.24 Exemptions (1) and (4) are based, only and exclusively, on the country of manufacture of the products.

5.25 Exemptions (2), (3) and (5) are also based on the country of manufacture of the products and, in addition, on their level of local content.

5.26 Exemption (6) applies to motor vehicles which fulfil the following three conditions:

- first, they must be National Cars manufactured by a Pioneer Company;
- second, they must have been manufactured in Indonesia; and
- third, the manufacturer must comply with certain local content requirements.

5.27 Exemption (7) is also based on three conditions:

- first, the cars must be National Cars manufactured by a Pioneer Company;
- second, they must have been manufactured with the "participation" of Indonesian nationals; and
- third, they must incorporate a certain percentage of "counter-purchased" parts and components exported from Indonesia.

5.28 For the purposes of exemption (6) and exemption (7) a motor vehicle is deemed to be a "National Car" if it satisfies the conditions enumerated in Article 1 of Decree 31/96, which provides that:

> National vehicles shall be those which:
>
> (a) are domestically produced by using facilities owned by national industrial companies or Indonesian statutory bodies with total shares belonging to Indonesian citizens; and
>
> (b) use trade marks created by relevant industrial companies themselves and not yet registered by other parties in Indonesia and owned by Indonesian citizens; and
>
> (c) are developed with technology, designs and engineering on the basis of national capacity to be realized in phases.

5.29 Clearly, motor vehicles manufactured in Indonesia are not, by definition, "unlike" motor vehicles manufactured in the territory of any other Member.

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[73]Appellate Body Report on Canada - Certain measures concerning Periodicals, WT/DS 31/AB/R, p.21.

[74]Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para 18.

5.30 Similarly, there is nothing which, a priori, makes Indonesian manufactured parts and components for the assembly of motor vehicles "unlike" Community manufactured parts and components.[75] It follows that motor vehicles with 61 per cent Indonesian made parts and components do not, for that reason alone, cease to be "like" motor vehicles with 100 per cent Community content for the purposes of Article III:2, first sentence.

5.31 The additional criteria on which exemptions (6) and (7) for National Cars are based do not relate, directly or indirectly, to the characteristics of those cars but, instead, to the characteristics of the car manufacturers. As established by previous Panel Reports, differences in the producers' characteristics which do not affect the products' characteristics can never justify a different tax treatment of the products involved.

5.32 Thus, the Panel report on United States - Measures affecting Alcoholic and Malt Beverages, concluded that the granting of a tax credit for beer from small breweries but not for beer from large breweries infringed Article III:2, first sentence, whether or not this credit was also available in the case of imported beer because:

> ... beer produced by large breweries is not unlike beer produced by small breweries. Indeed the United States did not assert that the size of the breweries affected the nature of the beer produced or otherwise affected beer as a product ... .[76]

5.33 This finding was invoked as a precedent by the subsequent Panel Report on United States - Standards for Reformulated and Conventional Gasoline, which in clear and unequivocal manner stated the principle that:

> Article III:4 of the General Agreement deals with the treatment to be accorded to like products; its wording does not allow less favourable treatment dependent on the characteristics of the producer. [77]

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[75]In United States - Measures affecting Alcoholic and Malt Beverages, (adopted on 19 June 1992, BISD 39S/206, at para 5.22) the Panel found that the granting of tax exemptions and tax credits by the states of Michigan, Ohio and Rhode Island only to wines produced using local ingredients was in violation of Article III:2, first sentence.

[76]Panel Report on United States - Measures affecting Alcoholic and Malt Beverages, adopted 19 June 1992, BISD 39S/206, at para 5.19

[77]Panel Report on United States - Standards for Conventional and Reformulated Gasoline, WT/DS 2/R, adopted 20 May 1996, para 6.11. The Panel went on to state the following (at paras 6.11 and 6.12):

> The Panel noted that in the Malt Beverages case, a tax regulation according less favourable treatment to beer on the basis of size of the producer was rejected. Although this finding was made under Article III:2 concerning fiscal measures, the Panel considered that the same principle applied to regulations under Article III:4. Accordingly, the Panel rejected the United States argument that the requirements of Article III:4 are met because imported gasoline is treated similarly to gasoline from similarly situated domestic parties.
>
> Apart from being contrary to the ordinary meaning of the terms of Article III:4, any interpretation of Article III:4 in this manner would mean that the treatment of imported and domestic goods concerned could no longer be assured on the objective basis of their likeness as products. Rather, imported goods would be subject to a highly subjective and variable treatment according to extraneous factors. This would thereby create great instability and uncertainty in the conditions of competition as between domestic and imported goods in a manner fundamentally inconsistent with the object and purpose of Article III

See also Panel Report on United States - Taxes on Automobiles, DS 31/R, unadopted, at paras 5.53-5.54.

5.34 Although this conclusion concerns Article III:4, the Panel made it clear that the same principle applied also to fiscal measures under Article III:2.

5.35 In light of the foregoing, the European Communities submits that each of the following categories of goods should be considered as a single category of "like products" for the purposes of applying Article III:2, first sentence, in the present case:

- imported and Indonesian made motorcycles of 250 cc or less;

- imported combines, minibuses, vans and pick-ups and Indonesian made combines, minibuses, vans and pick ups, including those with a local content of 60 per cent or more;

- imported and Indonesian made buses;

- imported sedans and stations wagons of less than 1,600 cc and Indonesian made sedans and station wagons of less than 1,600 cc, including those with a local content of 60 per cent or more;

- imported motor vehicles and National Cars assembled in Indonesia by Pioneer Companies; and

- imported parts, components and raw materials for the assembly of motor vehicles and Indonesian made parts, components and raw materials, including those incorporated into imported National Cars.

(c) Imported motor vehicles are taxed in "excess of" domestic like motor vehicles

5.36 Imported motor vehicles are taxed "in excess of" domestic like products because they are always subject to the Sales Tax on Luxury Goods at a rate ranging from 20 per cent to 35, whereas like domestic products can benefit from exemptions (1) through (6).

5.37 The fact that some domestically made like products (namely, motor vehicles other than buses and motorcycles of less than 250 cc manufactured by non-Pioneer companies and with less than 60 per cent local content) are also subject to the Sales Tax on Luxury Goods does not preclude a violation of Article III:2, first sentence. As noted in the Panel Report on United States - Measures affecting Alcoholic and Malt Beverages:

> 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 .... [T]he fact that only approximately 1.5 per cent of domestic beer in the United States is eligible for the lower tax rate cannot justify the imposition of higher internal taxes on imported Canadian beer than on competing domestic beer" .[78]

5.38 For the same reasons, it is irrelevant that some of the exemptions (e.g. exemption (5)) may in practice not have been applied yet due to the temporary lack of qualifying domestic production. As noted also in United States - Measures affecting Alcoholic and Malt Beverages:

[78]Panel Report on United States - Measures affecting Alcoholic and Malt Beverages, adopted 19 June 1992, BISD 39S/206, para 5.6.

> legislation mandatorily requiring the executive authority to take action inconsistent with the General Agreement would be inconsistent with Article III, whether or not the legislation were being applied.[79]

5.39 It is also without relevance that National Cars imported from Korea by PT TPN were exempted from the Sales Tax on Luxury Goods by Presidential Decree 42/96. There subsists a violation of Article III:2 because not all imported cars that are "like" the exempted domestic cars benefit from that exemption.

5.40 As put by the Panel Report on United States - Measures affecting the Importation, Internal Sale and Use of Tobacco:

> "In accordance with the national treatment provisions of Article III:2 each pound of tobacco imported into the United States had to be accorded treatment no less favourable in respect of internal taxes than that accorded to like domestic products."[80]

5.41 By the same token, in the present case every single motor vehicle imported into Indonesia (and not just National Cars imported from Korea) should be accorded treatment "no less favourable" in respect of the Sales Tax on Luxury Goods than that granted in each case to the "most favoured" category of like domestic products.

(d) Imported parts and components are 'indirectly' taxed 'in excess of' like domestic parts, components and materials

5.42 Article III:2 prohibits not just "direct" discrimination against imported products but also any kind of "indirect" discrimination.

5.43 When the level of the tax applicable on a finished product is function of its local content level, imported parts and components are, as a result, subject "indirectly" to a tax which is in excess of that indirectly applied on domestic like parts and components. This form of indirect tax discrimination arises whether or not, in addition, there is also "direct" tax discrimination between the domestic and imported finished goods into which the parts and components are incorporated.

5.44 Confirmation of the above is provided by the Panel Report on EEC - Regulation on Imports of Parts and Components. In that case, the Panel found that the anti-circumvention duties imposed by the Community pursuant to its anti-dumping regulations on finished products assembled within the Community territory which did not meet certain local content requirements:

> subject imported parts and materials indirectly to an internal charge in excess of that applied to like domestic products and [...] are consequently contrary to Article III:2 first sentence".[81]

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[79]Id. at para 5.39. See also Panel Report on US - Taxes on Petroleum and Certain Imported Substances, adopted 17 June 1987, BISD 34S/136, para 5.2.2; and Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, adopted on 7 November 1990, 37S/200, 227, para 84.

[80]Panel Report on United States - Measures affecting the Importation, Internal Sale and Use of Tobacco, adopted on 4 October 1994, para 98. In support of this conclusion, the Panel referred to the "no-balancing" principle established with respect to Article III:4 by the Panel report on United States - Section 337 of the Tariff Act of 1930, adopted on 7 November 1989, BISD 36S/345, 387. This principle has been recently restated by the Panel report on United States- Standards for Conventional and Reformulated Gasoline, WT/DS 2/R, adopted 20 May 1996, at paras 6.14-6.15.

[81]Panel Report on EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990, BISD 37S/132 at para 5.9.

5.45 Exemptions (2) (3) (5) (6) and (7) are to be condemned under Article III:2, first sentence, the European Communities cites for the same reasons as the duties in the above case.

5.46 As shown above, exemptions (2) (3) (5) and (6) are "directly" discriminatory against imported motor vehicles in that they are available only for domestically produced motor vehicles. In addition, they discriminate "indirectly" against imported parts and components because, in order to qualify for the exemptions, domestic motor vehicles must incorporate a minimum percentage of locally made parts and components.

5.47 Exemption (7) does not discriminate "directly" against imported motor vehicles. To the contrary, it is an exemption reserved for certain imported motor vehicles. Nonetheless, exemption (7) infringes Article III:2, first sentence, because it is linked to a local content requirement and, therefore, discriminates "indirectly" against imported parts and components.

3. Claims Raised by the United States

5.48 The **United States** claims that Indonesia's discriminatory application of the luxury tax (See Section III.C) is inconsistent with Article III:2, first sentence, of GATT 1994. The following are the **United States'** arguments in support of this claim.

5.49 Article III:2, first sentence, provides as follows:

> 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.

5.50 Under Regulation No. 36/1996, motor vehicles produced or assembled in Indonesia with a local content in excess of 60 per cent, or national motor vehicles that satisfy the local content requirements of Decree No. 31/1996, are exempt from the luxury tax. However, imported CBU motor vehicles that are "like" their Indonesian-made counterparts are subject to the luxury tax, the precise amount of the tax depending on the type of motor vehicle.[82] Thus, the luxury tax on imported motor vehicles is "in excess of" the tax on like domestic motor vehicles that are exempt from the tax under Regulation No. 36/1996. As the Appellate Body stated in Japan - Taxes on Alcoholic Beverages, for purposes of Article III:2, first sentence, "[e]ven the smallest amount of 'excess' is too much".[83] Here, the amounts are not small, but instead are the difference between 0 and 35 per cent.

B. Claims Under Article III:2, Second Sentence of GATT 1994

1. Claims Raised by Japan

5.51 **Japan** argues that "the National Car Programme" of February 1996 (See Section III.A) violates Article III:2, second sentence of GATT 1994. The following are **Japan's** arguments in support of this claim:

5.52 Even if the National Car Programme did not violate Article III:2, first sentence, the National Car Programme still violates Article III:2, second sentence, which prohibits a Member country from

[82]To reiterate, the applicable luxury tax rates under Regulation No. 36/1996 are: (1) 35 per cent for passenger cars and jeeps; (2) 25 per cent for light commercial vehicles (other than jeeps) that use diesel as fuel; and (3) 20 per cent for light commercial vehicles (other than jeeps) that use gasoline as fuel.

[83]WT/DS8/R, WT/DS10/R, WT/DS11/R, Report of the Appellate Body, adopted 1 November 1996, p. 24.

applying "internal taxes or other internal charges to imported or domestic products in a manner contrary to the principle set forth in paragraph 1."

5.53 A recent Appellate Body report has held that:

> ... three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:
>
> > (1) the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other;
> >
> > (2) the directly competitive or substitutable imported or domestic products are "not similarly taxed"; and
> >
> > (3) the dissimilar taxation of the indirectly competitive or substitutable imported domestic products is "applied ... so as to afford protection to domestic production".[84]

(a) National Cars and imported automobiles are "directly competitive or substitutable" products

5.54 **Japan** indicates that the same evidence presented in the context of its "like product" argument for its claim under Article III:2, first sentence (See Section V.A.1) supports its argument in the context of its claim under Article III:2, second sentence that National Cars are indistinguishable from imported automobiles.

(b) National Cars and imported automobiles are not "similarly taxed"

5.55 Since National Cars are exempted from the luxury tax while any imported sedans are subject to 35 per cent luxury tax, they are obviously not taxed "similarly".

5.56 Moreover, according to the Indonesia in its notification of subsidies, the luxury tax exemption constitutes a "subsidy". If National Cars and imported sedans are indeed similarly taxed within the margin of de minimis magnitude[85], it is inconceivable how the tax exemption could constitute a "subsidy". Accordingly, by Indonesia's own admission National Cars and imported sedans are not similarly taxed.

(c) The tax exemption is accorded "so as to afford protection"

5.57 Indonesia has accorded the title of its Programme: "Development of the National Automobile Industry"[86] to the Presidential Instruction, which initiated the Programme. In addition to the Indonesian stated purpose of "the development of domestic motor vehicles in order that the national mobile industry can [quickly come] into being and can produce using brands created by itself", this objective is expressed unambiguously in "Elucidation on Government Regulation No. 36/1996", a supplementary legislative document for the government regulation granting tax exemption to National Cars.[87] It states:

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[84]Report of the Appellate Body on Japan - Alcoholic Beverages II, p.24. This three part test was affirmed by the Appellate Body Report in Canada - Periodicals, p.23.

[85]Report of the Appellate Body on Japan - Alcoholic Beverages II, pp.26-27. We discuss whether the characterization of a "subsidy" constitutes the valid defence in para. 3.501 - 3.521 below.

[86]Presidential Instruction No.2/1996 (Japan Exhibit 8).

[87]Government Regulation No.36/1996 (Japan Exhibit 25).

> [I]t is necessary to support the domestic automotive industry in order to further promote its growth particularly in the face of global competition. One of the methods which can be added is the provision of a tax incentive in the form of exception from the imposition of sales tax on luxury goods.... (Emphasis added.)

5.58 "Objective" factors surrounding the tax exemption testify to its "protective" character as well.[88] As we have already discussed, the share of imported passenger automobiles has been insignificant for a variety of reasons which are unrelated to competitiveness of foreign products. To grant an additional advantage to domestic production in this environment would do nothing more than add a layer of "insulation" to the Indonesian market.

2. Claims Raised by the United States

5.59 The **United States** claims that Indonesia's discriminatory application of the luxury tax is inconsistent with Article III:2, second sentence, of GATT 1994. The following are the **United States'** arguments in support of this claim:

5.60 As argued in Section V.A.(3) the exemption from the luxury tax under the National Car Programme violates Article III:2, first sentence, of GATT 1994. Should the Panel find otherwise, it is nevertheless the case that this exemption constitutes a violation of Article III:2, second sentence, which prohibits a Member from applying "internal taxes or other internal charges to imported or domestic products in a manner contrary to the principle set forth in paragraph 1".[89]

5.61 In Japan Liquor II, the Appellate Body set forth the following test for establishing a violation of Article III:2, second sentence:[90]

> ... [T]hree separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:
>
> (1) the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other;
>
> (2) the directly competitive or substitutable imported and domestic products are "not similarly taxed"; and

[88]Report of the Appellate Body on Japan - Alcoholic Beverages II, pp.27-31; Report of the Appellate Body on Canada - Periodicals, pp31-32.

[89]In its request for the establishment of a panel in this case, the United States did not limit its claim under Article III:2 to the first sentence of that provision. In its first submission to the Panel, however, the United States limits its arguments to Article III:2, first sentence, based on the belief that there can be no serious disagreement that the tax incentives under the National Car programme discriminate against imported passenger cars that are "like" domestic passenger cars. Based on its interpretation of Indonesia's arguments submitted as of the end of the first meeting of the Panel, the United States does not believe that Indonesia has contested the fact that, insofar as Article III:2 is concerned, the products in question are "like products". However, in anticipation that Indonesia may revise its arguments at this stage of the proceeding, the United States addresses its claim under Article III:2, second sentence.

[90]Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, page 25 (italics in original). The Appellate Body subsequently affirmed this test in Canada - Certain Measures Concerning Periodicals, WT/DS31/AB/R, Report of the Appellate Body adopted 30 July 1997, page 23.

(3) the dissimilar taxation of the directly competitive or substitutable imported domestic products is "applied ... so as to afford protection to domestic production".

5.62 All of the elements required by Article III:2, second sentence, as interpreted by the Appellate Body, are present in this case. First, there is ample evidence that the Timor Kia Sephia is "directly competitive or substitutable" with imported passenger cars. Second, the difference between a tax rate of zero and a tax rate of 35 per cent clearly constitutes non-similar taxation.

5.63 Finally, the tax exemption is accorded "so as to afford protection". The Elucidation on Government Regulation No. 36/1996, the instrument that actually confers the tax exemption, states that the purpose of the exemption is to "support the domestic automotive industry in order to further promote its growth particularly in the face of global competition".[91] Moreover, the very size of the tax differential makes it clear that the dissimilar taxation was applied "so as to afford protection".[92]

C. Claims Under Article III:4 of GATT 1994

1. Claims Raised by Japan

5.64 **Japan** claims that the local content requirements for the National Cars and their parts and components under the February 1996 programme (See Section III.A) violate Article III:4 of GATT 1994. The following are **Japan's** arguments in support of these claims:

5.65 The manufacturer of the National Cars (i.e., so called "pioneers") receive the following two substantive competitive benefits:

(1) it may import automotive parts and components used in the assembly of National Cars duty free; and

(2) purchasers of such National Cars pay no luxury tax, in comparison to the 20 per cent-35 per cent luxury tax that would normally apply.

These benefits are conditioned on the attainment of the following levels of local content:

- At the end of first year, the local content rate of more than 20 per cent;
- At the end of second year, the local content rate of more than 40 per cent;
- At the end of third year, the local content rate of more than 60 per cent.

(a) Article III:4 of GATT 1994 requires each WTO Member to guarantee equality of competitive opportunity between domestic goods and imported goods

5.66 GATT Article III:4 provides as follows:

> The products of the territory of any Member imported into the territory of any other Member 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.

5.67 In Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, the panel found:

[91]US Exhibit 10.

[92]Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, page 32.

> the requirement of Article III:4 to accord imported products treatment no less favourable than that accorded to domestic products was a requirement to accord imported products competitive opportunities no less favourable than those accorded to domestic products.[93]

5.68 The test for compliance with GATT Article III:4 is two-fold. First, are the imported and domestic goods in question "like products"? Second, have the imported products received treatment "less favourable" than the domestic like product? Therefore, interpretation of Article III:4 in the context of the present dispute boils down to the following two elements:

(1) whether or not imported automotive parts and components and domestic automotive parts and components are "like" products; and

(2) whether imported automotive parts and components are accorded less favourable treatment than domestic like products, in view of the local content requirements.

(b) Imported parts and components and domestic parts and components are "like" products

5.69 Relevant factors in determining whether or not imported automotive parts and components and domestic automotive parts and components are "like products" may be constructed on a case-by-case basis by examining relevant factors including:

(i) the product's end-uses in a given market,
(ii) consumers' tastes and habits, and
(iii) the product's properties, nature and quality.[94]

5.70 Domestic automotive parts and components and automotive parts and components from Japan are regarded as a single product for use in the assembly of automobiles, and thus it is practically unnecessary to discuss the "like" products issue further in this present case. Automotive parts and components are identical in all respects (including the end-uses, properties, nature and quality) with domestic ones may be imported from abroad.

5.71 Imported automotive parts and components from Japan and other WTO Members are "like" domestic parts and components that may be used in the assembly of National Cars. The only distinction that the Indonesia has made relevant under the Programme is not whether imported or domestic parts and components differ in any physical respect, but where they originate. Thus, imported and domestic parts and components are "like products" under Article III:4.

(c) Imported parts and components are accorded less favourable treatment than domestic like products in two respects

5.72 Only parts and components that originate in Indonesia contribute to the satisfaction by a National Car producer of the local content requirement upon which Indonesia has conditioned the duty free treatment of the remaining imported parts and components used to assemble the National Car and the luxury tax exemption on National Cars.

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[93]Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, DS21/R, adopted on 18 February 1992 (BISD 39S/27) para.5.5.

[94]Working Party Report on Border Tax Adjustment, para.18; Report of the Appellate Body on Japan - Alcoholic Beverages II, p.19; Report of the Appellate Body on Canada - Periodicals, pp.19-20.

(1) The import duty exemption on automotive parts and components used in the assembly of National Cars conditioned upon the attainment of certain levels of local content accords advantages to domestic automotive parts and components not available to imported like products

5.73 WTO/GATT panels have consistently found that requirements to purchase domestic products to obtain an advantage violate Article III:4. The EC-Bananas III case, a WTO panel quoted and reaffirmed the following description by the 1994 GATT panel on EC-Bananas II regarding the scope of Article III:4:

> previous panels had found consistently that this obligation applies to any requirement imposed by a contracting party, including requirements 'which an enterprise voluntarily accepts in order to obtain an advantage from the government (EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990 (BISD 37S/132), para. 5.21).' 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.[95]

5.74 The Bananas III finding reinforces firmly established GATT precedent (e.g. the 1958 panel report on Italian Discrimination Against Imported Agriculture Machinery[96] and the 1984 report on Canada - Administration of the Foreign Investment Review Act ("FIRA")[97]).

5.75 On the basis of their domestic origin, Indonesian automotive parts and components receive treatment substantially more favourable than do even identical automotive parts and components imported from Japan and other WTO Members. In particular, only parts and components that originate in Indonesia contribute to the satisfaction by a National Car producer of the local content requirement upon which Indonesia has conditioned the import duty (and further luxury tax) exemption. In other words, Indonesia's National Car Programme established local content targets that automakers must satisfy in order to obtain a sliding scale of duty preferences, thereby favouring the purchase of domestic over imported like products for purposes of automobile production. The plain language of Article III:4, as applied in the EC - Bananas III and other cases (including the FIRA and Italian Agriculture Machinery cases) leaves no doubt that such an arrangement violates Article III:4.

(2) The luxury tax exemption on sales of National Cars conditioned upon the attainment of certain levels of local content accords advantages to domestic automotive parts and components not available to imported like products

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[95]EEC-Import Regime for Bananas, DS38/R, para. 146, 11 February 1994 (not adopted)("EC - Bananas II"), as quoted and adopted by the WTO panel in EC - Regime for the Importation, Sale and Distribution of Bananas ("EC - Bananas III"), WT/DS27/R/USA, paras. 7.179 and 7.180.

[96]See the 1958 panel report on Italian Discrimination Against Imported Agriculture Machinery, which concluded that Italian government credits for the purchase of domestically-produced machinery "might adversely modify the conditions of competition between the domestic and imported products" in violation of Article III:4. (BISD 7S/60, para. 12, adopted on 23 October 1958).

[97]See 1984 report on Canada - Administration of the Foreign Investment Review Act ("FIRA"), in which the panel found that "requirements to buy from Canadian suppliers are inconsistent with Article III:4." (BISD 30S/140, para. 5.10, adopted on 7 February 1984.) In particular, the *FIRA* panel noted that the coverage of "requirements" under Article III:4 included "undertakings," even if voluntary, to purchase domestic products if: "once they were accepted [such undertakings] became part of the conditions under which the investment proposals were approved, in which case compliance could be legally enforced." (para. 5.4)

5.76 On the basis of their domestic origin, Indonesian automotive parts and components receive treatment substantially more favourable than do even identical automotive parts and components imported from Japan and other WTO Members.

5.77 The conditioning of the luxury tax exemption on a local content requirement affords protection to domestic automotive parts and components because it promotes the sale of National Cars over other domestically assembled sedans that contain a greater proportion of imported parts. Such less favourable luxury tax treatment of imported products relative to a domestic like product stands in clear violation of Article III:4 precisely in the same way as the import duty exemption discussed in the preceding section.

2. Claims Raised by the European Communities

5.78 The **European Communities** claims that the following measures (See Section III.B) applied by Indonesia are inconsistent with Article III:4 of GATT 1994 because they favour the "use" by Indonesian car manufacturers of domestic parts and components over "like" imported parts and components:

(1) the exemption from the Sales Tax on Luxury Goods of locally manufactured combines, minibuses, vans and pick-ups with more than 60 per cent local content;

(2) the exemption from the Sales Tax on Luxury Goods of locally manufactured sedans and stations wagons of less than 1,600 cc with more than 60 per cent local content;

(3) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Indonesia by Pioneer companies meeting certain local content requirements;

(4) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Korea by "overseas producers" meeting certain counter-purchasing obligations;

(5) the grant of import duty relief to parts and components used in the assembly of motor vehicles (or of other parts and components for the assembly of motor vehicles) in Indonesia based on the finished vehicles (or the parts and components) meeting certain local content requirements; and

(6) the exemption from import duties for parts and components used for the assembly of National Cars in Indonesia by Pioneer Companies meeting certain local content obligations.

5.79 The following are the **European Communities's** arguments in support of these claims:

5.80 Article III:4 of GATT provides in pertinent part that:

> The products of the territory of any contracting party imported into the territory of any contracting party shall be accorded treatment no less favourable than that accorded to the products of national origin in respect of all laws, regulations and requirements affecting their internal .... use.

5.81 In order to rule on this claim, the Panel is required by the wording of Article III:4 to make the following determinations:

- first, whether the measures at issue are "laws, regulations or requirements";

- second, whether they "affect the internal use" of parts and components for the assembly of motor vehicles;

- third, whether imported parts and components are "like" domestic parts and components; and

- fourth, whether the measures afford "less favourable treatment" to imported parts and components.

(a) The measures at issue are "laws, regulations or requirements"

5.82 The measures at issue are contained in generally applicable Presidential Instructions, Government Regulations and Decrees of the Minister of Finance and of the Minister of Industry and Trade. Therefore, they are "laws or regulations" within the meaning of Article III:4.

5.83 The measures are "voluntary" in the sense that car manufacturers are not under a legal obligation to use local parts and components and that failure to comply with the local content targets set by the measures only entails the loss of the tax and tariff benefits linked thereto. This, however, does not have the consequence of placing the measures outside the purview of Article III:4.

5.84 Previous Panels have made clear that III:4 does not apply only to "mandatory" measures. Where compliance with a certain measure is necessary in order to secure an advantage or benefit, such measure may also be covered by Article III:4. As noted by the Panel Report on EEC - Regulation on Imports of Parts and Components:

> ... the comprehensive coverage of 'all laws, regulations or requirements affecting' [emphasis added by the Panel] the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, such as those examined by the FIRA Panel .... but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute 'requirements' within the meaning of that provision.[98]

5.85 The "advantage" in question may consist of a benefit granted in respect of an import measure, such as for instance a tariff exemption. Thus, in EC - Regime for the Importation, Sale and Distribution of Bananas the Panel found that a requirement to purchase domestic bananas in order to obtain the right to import bananas at a lower duty rate under a tariff rate quota was a requirement affecting the internal purchase of a product within the meaning of Article III:4.[99]

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[98]Panel Report on European Communities - Regulation on imports of Parts and Components, adopted on 16 May 1990, 37S/132, 197, para 5.21.

This principle has been consistently followed by other Panels. Thus, the Panel Report on Italian discrimination against Imported Agricultural Machinery (adopted on 23 October 1958, BISD 7S/60, 64, para 12) found that an Italian law providing especial credit terms to farmers for the purchase of agricultural machinery conditional on the purchase by the farmers of Italian machinery was contrary to Article III:4. Similarly, the Panel Report on EEC - Payments and subsidies paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins (adopted on 25 January 1990, BISD 37S/86, 124-125) concluded that the payment by the Community of subsidies to the processors of oilseeds who purchased oilseeds of Community origin was contrary to Article III:4.

[99]See e.g. Panel report on EC - Regime for the Importation, Sale and Distribution of Bananas, adopted 25 September 1997, WT/DS 27/R/USA, paras. 7.179 and 7.180. On appeal, this finding has been upheld by the Appellate Body (WT/DS 27/AB/R, adopted 25 September 1997, at para 211).

(b) The measures "affect the internal use" of parts and components for the assembly of motor vehicles

5.86 For a measure to "affect" the use of parts and components for motor vehicles, it does not have to regulate directly those products. It only has to affect the conditions of competition between domestic and imported parts and components. In the words of the Panel Report on Italian Discrimination Against Imported Agricultural Machinery:

> ... The selection of the word 'affecting' would imply [...] that the drafters of the Article intended to cover in [Article III:4] not only the laws and regulations which directly governed the conditions of sale or 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.[100]

5.87 The measures in dispute "affect" the internal use of automotive parts and components because they "modify adversely the conditions of competition"' between domestic and imported parts and components by giving to the Indonesian car manufacturers tax and tariff incentives for using local parts and components instead of imported like parts and components.[101]

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[100]Panel Report on "Italian Discrimination against Imported Agricultural Machinery", adopted on 23 October 1958, 7S/60, 64, para 12.

[101]That the purpose of the measures at issue is to increase the use of local parts and components at the expense of imported parts is not only obvious from the structure and design of the measures but has been openly acknowledged by the Indonesian authorities.

Thus, the only recital of Decree 645/93 reads as follows:

> "Considering that to increase the efficiency of the motor - vehicle assembling industry, the parts and accessories industry thereof, and in the framework of saving foreign exchange as well as increase domestic production, it is deemed necessary to regulate relief of import duty on importation of certain parts and accessories for assembling purposes" [emphasis added]

The recital of Decree 223/95 amending Decree 645/93 is even less ambiguous in this respect:

> "considering that with a view to increase the volume of local contents used in the industry of automotive assembly and the industry of automotive parts and accessories, as well as within the framework of economising on foreign exchange and enhancing the utilisation of domestic products it is necessary to improve..." [emphasis supplied].

A similar statement is found in the first recital of Government Regulation 36/96:

> "Considering that in an effort to motivate development in the car industry to expand the use of domestic car components, it is deemed necessary to provide facilities of Sales Tax on certain goods considered as Luxury, on the transfer of certain motor vehicles " [emphasis supplied]

More recently, the "policy objective" of the measures at issue has been defined in the following terms in Indonesia's notification under Article XVI:1 of GATT 1994 and Article 25 of the SCM Agreement as

> "to support development of the domestic automotive industry, including increased use of domestically produced components" [emphasis supplied] (G/SCM/N/16/IDN)

(c) Imported parts and components and domestic parts and components are "like" products

5.88 The mere fact of being manufactured in Indonesia does not of itself confer upon Indonesian made parts and components any specific characteristics, properties, nature or quality which makes them "unlike" parts and components made in the Community.

(d) The measures at issue give "less favourable treatment" to imported parts and components

5.89 The measures at issue afford "less favourable treatment" to imported parts and components because the use of those parts does not entitle Indonesian car manufacturers to the same tax and tariff benefits as the use of like domestic parts. As a result, whenever both Community made parts and components and Indonesian made parts and components can be obtained on the same conditions, the Indonesian car manufacturers will give preference to the purchase or internal production of Indonesian made parts and components over the importation of Community made ones.

(e) Local content requirements have already been found contrary to Article III:4 of GATT

5.90 Local content requirements similar to the ones under consideration have already been found to be inconsistent with Article III:4 of GATT by previous Panels.

5.91 In the 1984 case concerning Canada's Foreign Investment Review Act ("FIRA"), the Panel found that the undertakings given to the Canadian Government by certain foreign investors to, *inter alia*, purchase goods of Canadian origin in specified amounts or proportions afforded "less favourable treatment" to like imported products and were therefore contrary to Article III:4.[102]

5.92 Local content requirements have also been found contrary to Article III:4 by the 1990 Panel Report on EC - Regulation on Imports of Parts and Components. In that case, the Panel concluded that, by making the suspension of anti-circumvention proceedings initiated in accordance with the Community's anti-dumping regulations against the subsidiaries of Japanese companies established in Community territory conditional upon the investigated companies giving an undertaking to limit the use of Japanese parts and materials, without imposing similar limitations on the use of like domestic products, the latter were given more favourable treatment in violation of Article III:4.[103]

(f) The TRIMs Agreement confirms that the measures are incompatible with Article III:4 of the GATT

5.93 The TRIMs Agreement has confirmed beyond doubt that local content requirements such as the ones under consideration are inconsistent with Article III:4 of GATT. Indeed, the Illustrative List of TRIMs annexed to that Agreement reads in relevant parts as follows:

> 1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those [....] 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 [...] in terms of a proportion of volume or value of its local production.

[102]Panel report on Canada - Administration of the Foreign Investment Review Act, adopted on 7 February 1984, BISD 30S/140, paras 5.4-5.12.

[103] Panel report on EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990, BISD 37S/132, paras 5.19-5.21.

5.94 The measures in dispute fall squarely within point 1 (a) of the Illustrative List and are therefore contrary to GATT Article III:4.

3. Claims Raised by the United States

5.95 The **United States** claims that Indonesia's system of tariff and tax incentives and the government-directed $690 million loan to TPN (See Section III.C), all of which are contingent upon the use of domestic automotive parts, are inconsistent with Article III:4 of GATT 1994 and are not covered by Article III:8(b) of GATT 1994. The following are the **United States'** arguments in support of these claims:

(a) Summary of the measures

5.96 Imported automotive parts, as well as imported subparts, face discrimination once they arrive in Indonesia. Indonesia offers several incentives to purchasers and users of automotive parts and subparts that are intended to encourage the use of Indonesian-made parts and subparts. These incentives can be summarized as follows:

(1) Import duty incentives

5.97 Under Decree No. 645/1993, as amended by Decree No. 223/1995, the import duty rate on imported automotive parts and subparts decreases as the local content of the finished product (either a motor vehicle or a motor vehicle part) increases.[104] If the degree of local content exceeds a certain threshold (60 per cent in the case of passenger cars, 40 per cent in the case of light commercial vehicles, and 40 per cent in the case of subparts of passenger cars and light commercial vehicles), imports may enter duty-free. (See Tables 6 and 7)

5.98 In addition, under the National Motor Vehicle programme, Article 4(2) of Decree No. 645/1993, as amended by Article 1 of Decree No. 82/96, exempts "[i]mports of parts and equipment of motor vehicles for assembling purposes or manufacture of national motor vehicles which fulfil the required local contents stipulated by the Minister of Industry and Trade ... ." As set forth in Article 3(1) of Decree No. 31/1996, in order to receive national motor vehicle benefits, the local content rates shown in Table 8 must be achieved.

5.99 Finally, under Article 1 of Presidential Decree No. 42/1996, national motor vehicles produced abroad were allowed to be imported free of the 200 per cent Indonesian tariff on CBU passenger cars if such cars "fulfill[ed] the local content requirements as stipulated by the Minister of Industry and Trade"; i.e., if they satisfied the local content rates of Decree No. 31/1996 set forth in the preceding paragraph. Thus, TPN was allowed to import CBU Kia Sephia sedans from Korea without having to pay the 200 per cent tariff on finished passenger cars. TPN was allowed to do so only because, as a participant in the joint venture to assemble a "national motor vehicle", it was subject to the local content schedule set forth in Decree No. 31/1996.

(2) Tax incentives

5.100 Under Decree No. 647/1993, passenger cars and jeeps were subject to a luxury tax of only 20 per cent, provided that their local content exceeded 60 per cent. Otherwise, the luxury tax for these motor vehicles was 35 per cent. Regulation No. 20/1996 established a more complex luxury tax schedule, although the distinguishing feature of the schedule continued to be that the luxury tax rate decreased as the rate of local content increased. Finally, Regulation No. 36/1996 increased the degree of discrimination inherent in Indonesia's luxury tax structure by establishing a luxury tax rate of 0 per cent

[104]Decree No. 223/1995 replaced the incentive schedule originally contained in Decree No. 645/1993.

for national motor vehicles and motor vehicles with a local content greater than 60 per cent. Under Regulation No. 36/1996, the following luxury tax schedule currently exists:

Table 12
Luxury Tax Relief

Type of Motor Vehicle	Luxury Tax Rate
passenger cars ≥ 1600cc passenger cars with local content ≤ 60% jeeps with local content ≤ 60%	35%
light commercial vehicles (other than jeeps) using diesel fuel with local content ≤ 60%	25%
light commercial vehicles (other than jeeps) using gasoline with local content ≤ 60%	20%
passenger vehicles < 1600cc manufactured in Indonesia with local content > 60% light commercial vehicles (diesel or gasoline) With local content > 60% national motor vehicles	0%

Under this schedule, all passenger vehicles and light commercial vehicles (with the exception of passenger cars with a cylinder capacity greater than or equal to 1600cc) are exempt from the luxury tax provided that the local content of the vehicle exceeds 60 per cent. Thus, the incentive to use domestic, rather than imported, automotive parts is even greater. And, of course, national motor vehicles are subject to their own local content schedule, as set forth in Decree No. 31/1996.

(3) The government-directed $690 million loan

5.101 Finally, there is the government-directed $690 million loan to TPN. This loan conferred an advantage on TPN because of (1) the concessional terms of the loan; and (2) in the absence of this intervention by Indonesia, TPN would not have been able to obtain such a loan due to its own financial situation, the financial situation of its partner, Kia Motors, and the overall clamp down on lending by the Indonesian Government. In addition, the evidence is overwhelming that Indonesia ordered the consortium of government-owned banks and private banks to provide the loan because of TPN's status as a participant in the production of a "national motor vehicle". TPN's status, in turn, was contingent upon satisfaction of the local content requirements for a "national motor vehicle" set forth in Decree No. 31/1996.

5.102 The most recent component of the National Motor Vehicle programme was introduced on 11 August 1997, when a consortium of four government-owned banks and twelve private banks decided to disburse US$650 million in ten-year loans to TPN to carry out the national car project.[105] Although the twelve private banks have not been identified in full, the four government-owned banks reportedly are Bank Dagang Nagara (BDN), Bank Expor Impor, Bank Rakyat Indonesia, and Bank Tabungan Negara.[106] BDN previously had disbursed a US$40 million bridging loan to TPN, bringing the total loan amount to US$690 million. The loans reportedly will carry an annual interest rate of 3 per cent

[105]"16 Banks to Lend $690 Million for Timor Car Project", Jakarta Post, 12 August 1997 (US Exhibit 14, pp. 161-162).

[106] Id.

over the 3-6 month deposit rate, a maturity of 10 years, and a grace period of 3 years.[107] The four government-owned banks would provide one-half of the $650 million loan.[108]

5.103 The circumstances surrounding this loan indicate that the loan was provided at the express direction of the Government of Indonesia, and that but for the Government's involvement, TPN never would have obtained the loan.

5.104 On 21 April 1997, nine economics ministers were instructed by the President to coordinate efforts to implement the car programme.[109] This group was given a mandate to ensure that the Kia Timor venture has a local content of 60 per cent by 1999.[110] The President's directive apparently resulted, among other things, in a directive from the Minister of National Development Planning that "All government bodies and state-owned companies should purchase the Timor when they need new sedans".[111]

5.105 In May, the Coordinating Minister for Economy and Finance announced that Indonesia had "ordered" 13 banks to lend US$1.3 billion to TPN.[112] The private banks hesitated to do so, but were eventually persuaded to do so.[113] Even after being persuaded, the private banks would agree to provide no more than one-half of the financing.

5.106 In addition, the decision to grant the $690 million loan package came at a time when Indonesia, due to the depreciation of the rupiah and overly aggressive lending by banks, was clamping down on credit and cancelling large projects, thereby making the loan to TPN all the more extraordinary.[114] Indeed, the President of Indonesia, in his state of the nation address, announced "that all projects that were not a national priority would be shelved given the 'new realities' facing the country".[115] As a

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[107] Id.

[108] Id.

[109] "RI to Finish Car Programme by '99", The Jakarta Post, 23 April 1997, p. 1 (US Exhibit 14, pp. 105-107).

[110] "Timor in Trouble at WTO and at Home", Business Times (Singapore), 25 June 1997 (US Exhibit 14, pp. 143-145).

[111] "Timor Faces Rough Road at WTO; Indonesia's Government Promises to Back Vehicle Project", The Nikkei Weekly, 23 June 1997, p. 23 (US Exhibit 14, pp. 140-142).

[112] "Analysts Warns [*sic*] About Loans for Timor Car", Jakarta Post, 13 August 1997, p. 1 (US Exhibit 14, pp. 163-165).

[113] "Indon Banks May Land in the ER", Business Times (Singapore), 15 August 1997, p. 7 (US Exhibit 14, pp. 166-169); see also "Indonesia Company: Suharto Clan's Business Activities", EIU Viewswire, 28 July 1997 (US Exhibit 14, pp. 154-157) ("This year the government twisted bankers' arms to procure a $690m loan to finance [TPN's] assembly plant."). Apparently, while the Government of Indonesia initiated the "national motor vehicle" programme, it lacked the money to pay for it. Therefore, the involvement of private lenders was necessary. "BRI Not Under Pressure to Support Nat'l Car Programme," ANTARA - The Indonesian National News Agency, 13 June 1997 (US Exhibit 14, pp. 136-137). Moreover, international banks had refused to lend to TPN. "Bumpy Road Ahead for Motoring Plan", South China Morning Post, 8 June 1997, p. 7 (US Exhibit 14, pp. 132-135).

[114] As one commentator noted of the decision to grant the $690 million loan, "The move appears to contradict government policy to clamp down on credit growth." "Jakarta Plans New 'National' Car", Financial Times (London), 7 May 1997, p. 4 (US Exhibit 14, pp. 110-111).

[115] "Timor Car Project Not to Be Rescheduled in Face of Currency Crunch" Agence France Presse, 20 August 1997 (US Exhibit 14, pp. 170-171); see also "Timor Car Project Won't Be Rescheduled", Jakarta Post, 21 August 1997 (US Exhibit 14, pp. 172-173), in which it was reported that:

> President Soeharto, in his National Day Address last Saturday, called on the business community to select projects for implementation carefully in view of the currency upheaval currently confronting the economy. Soeharto said the government and business should review their investment projects to ascertain which should be given top priority and which should be postponed.

result, according to the Coordinating Minister for Economy and Finance, the Government "took stock of projects according to their scale of priority. Obviously, high priority programmes will not be axed".[116] However, when asked by reporters whether the Timor car project would be rescheduled, the Coordinating Minister responded that "the term 'national' classifies it as a high priority project".[117] This followed an earlier statement by the Coordinating Minister that "Everyone must support the [national car] programme".[118]

5.107 Likewise, the Minister of Industry and Trade was reported as declaring that, because the Timor car project was a national project, it would not be rescheduled despite the rupiah plunge that prompted the rescheduling of other major projects.[119] This followed earlier statements by Government officials stressing the critical importance of the Kia Timor project:

> "The government, as the facilitator, will provide whatever assistance they need, either in construction, licensing or other aspects of the industry."[120]
>
> "We have to support the programme from all sides so the project can be finished as soon as possible."[121]
>
> "The government has money to spend. And, naturally, it is in the government's interest to use that money for priority programmes, particularly a national programme".[122]

5.108 Banking sources indicated that Bank Indonesia, the central bank, would provide subsidized liquidity credit of up to 70 per cent of the funds needed for the car project.[123] In summarizing the decision to grant the $690 million loan package, one economist characterized the loans as "special credit which 'seemed to be endorsed by the central bank'."[124] However, an editorial in The Jakarta Post best captured the situation:[125]

> Given the power of the government, and in view of the "national" label put on the Timor car programme, those banks will have no other choice but to give the required loans, at the great risk of suffering bad credit.

See also, "Indonesia: Jakarta Pledges to Cut Big Projects", Financial Times (USA) (17 September 1997) <http://www.usa.ft.com/hippocampus/v4514e.htm> (US Exhibit 15, pp. 3-4).

[116] "Ministers Review Projects Rescheduling", Business Daily, 8 Sepember 1997 (US Exhibit 14, pp. 174-175).

[117] Id.

[118] "13 Banks Ordered to Finance Timor Car Project", The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114).

[119] "National Car Programme Not Affected by Currency Crisis", ANTARA - The Indonesian National News Agency, 10 September 1997 (US Exhibit 14, pp. 176-178).

[120] "RI to Finish Car Program by '99", The Jakarta Post, 23 April 1997, p. 1 (US Exhibit 14, pp. 105-107).

[121] "Government Agencies Urged to Buy Timor Nat'l Car", ANTARA - The Indonesian National News Agency, 5 June 1997 (US Exhibit 14, pp. 129-131).

[122] "Govt Offices to Be Obliged to Buy Timor Car", The Jakarta Post, 4 June 1997, p. 1 (US Exhibit 14, pp. 126-128).

[123] "13 Banks Ordered to Finance Timor Car Project" The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114).

[124] "Analysts Warn About Loans for Timor Car" Jakarta Post. 13 August 1997 (US Exhibit 14, pp. 163-165).

[125] Quoted in "Indonesia 'National' Car Stalls" International Herald Tribune, 27 May 1997, p. 17 (US Exhibit 14, pp. 123-125).

5.109 Indeed, newspapers reported that the Governor of Bank Indonesia (the Indonesian central bank) was opposed to state banks granting a large loan to TPN.[126] However, the Governor reportedly was forced to approve the deal following a meeting with the President.[127]

5.110 Finally, all indications are that TPN was not perceived as a sound credit risk, and that the decision to grant the US$690 million loan package was based on something other than commercial considerations. Reportedly, some of the private banks involved were willing to immediately write off any credit they would give to TPN.[128] Some analysts regarded the decision "as a double standard and a violation of prudent banking principles."[129] Other analysts were more specific[130]:

> Economist Faisal Basri from the University of Indonesia and automobile analyst Suhari Sargo doubted [TPN's] capacity to repay the debts in view of the small sales target set by the company. "An annual sales target of 40,000 vehicles per annum is too small to reach a break-even point," Faisal was quoted by Antara as saying. Faisal also doubted whether the US$690 million loans would be sufficient for [TPN] to develop a manufacturing industry with a minimum local content of 60 per cent, as required by the government. Analyst Suhari foresaw a financial burden of at least US$170 million a year for [TPN] simply to install and service the debts beginning in 2000. "This amount will be equivalent to 15,000 cars. That's very hard for [TPN] because it has to produce and sell 150,000 vehicles a year to get a 20 per cent profit margin, ..." He said between 30,000 and 50,000 sedans were sold each year, or 15 per cent to 20 per cent of the country's total automobile market.

5.111 Moreover, the Kia Timor project was in so much trouble that the Government of Indonesia finally wound up "roping in two leading domestic automakers, PT Astra International and PT Indomobil."[131] Indomobil was charged with assembling the Timor Kia Sephias, while the Government asked Astra to participate by supervising the construction of assembly facilities and the nation-wide distribution of the cars.[132]

5.112 To make matters worse, and the decision to grant the loan package even more questionable, the decision was made in light of the fact that TPN's partner, Kia, was in extremely perilous financial condition. Kia was responsible for putting up US$400 million to build the assembly plant.[133] On 15 July 1997, the Kia Group was placed under control of a bankruptcy protection committee by bankers

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[126] "Indonesian National Car Marker to Get Loans from State Banks", Agence France Presse, 29 April 1997 (US Exhibit 14, pp. 108-109); see also "Minister Says Indonesia to Slash Credit to National Car", Agence France Presse, 14 May 1997 (US Exhibit 14, pp. 119-120); "Indonesia Preparing Team to Defend Nat'l Car Policy at WTO", ANTARA - The Indonesian National News Agency, 9 May 1997 (US Exhibit 14, pp. 115-118); and "Jakarta Plans New 'National' Car", Financial Times (London), 7 May 1997, p. 4 (US Exhibit 14, pp. 110-111).

[127] Id. See also "13 Banks Ordered to Finance Timor Car Project", The Jakarta Post, 7 May 1997, p.12 (US Exhibit 14, pp. 112-114).

[128] "13 Banks Ordered to Finance Timor Car Project", The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114).

[129] "Indonesia Tries to Head Off Bank Crisis" The Nikkei Weekly, 4August 1997, p. 20 (US Exhibit 14, pp. 158-160).

[130] "Analysts Warn About Loans for Timor Car", Jakarta Post, 13 August 1997 (US Exhibit 14, pp. 163-165).

[131] "Astra, Indomobil Roped in to Speed Up Timor Car Project" Business Times (Singapore), 16 May 1997, p.1 (US Exhibit 14, pp. 121-122). One source described TPN's manufacturing plans as "currently in disarray". Id.

[132] Id. Astra's decision to "help" did not come as a surprise to some observers, because Astra is 9.3 per cent owned by the Nusamba Group, an investment company controlled by three foundations controlled by the President. Id.

[133] "A Furious Flap Over Favoritism", Business Week, 8 July 1996, p. 14 (US Exhibit 14, pp. 92-95).

concerned about the company's debt of nearly US$11 billion.[134] On 22 July 1997, South Korean banks refused to meet the full funding requested by the Kia Group, and demanded that Kia executives surrender management control.[135] Subsequently, on 22 September 1997, the main units of the Kia Group, including Kia Motors, filed for special court protection "in a last-ditch attempt to prevent South Korea's eighth-largest conglomerate from being dismantled and its management ousted by bank creditors."[136]

5.113 Finally, in October 1997, Indonesia appealed to the International Monetary Fund and the World Bank for help in the face of a 32 per cent decline in the rupiah since August 1997.[137] However, notwithstanding this crisis, and notwithstanding calls for further budget cuts, newspapers reported that "[t]he government has ruled out cuts in the controversial national car programme ... ."[138]

(b) The tariff and tax incentives and the government-directed $690 million loan are inconsistent with Article III:4

5.114 Article III:4 states the following:

> 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. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5.115 Indonesia's tariff and tax incentives for automotive parts and subparts and the provision of the $690 million loan are openly discriminatory and are in plain contravention of Article III:4 of GATT 1994. First, they each constitute regulations or requirements that "affect" the sale, purchase, transportation and distribution of imported and domestic automotive parts and subparts. Second, imported automotive parts and subparts are "like" domestic automotive parts and subparts. Third, the tariff and tax incentives and the $690 million loan discriminate against imported automotive parts and subparts.

(1) The tariff and tax incentives and the government-directed $690 million loan are regulations or requirements that affect the internal sale, etc. of automotive parts and subparts

5.116 Indonesia's tariff and tax incentives are "regulations" or "requirements" that affect the internal sale, offering for sale, purchase, distribution or use of automotive parts and subparts in Indonesia. Manufacturers or assemblers of motor vehicles (or motor vehicle parts) pay a lower duty on imported parts (or subparts) if the finished motor vehicle (or the finished part) satisfies local content targets

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[134] "S. Korea Bankruptcy Panel Takes Control of Kia", Los Angeles Times, 16 July 1997 (US Exhibit 14, pp. 146-148); see also "South Korea: Emergency Loans Give Breathing Space to Carmaker Kia", Financial Times (London), (16 July 1997 (US Exhibit 14, pp. 149-150); and "Koreans Place Kia Motors Under Bankruptcy Shield" New York Times, 16 July 1997 (US Exhibit 14, pp. 151-153).

[135] "South Korea: Banks Refuse Full Funding of Kia Rescue", Financial Times (23 July 1997) <http://www.usa.ft.com/hippocampus/7f12a.htm> (US Exhibit 15, pp. 1-2).

[136] "Kia: Debt-Hit Motor Group Seeks Court Protection", Financial Times (USA) (23 September 1997) <http://www.usa.ft.com/hippocampus/v47d5a.htm> (US Exhibit 15, p. 5).

[137] "Indonesia: IMF Urged to Back Rescue", Financial Times (USA) (13 October 1997) <http://www.ft.com/hippocampus/v50cd6.htm> (US Exhibit 15, pp. 8-9).

[138] "Indonesia: Fund Managers Urge Government to Cut Budget Deep", Financial Times (USA) (11 October 1997) <http://www.ft.com/hippocampus/v5074c.htm> (US Exhibit 15, pp. 6-7).

decreed by the Government. As such, the various Indonesian measures clearly create an incentive for manufacturers or assemblers to purchase domestic parts or subparts, as opposed to imported parts or subparts.

5.117 Moreover, while "a determination of whether there has been a violation of Article III:4 does not require a separate consideration of whether a measure 'afford[s] protection to domestic production'"[139], it is worth recounting that Indonesia has made no secret of the fact that the purpose of the various measures is to protect the domestic automotive parts industry. The preamble to Decree No. 114/1993 (which establishes the local content thresholds for the 1993 programme) states that the objective of the measure is "supporting and encouraging the development of the automotive industry and/or the component industry ...". Likewise, the Elucidation to Regulation No. 20/1996 (which established luxury tax incentives) states that the purpose of the regulation was "to speed up the achievement [of] the national motor vehicle industry using local components ...". The Elucidation to Regulation No. 36/1996 is to the same effect. Most recently, in its notification to the SCM Committee, Indonesia stated that the objective of both the 1993 and National Motor Vehicle programmes was the "increased use of domestically produced components".[140]

5.118 In the Screwdriver panel report, the panel recognized that requirements that an enterprise voluntarily accepts to gain government-provided advantages are nonetheless "requirements"[141]:

> The Panel noted that Article III:4 refers to "all laws, regulations or requirements affecting (the) internal sale, offering for sale, purchase, transportation, distribution or use". The Panel considered that the comprehensive coverage of "all laws, regulations or requirements affecting" the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, ... but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute "requirements" within the meaning of that provision ... .

5.119 Indonesian producers or assemblers of motor vehicles (or motor vehicle parts) that seek to take advantage of the tariff and tax incentives offered by the Government must satisfy the local content targets of the relevant measures. These targets are requirements - or regulations - within the meaning of Article III:4.

5.120 These tariff and tax incentives also clearly "affect" the sale of imported automotive parts and subparts, because they provide a clear incentive to an Indonesian manufacturer or assembler to augment its purchases of Indonesian-made parts. For example, a manufacturer or an assembler of motor vehicles can obtain a complete exemption from tariffs on imported parts and the luxury tax on finished motor vehicles if the local content of the vehicle exceeds 60 per cent. In the case of a producer of a "national motor vehicle", such as Kia Timor, the target is even lower; 20 per cent local content in the first year. These incentives directly affect (and it is their stated purpose to affect) the competitive conditions under which automotive parts and subparts are sold to manufacturers and assemblers. Therefore, these incentives "affect" the sale of automotive parts subparts in Indonesia.[142]

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[139] "European Communities - Regime for the Importation, Sale and Distribution of Bananas", Report of the Appellate Body, WT/DS27/AB/R, adopted 25 September 1997, para. 216 (emphasis in original).

[140] G/SCM/N/16/IDN (13 January 1997), pp. 3 and 4.

[141] "EEC - Regulation on Imports of Parts and Components", L/6657, adopted on 16 May 1990, BISD 37S/132, 197, para. 5.21 (emphasis in original). See also "Canada - Administration of the Foreign Investment Review Act", L/5504, adopted on 7 February 1984, BISD 30S/140, 158, para. 5.4.

[142] See "Italian Agricultural Machinery", L/833, adopted 23 October 1958, BISD 7S/60, 64, para. 12 (". . . [T]he text of paragraph 4 referred . . . to laws and regulations and requirements affecting internal sale, purchase, etc., and not to laws, regulations and requirements governing the conditions of sale or purchase. The selection of the word 'affecting' would imply, in the opinion of the Panel, that the drafters of the Article

5.121 As for the $690 million loan to TPN, this loan is no different in kind from the special credit facilities that were condemned by the panel in Italian Agricultural Machinery. TPN received the government-directed loan because of its status as a participant in the Kia Timor joint venture to produce a "national motor vehicle". Kia Timor achieved its status because of its commitment to satisfy the local content requirements of Decree No. 31/1996. As such, the loan, just as much as the tariff and tax incentives, adversely modifies the conditions of competition between domestic and imported automotive parts and subparts on the Indonesian market.

(2) Domestic and imported automotive parts and subparts are "like products"

5.122 Although there obviously are hundreds, if not thousands, of individual parts that go into a finished motor vehicle, for purposes of Article III:4, imported automotive parts and subparts are "like" automotive parts and subparts made in Indonesia. Domestic and imported products share the same physical characteristics and commercial uses. Thus, while a clutch and a shock absorber may differ from each other, a domestic and imported clutch are "like" each other, just as a domestic and imported shock absorber are "like" each other. In Indonesia, however, the Government discriminates against the imported clutch and shock absorber by providing incentives that favour the purchase and use of their domestic counterparts.

(3) Indonesia's tariff and tax incentives and the government-directed $690 million loan to TPN provide less favourable treatment to imported automotive parts and subparts

5.123 Indonesia imposes progressively lower import duties on imported automotive parts and subparts based on the local content of the finished motor vehicle or the finished part. Similarly, Indonesia exempts sales of motor vehicles from the luxury tax if the local content of the vehicle exceeds 60 per cent. Finally, the Indonesian government directed a consortia of banks to extend special credit facilities, in the form of a $690 million loan, to TPN in order to enable the joint venture in which it is the predominant partner, Kia Timor, to produce a "national motor vehicle" that will satisfy local content targets. Each of these measures accords manifestly less favourable treatment to imported automotive parts and subparts in comparison to their domestically-made counterparts, and each of these measures is calculated to place imported products at a competitive disadvantage by creating an incentive for Indonesian manufacturers or assemblers of motor vehicles or motor vehicle parts to use Indonesian-made parts or subparts. Indeed, Indonesia has made no secret of the fact that the express purpose of this discriminatory treatment is to increase the use of Indonesian-made parts. Indonesia's discriminatory measures constitute precisely the type of protectionist regulatory measures that Article III:4 condemns.

(c) Indonesia's discriminatory tariff and tax incentives and the government-directed $690 million loan do not constitute a direct subsidy to domestic producers within the meaning of Article III:8(b)

5.124 Indonesia's discriminatory tariff and tax incentives and the government-directed $690 million loan do not constitute "the payment of subsidies exclusively to domestic producers" within the meaning of Article III:8(b), because domestic producers of automotive parts or subparts do not receive subsidy payments. In the case of tariff incentives that favour the use of domestic automotive parts, the subsidies go to domestic producers or assemblers of motor vehicles in the form of lower (or no) import duties on imported automotive parts.[143] In the case of tariff incentives that favour the use of domestic automotive subparts, the subsidies go to domestic producers or assemblers of automotive parts in the form of lower

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intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or 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." (Emphasis in original)).

[143]In the case of Presidential Decree No. 42/1996, the subsidy took the form of an exemption from the 200 per cent tariff on imports of completely built-up Kia Sephia sedans.

(or no) import duties on imported subparts. In the case of tax incentives that favour the use of domestic automotive parts, the subsidies go to domestic producers or assemblers of motor vehicles in the form of an exemption from the luxury tax.[144] Finally, in the case of the government-directed $690 million loan, TPN received the loan in its capacity as a producer of the "national motor vehicle" and as user of parts.[145] As such, these discriminatory measures do not constitute payments exclusively to Indonesian producers of automotive parts (or subparts); rather, they modify the conditions of competition between domestic and imported products in contravention of Article III:4.

5.125 Article III:8(b) states:

> The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

5.126 A series of GATT 1947 panel reports have interpreted Article III:8(b) very narrowly to hold that the only subsidies subject to exclusion from the national treatment obligations of Article III are those subsidies that are paid exclusively to domestic producers. Thus, for example, credit facilities provided to purchasers[146], and not producers, and payments whose benefits could be partially retained by processors[147], have been found not to qualify under Article III:8(b).

5.127 Of particular relevance is the panel report in the Italian Agricultural Machinery case. In that case, the Italian Government provided special credit facilities to purchasers of Italian agricultural machinery. In finding these facilities to be in violation of Article III:4, and not excluded by Article III:8(b), the panel "agreed . . . that . . . the provisions of paragraph 8(b) would not be applicable to this particular case since the credit facilities provided under the Law were granted to the purchasers of agricultural machinery and could not be considered as subsidies accorded to the producers of agricultural machinery."[148] With respect to the Indonesian subsidies at issue here, these subsidies are provided to the purchasers of automotive parts (or, in some cases, subparts) and cannot be considered as subsidies accorded to the producers of automotive parts (or subparts).

D. General response by Indonesia to claims Under Article III of GATT 1994 - SCM Agreement prevails

5.128 **Indonesia** makes a general response to all of the claims raised by the complainants, including those under Article III, by arguing that the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") is the *lex specialis*, and prevails, for review of the 1993 and 1996 subsidy programmes, which Indonesia, as a developing country, is permitted to maintain. In addition, **Indonesia** responds specifically to the claims under Article III:4 regarding the tariff measures, by arguing that these are border measures and voluntary measures and thus not governed by Article III. (See Section V.F.1.) **Indonesia** also responds specifically to all of the claims (including those under Article III) made with

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[144]Under Regulation No. 36/1996, there are no gradations in terms of local content rates. If local content exceeds 60 per cent, the vehicle is exempt from the luxury tax. If not, the vehicle is subject to the luxury tax based on the rate applicable to the vehicle type. In the case of a "national motor vehicle," the applicable local content rate varies by year.

[145]At the risk of repetition, TPN received the government-directed loan due to its status as a participant in the Kia Timor joint venture to produce the "national motor vehicle." Kia Timor's status, in turn, was based on its obligation to satisfy specific local content targets under Decree No. 31/1996.

[146]"Italian Agricultural Machinery", L/833, adopted 23 October 1958, BISD 7S/60, 64, para. 16.

[147]"European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins", L/6627, adopted on 25 January 1990, BISD 37S/86, para. 137.

[148] BISD 7S/60, 64, para. 14.

respect to the June 1996 measures by arguing that those measures have expired. (See Section X.A.) The following are **Indonesia's** general responses to the Article III claims raised.

1. The SCM Agreement is the *lex specialis* for review of the 1993 and 1996 subsidy programmes, which Indonesia, as a developing country, is permitted to maintain

5.129 The provisions of the SCM Agreement prevail over those of the General Agreement in the instant dispute because they are more specific to subsidies. Sinclair[149] describes lex specialis as "the concept that a specific norm of conventional international law may prevail over a more general norm".[150] *Lex specialis* is "widely supported in doctrine"[151] and extends back to Grotius.[152] "Among agreements that are equal in respect to the qualities mentioned, that should be given preference which is more specific and approaches more nearly to the subject in hand: for special provisions are ordinarily more effective than those that are general".[153] Furthermore, GATT panels have recognized *lex specialis*. For example, the Panel in EEC - Restrictions on Imports of Dessert Applies - Complaint by Chile examined the restrictive measures at issue in the context of Article XIII instead of Article I because, if found, Article XIII was lex specialis.[154]

5.130 The 1993 and 1996 subsidy programmes are out of the scope of the provisions of the General Agreement. Generalia specialbus, which is related to lex specialis, "does not merely involve that general provisions do not derogate from specific ones, but also, or perhaps as an alternative method of statement, that a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of a general provision dealing with the category of subject to which that matter belongs, and which therefore might otherwise govern it as part of that category".[155]

5.131 Because the SCM Agreement addresses subsidies in a manner far more specific than the General Agreement, it is *lex specialis* for this dispute.

5.132 Complainants seek to mask their inability to prove that the two Indonesian programmes still in effect (the 1993 incentive programme and the February 1996 national car programme) are causing adverse effects to their interests. They unsuccessfully attempt to do so by asserting that the programmes are inconsistent with Article III of the GATT 1994 (as well as Article I of GATT 1994 and Article 2 and the Illustrative List of the TRIMs Agreement.)[156] Their attempts fail. Both programmes are subsidy measures and so the SCM Agreement (as well as GATT Article XVI) is the *lex specialis*. Unlike many other WTO agreements, the SCM Agreement provides substantial special and differential treatment for developing countries like Indonesia. The 1993 and February 1996 subsidy programmes fully conform

[149]Sir Ian Sinclair, K.C.M.Q., Q.C., Bencher of the Middle Temple, Member of the International Law Commission, Associate member of the Institut de Droit International, Sometime Legal Advisor to H.M. Foreign and Commonwealth Office.

[150]Ian Sinclair, The Vienna Convention on the Law of Treaties 96 (2nd ed. 1984).

[151]Ian Sinclair, The Vienna Convention on the Law of Treaties 96 (2nd ed. 1984) (citing Y.B. of the Int'l L. Commission (1976-II), 120.

[152]Wilfred Jenks, The Conflict of Law-Making Treaties, 1953 Brit. Y.B. Int'l L. 446.

[153]Book II, Cap. XVI, sec. xxix (1): translation by Kelsey in Classics of International Law edition, vol. ii (1929) 428. cited in Wilfred Jenks, The Conflict of Law-Making Treaties, 1953 Brit. Y.B. Int'l L. 446.

[154]EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile (22 June 1989), BISD 36S/93, 133, para. 12.28.

[155]Gerald Fitzmaurice, The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Other Treaty Points, 1957 Brit. Y.B. Int'l L. 236 (second emphasis added). Sir Gerald Fitzmaurice, K.C.M.Q., Q.C., was Legal Advisor to the Foreign Office.

[156]As will be discussed, the third Indonesian programme subject to complaint--established by the June 1996 decrees and regulations--is no longer in effect. By its terms it expired 30 June 1997 and has not been (and will not be) renewed.

to Indonesia's obligations, as a developing country, under the SCM Agreement. The Panel, therefore, should dismiss all three complaints.

(a) The 1993 incentive programme grants an exemption from or reductions in import duties and the luxury tax available to all companies in the automotive industry

5.133 In June 1993, the Government recognized that its existing policy of seeking to have manufacturers and assemblers of automobiles and automotive components, subcomponents and parts produce their products in Indonesia was unsuccessful. The Government therefore created a new policy, the 1993 Incentive Programme. Under the programme, manufacturers and assemblers are free to source wherever they wish (in Indonesia or abroad). The Government, however, grants exemptions from or reductions in import duties and the luxury tax for companies that choose to source specified percentages of their parts and components in Indonesia.

5.134 Decree of the Minister of Industry No. 114/M/SK/6/1993 (9 June 1993) granted incentives in the form of exemption from or reduction in import duties to automotive component producers and assemblers that purchase Indonesian parts and components.[157] Since 21 January 1997, pursuant to Decree of the Minister of Finance No. 36/KMK.01/1997, the import duty on major components has ranged from 65 per cent for producers and assemblers who source less than 20 per cent of their parts and components domestically to 0 per cent for those who source more than 60 per cent domestically.[158] For subcomponents and parts, the duty ranges from 25 per cent for those who source less than 20 per cent domestically to 0 per cent for those who source more than 40 per cent domestically.

5.135 At present, pursuant to Decree of the Minister of Finance No. 272/KMK.04/1995 (28 June 1995), the luxury tax rate is 20 per cent for domestically produced sedans of 1600cc or less and domestic content of more than 60 per cent; it is 35 per cent for other sedans.[159]

(b) The February 1996 National Car Programme grants import duties and luxury tax exemptions to producers of a National Car

5.136 Instruction of the President No. 2/1996 (19 February 1996) establishes the national car programme and directs the Minister of Finance to grant exemption from import duties regarding imported parts and components and from payment of luxury tax to companies designated as producers of a national car.[160] The exemption from import duties currently is implemented by Article 4 of Decree of the Minister of Finance No. 36/KMK.01/1997 (21 January 1997) and the exemption from the luxury tax is implemented by Government Regulation No. 36/1996 (4 June 1996).[161]

5.137 Decision of the State Minister for the Mobilization of Investment Funds No. 02/SK/1996 (5 March 1996) designated Timor Putra Nasional (TPN) to produce a national car.[162] Under Decree of the Minister of Industry and Trade No. 31/MPP/SK/2/1996 (19 February 1996), TPN's receipt of the import duty and luxury tax exemptions is conditioned on, among other things, the sourcing of at least 20 per cent of the national car's parts and components domestically at the end of the first year, at least 40 per cent at the end of the second year and at least 60 per cent at the end of the third year. The programme effectively terminates in the third year.[163]

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[157]See Indonesia Exhibit 8. The schedule of incentives granted has been amended several times since 1993.

[158]See Indonesia Exhibit 9.

[159]See Indonesia Exhibit 10.

[160]See Indonesia Exhibit 1.

[161]See Indonesia Exhibit 9 and 3, respectively.

[162]See Indonesia Exhibit 5.

[163]See Indonesia Exhibit 2.

(c) The Government's grant of exemptions and reductions in import duties and the luxury tax to certain manufacturers and assemblers of automobiles and automotive parts is a subsidy

5.138 Articles 1 and 2 of the Subsidies Agreement define specific subsidy. They provide in relevant part that "a subsidy shall be deemed to exist if ... there is a financial contribution by a government" where:

- "government revenue that is otherwise due is foregone or not collected" (Article 1.1(a)(l)(ii)); and
- a benefit is thereby conferred that is "specific to an enterprise or industry or group of enterprises or industries" (Article 2.1).

5.139 Under the 1993 incentive programme, the Government forgoes or does not collect revenue that is otherwise due by granting an exemption from or reduction in the rate of import duties on automotive parts and components. Thus, there is the requisite financial contribution by the Government. As will be discussed in the next subsection, the subsidy falls under the provisions of Article 3 of the Subsidies Agreement. Thus, by virtue of Article 2.3 of that Agreement, there is the requisite specificity.[164]

5.140 The same is true with regard to the February 1996 national car programme. It exempts companies designated by the Government as producers of a national car from the payment of either import duties on automotive parts and components or the luxury tax. The Government, therefore, forgoes or does not collect revenue otherwise due from specific enterprises.

5.141 Because both programmes indisputably provide subsidies, the SCM Agreement is the *lex specialis* and the WTO conformity of the programmes must be assessed pursuant to the provisions of only this Agreement.

(d) Article 27.3 of the SCM Agreement permits Indonesia, as a developing country, to maintain the subsidies granted under the 1993 and February 1996 programmes

5.142 Entitlement to the subsidies granted under both the 1993 and February 1996 programmes and the level of the subsidy granted to each recipient depends upon the percentage of locally sourced parts and components in a particular car model or automotive component. Therefore, these subsidies technically fall within the scope of Article 3.1(b) as "subsidies contingent (whether solely or as one of several other conditions) upon the use of domestic over imported goods".

5.143 Indonesia is a developing country. Accordingly, Indonesia is within the ambit of Article 27.3 of the Subsidies Agreement, which provides that "[t]he prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years ... from the date of entry into force of the WTO Agreement [i.e., until 1 January 2000]." Instead, the provisions of Articles 5 to 7 regarding "actionable subsidies" apply. (See Section VIII.B.2(c)). No Complainant has, as required by Article 6, demonstrated by positive evidence that the Indonesian auto subsidies result in "serious prejudice" to its interests. (See Section VII.B). Therefore, the Panel should: (1) rule that the subsidies provided by Indonesia under the 1993 and February 1996 programmes are consistent with Indonesia's obligations under the Subsidies Agreement; and (2) because the Subsidies Agreement is the *lex specialis*, dismiss all three complaints.

[164]The United States Government officially has recognized that the 1993 programme is a subsidy programme. In its April 1997 report entitled Indonesia's Automotive Market Summary, the US Department of Commerce declared that "[t]his policy [the February 1996 national car programme] represents a net increase in the amount of subsidy paid under the system". (Emphasis added.) See Indonesia Exhibit 11.

(e) Introduction of the February 1996 subsidy programme was not inconsistent with Indonesia's obligations under the SCM Agreement

5.144 **Indonesia** further asserts that Indonesia's introduction of the February 1996 programme was consistent with its obligations under Articles 27.3 and 28.2 of the Subsidies Agreement. These arguments are set forth in detail in Section VIII.C, which covers the claim raised by the **United States** under Article 28 of the SCM Agreement, and **Indonesia's** responses to this claim.

2. Indonesia's luxury tax subsidies to the automotive industry are governed by the disciplines of the SCM Agreement and not by Article III of the GATT 1994

5.145 This is the first dispute involving the relationship between the WTO Agreement on Subsidies and Countervailing Measures and Article III of the General Agreement.[165] Prior to the entry into force of the WTO Agreements, no international legal definition of subsidy existed. There was no all-encompassing structure of remedies applicable to subsidies. Subsidy disciplines applied only to a small number of GATT Contracting Parties and there was no over-arching WTO agreement governing the relationship of the substantive agreements. Thus, there was no basis for claiming that the Tokyo Round Subsidies Code was *lex specialis* in instances such as those presented in this dispute. This all changed with the entry into force of the WTO. Subsidies are governed by and subject to the disciplines of the Subsidies Agreement, not Article III of the General Agreement.

(a) Both the 1993 incentive programme and the February 1996 National Car Programme subsidize certain automobile producers by granting reduced luxury tax

5.146 The luxury tax rate for sedans (passenger vehicles) is 35 per cent.[166] Decree No. 272 implements the 1993 Incentive Programme. Article 2(1) sets a subsidized luxury tax rate of 20 per cent for domestically produced sedans with an engine capacity of less than 1600cc and with local content of greater than 60 per cent. Also, the Government forgoes collection of 15 per cent of the generally applied 35 per cent luxury tax rate with respect to those enterprises producing automobiles meeting these criteria. Therefore, the measure is a specific subsidy within the meaning of Articles 1.1(a)(l)(ii) and 2 of the Subsidies Agreement.

5.147 With respect to producers of a national car, Instruction of the President No. 2/1996 (19 February 1996)[167] and its implementing regulations and decrees declare that the 35 per cent luxury tax is "borne by the Government." Thus, the February 1996 programme also provides a subsidy within the meaning of Article 1.1(a)(1)(ii) of the Subsidies Agreement that is specific within the meaning of Article 2.[168]

(b) Subsidies are governed by and subject to the disciplines of the SCM Agreement

5.148 Articles 3 through 9 of the SCM Agreement set out the disciplines applicable to different types of subsidies and the remedies applicable to each type. All subsidies fall into one of three categories - prohibited, actionable or non-actionable. Two types of subsidies are prohibited by virtue of Article 3.1 - subsidies contingent upon export performance and subsidies contingent upon the use of domestic over

[165]Canada did not argue that its "funded" postal rates for certain periodicals was a subsidy under the terms of, and subject to the disciplines of, the Subsidies Agreement. This is a crucial distinction between the instant dispute and Canada-Certain Measures Concerning Periodicals, WT/DS31/R (14 March 1997).

[166]See Decree of the Minister of Finance No. 272/KMK.04/1995 (28 June 1995) at Indonesia Exhibit 10.

[167]See Indonesia Exhibit 1.

[168]The United States also argues that the August 1997 loan is inconsistent with Article III:4 of the General Agreement. However, as demonstrated above, the loan is not within the Panel's Terms of Reference and so should not be examined.

imported goods. Four types of subsidies are non-actionable: subsidies which are "not specific within the meaning of Article 2" (Article 8.1(a)); assistance for certain research activities (Article 8.2(a)); assistance to disadvantaged regions (Article 8.2(b)); and assistance to promote adaptation to new environmental requirements (Article 8.2(c)). All subsidies which are neither prohibited under Article 3 nor non-actionable under Article 8 are actionable and are governed by Articles 5 through 7 of the SCM Agreement. Thus, all subsidies are covered. If they are one of the two subsidies identified in Article 3 they are prohibited. If they are one of the four identified in Articles 8, they are non-actionable. If they are specific subsidies within the meaning of Articles 1 and 2 but are not among the subsidies identified in Articles 3 or 8, then they fall into the residual category of actionable subsidies.

5.149 The SCM Agreement also sets out in detail the remedies applicable to the three categories of subsidies. For developed country WTO Members, the remedy applicable to the two types of subsidies identified in Article 3.1 is the mandate to "withdraw the subsidy without delay" (Article 4.7). The only prerequisite for such a mandate is the proven existence of a prohibited subsidy. The complaining party is not required to plead or prove any adverse effects. For all WTO Members, subsidies that meet the criteria of Article 8 are, as the term indicates, non-actionable. They are generally permissible and are not subject to remedial action.

5.150 For the residual category of actionable subsidies, including those not prohibited for developing countries by virtue of Article 27, a complaining party must establish both the existence of a subsidy within the meaning of Articles 1 and 2 and adverse effects to its interests through the use of that subsidy (Article 5). Where both the subsidy and the adverse effects are established, the remedy is that the developing country Member "shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy" (Article 7.8). In other words, the remedy is to eliminate the harm to the trade interests of the complaining Member. The subsidizing country can choose to do so by eliminating the measure, but it is not required to do so. Its only obligation then is to eliminate the adverse effects.

5.151 By virtue of the special and differential treatment provided by Article 27, the prohibitions of Article 3.1 do not apply to developing country WTO Members (Articles 27.2 and 27.3). Accordingly, the Article 7 remedy provisions applicable to actionable subsidies apply instead of the remedial provisions of Article 4 (Article 27.7). The effect is that, as here (because Indonesia is a developing country), Complainants must plead and prove not only the existence of one of the two types of subsidies identified in Article 3.1[169], but also that the subsidy alleged has caused adverse effects to their interests (Article 5).

5.152 In sum, the remedy where both the subsidy and the adverse effects are proven is the remedy applicable to actionable subsidies - the adverse effects of the subsidy shall be removed. The subsidizing developing country can choose to do so by eliminating the measure but it also has the option of maintaining the measure and taking action to eliminate the adverse effects.

[169]Both the 1993 and February 1996 programmes impose the type of local content eligibility requirements contemplated by Article 3.1(b). The June 1996 programme does not, but is irrelevant because it already has ended.

(c) General rules of treaty interpretation preclude finding that a subsidy permissible under the SCM Agreement is proscribed by Article III of the GATT 1994

5.153 Under general rules of treaty interpretation, one must give meaning and effect to all terms of a treaty. As properly recognized by the WTO Appellate Body: "An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".[170] Therefore, Article III:2 of the General Agreement cannot control this dispute because, if it did, the entire SCM Agreement would be reduced to inutility.

5.154 Under Article III:2 no imported product shall be subject to an internal tax in excess of that applied to a like domestic product. Article 3.8 of the WTO Dispute Settlement Understanding codifies long-standing GATT practice that infringement of an obligation of the General Agreement such as that of Article III:2 is considered *prima facie* to constitute a case of nullification or impairment. In other words, the covered practice is proscribed and the complaining party need not plead or prove adverse trade effects.[171]

5.155 The Indonesian luxury tax is an internal tax. Under the 1993 Incentive Programme, passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60 per cent are obliged to pay a subsidized luxury tax of only 20 per cent if they are produced in Indonesia, while the imported like product (imported passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60%) are subject to the non-subsidized luxury tax rate of 35 per cent. Under the February 1996 national car programme, the Government excuses TPN from payment of the luxury tax on the 1500cc Timor S515 (which meets the applicable local content level) while imposing the non-subsidized rate of 35 per cent on imports of like products. (There is no ban on imports of small-engine-capacity sedans that would be "like" the Timor. However, Complainants have the burden of proving that there actually are such imports because, if they do not do so, they fail to prove "serious prejudice" with respect to the "actionable" subsidization by Indonesia of the luxury tax rate for certain domestic sedans.)

5.156 If Article III:2 applied, then no more would need to be established. Complainants would not have to plead or prove that they have suffered adverse trade effects by reason of the subsidized luxury tax rates. Despite the Subsidies Agreement, which permits actionable subsidies to be maintained unless they are proven to cause adverse trade effects, the measure--indeed all such actionable subsidies - would be proscribed under Article III:2 of the General Agreement merely upon a showing of discrimination due to a subsidy. Such a holding would render meaningless the provisions of the Subsidies Agreement relating to actionable subsidies.

5.157 In this dispute the issue is limited to Article III:2 and tax subsidies.[172] However the same interpretational problem would arise with respect to virtually all subsidies other than subsidized import duties and other border charges. The purpose of most subsidies is to provide financial assistance to a targeted industry or a small group of industries. By their very nature and by design, subsidies discriminate against producers of like products (both domestic and imported) that do not receive the subsidy. To the extent that a subsidy is not provided to an imported product (which is the case in virtually every subsidy ever granted), then it does not provide national treatment. Accordingly, one

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[170]United States - Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R (20 May 1996) (p.23) footnote omitted). See also Japan - Taxes on Alcoholic Beverages, WT/DS/AB/R (4 October 1996) (p. 12); DSU, Article 3.2.

[171]In its Uruguay Round TRIMs submission of 6 February 1989, the United States recognized that certain GATT provisions (e.g., Article I) proscribe practices, while others (e.g., Article VI) remedy adverse trade effects (MTN.GNG/NG12/W/14 at pp. 12-13). GATT Article XVI and the Subsidies Agreement, like GATT Article VI, remedy trade effects of actionable subsidies.

[172]The import duty subsidies relate to border measures, not to internal laws subject to Article III:4 of the General Agreement. This renders much of Complainants' argumentation irrelevant.

cannot give meaning and effect to the framework of the Subsidies Agreement requiring proof of adverse trade effects as to actionable subsidies if Article III of the General Agreement and its national treatment principle is applied.

5.158 The importance of the existence of a legal definition of subsidies and an all-encompassing structure of remedies is evident by contrasting the subsidies provisions applicable to goods with those applicable to services. In its Explanatory Note on the Scheduling of Initial Commitments in Trade in Services[173] (intended to assist countries in preparing their services commitments in the Uruguay Round), the GATT Secretariat stated:

> Article XVII [national treatment] applies to subsidy-type measures in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines" to counter the distortive effects caused by subsidies. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article. Subsidy-type measures are also not excluded from the scope of Article II (MFN). An exclusion of such measures would require a legal definition of subsidies which is currently not provided for under the GATS.

5.159 The GATS contains no "legal definition of subsidies", and so the GATS requirements regarding national treatment (which permit scheduling a limitation on the obligation) apply. In the goods area, there is a legal definition in the SCM Agreement, thereby warranting exclusion of subsidies from application of the national treatment obligation of GATT Article III.

5.160 The only conceivable interpretation of the relationship of subsidies and Article III of the General Agreement that would not reduce the SCM Agreement to redundancy or inutility is that subsidies which meet the criteria of Articles 1 and 2 of the SCM Agreement are governed by and are subject to the disciplines of only the SCM Agreement. Actionable subsidies (including Article 3.1 subsidies which are actionable for developing countries by virtue of Article 27) require proof of adverse trade effects. That requirement cannot be subverted merely by arguing that the subsidy violates Article III of the GATT 1994 by denying national treatment.

(d) The proper interpretation of Article III:8(b) of the GATT 1994 supports the view that Article III does not override the SCM Agreement

5.161 In Canada-Certain Measures Concerning Periodicals, WT/DS31/AB/R (30 June 1997), the Appellate Body discussed and ruled upon Article III:8(b). The facts of the dispute show that Canada did not argue that its funded postal rates programme was a subsidy under the criteria of Articles 1 and 2 of the Subsidies Agreement and, therefore, was subject to the disciplines and remedies of only that Agreement. Rather, Canada argued simply that its practice was excused (i.e., not subject to any discipline or remedies) by virtue of Article III:8(b) of the General Agreement.

5.162 The United States disagreed, arguing that the transfer of funds from one government entity to another did not fulfil the condition of Article III:8(b) regarding "the payment of subsidies exclusively to domestic producers." The Panel sided with Canada. The finding of the Panel with which the Appellate Body disagreed and which it reversed was:

> Thus, we do not find that Canada Post retains any economic benefits from the "funded" rate scheme it applies to certain Canadian periodicals. The payment of the subsidy is made "exclusively" to Canadian publishers that qualify for the scheme. Since

[173]MTN.GNS/W/164 (3 September 1993) at p. 6 (emphasis added).

> Article III:8(b) explicitly recognizes that subsidies exclusively paid to domestic producers are not subject to the national treatment rules of Article III, including those under Article III:4, we find that Canada's "funded" rate scheme on periodicals can be justified under this provision.[174]

5.163 In analysing the Appellate Body's discussion, one must consider the following facts. The Appellate Body was ruling on whether the government paid a subsidy exclusively to domestic producers and it was doing so in a dispute in which both parties focused solely on the General Agreement. The Appellate Body was not asked to decide and it did not address the question presented in this dispute, which is whether a subsidy permissible under the SCM Agreement (except to the extent it is proven to cause adverse trade effects) can still be proscribed as a violation of the national treatment principle of Article III of the General Agreement.

5.164 With this in mind, let us analyze the text, drafting history, context, and object and purpose of Article III:8(b). The Chairman of the Working Party that examined the provision that became Article III:8(b) explained the purpose of and need for the provision as follows:

> This provision had been added to the Geneva draft [of the ITO Charter] because it was felt that if subsidies were paid on domestic and not on imported products it might be construed that Members were not applying the "national treatment" rule.[175]

At the Havana Conference, the Report of the Sub-Committee that examined Article 18 of the draft ITO Charter (the predecessor of Article III of the General Agreement) stated:

> This sub-paragraph [Article III:8(b)] was redrafted in order to make it clear that nothing in Article 18 could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 would override the provisions of Section C of Chapter IV [on Subsidies.][176]

Previous GATT panel reports addressing Article III:8(b) have focused on the first portion of this quotation from the Havana Reports. However, neither they nor the Appellate Body in Canada-Periodicals focused on or analyzed the portion emphasized above.

5.165 The panel report most relevant to this dispute is United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206.[177] There, the panel, as quoted by the Appellate Body in Canada-Periodicals, stated:

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[174]WT/DS31/R (14 March 1997) (para. 5.44).

[175]E/CONF.2/C.3/A/W.49, p. 2.

[176]Report of Committees and Principal Sub-committees, United Nations Conference on Trade and Employment, held at Havana, Cuba from 21 November 1947 to 24 March 1948, ICITO I/8 (September 1948) at 66, para. 69 (emphasis added).

[177]Two other reports discussing Article III:8(b) are not of value in this dispute because they address whether a subsidy was indeed paid exclusively to domestic producers, a fact not at issue in this dispute. Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60; and European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (25 January 1990), BISD 37S/86. The US erroneously claims that the requirement set out in Italian Machinery is not met with regard to what they term Indonesia's tariff and tax incentives for automotive parts and subparts. (See Section V.E.3(b)). As discussed in the next section of this submission, subsidized customs import duties are border measures, not internal measures, and therefore are not within the scope of Article III. The luxury tax subsidy applies to assembled automobiles and is provided exclusively to the

> Article III:8(b) limits therefore the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer like his foreign competitors must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.[178]

The full import of this statement is clear from the following finding of the United States-Measures Affecting Alcoholic and Malt Beverages Panel:

> The words "payment of subsidies" refer only to direct subsidies involving a payment, not to other subsidies such as tax credits or tax reductions.[179]

5.166 One must note, however, that United States Alcoholic Beverages was decided prior to the completion of the Uruguay Round negotiations and, therefore, under the then-existing GATT regime. The Tokyo Round Subsidies Code did not contain an all-encompassing definition of subsidies. Its membership was limited to those Contracting Parties who chose to adhere and the relationship of the Code to the GATT was not expressed and was subject to differing views. Further, because the GATT and the Code were separate legal instruments, provisions of one could not be raised and analyzed by a panel in a dispute involving the other.

5.167 All of that changed with the entry into force of the WTO Agreements. Article 1 of the SCM Agreement identifies four types of subsidies: (i) direct transfer of funds; (ii) forgoing of revenue otherwise due; (iii) provision of goods or services at non-market prices; and (iv) payment to a funding mechanism directed by a private body. Only the first type is a "direct subsidy." All Members of the WTO adhere to both the General Agreement and the SCM Agreement and both agreements are integral parts of the Agreement Establishing the World Trade Organization (see Article II.2 thereof). Finally, dispute settlement panels are mandated to address the relevant provisions of all WTO agreements cited by the parties to a dispute. (Article 7.2 of the Dispute Settlement Understanding.)

5.168 Under these circumstances, general rules of treaty interpretation require rethinking the scope of Article III:8(b). Under the WTO, "the payment of subsidies" language in Article III.8(b) must refer to all subsidies identified in Article 1 of the SCM Agreement, not merely to the subset of "direct" subsidies. This interpretation, and only this interpretation, avoids rendering the SCM Agreement meaningless. Under this interpretation, any and all subsidies provided exclusively to domestic producers are not governed by the national treatment principle of Article III of the General Agreement (which by definition they could not meet). Rather, subsidies that fall within the scope of Articles 1 and 2 of the SCM Agreement and that are actionable under Articles 5 and 6, are subject only to the disciplines of Article 7 of the SCM Agreement and, even then, only if they cause adverse effects to the interests of other Members.

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producers or assemblers, thereby fulfilling the criterion set out in Italian Machinery. United States-Measures Affecting the Importation, Internal Sale and Use of Tobacco (12 August 1994), DS44/R, also is not relevant. There, the complaining parties sought unsuccessfully to use Article III:8(b) to argue that United States producers (but not importers) benefitted from a subsidy derived from the proceeds of an internal tax which was not within the scope of Article III:8(b) but was in violation of Article III:2.

[178]BISD 39S/206 (para 5.10 at p. 272)(emphasis added).

[179]Id. at p. 271-72, para. 5.8 (emphasis added).

(e) In a conflict between the SCM Agreement and Article III of the GATT 1994, the SCM Agreement Prevails

5.169 The "General interpretative note to Annex 1A" of the Agreement Establishing the World Trade Organization states:

> In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization (referred to in the agreements in Annex 1A as the "WTO Agreement"), the provision of the other agreement shall prevail to the extent of the conflict.

The Report of the Panel in European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA (22 May 1997), defines "conflict" as follows:

> As a preliminary issue, it is necessary to define the notion of "conflict" laid down in the General Interpretative Note. In light of the wording, the context, the object and the purpose of this Note, we consider that it is designed to deal with (i) clashes between obligations contained in GATT 1994 and obligations contained in agreements listed in Annex 1A, where those obligations are mutually exclusive in the sense that a Member cannot comply with both obligations at the same time, and (ii) the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits .
>
> However, we are of the view that the concept of "conflict" as embodied in the General Interpretative Note does not relate to situations where rules contained in one of the Agreements listed in Annex 1A provide for different or complementary obligations in addition to those contained in GATT 1994. In such a case, the obligations arising from the former and GATT 1994 can both be complied with at the same time without the need to renounce explicit rights or authorizations. In this latter case, there is no reason to assume that a Member is not capable of, or not required to meet the obligations of both GATT 1994 and the relevant Annex 1A Agreement. (Emphasis added; footnote omitted.)

5.170 If the Panel were to conclude that it cannot reconcile the coverage and disciplines of the SCM Agreement and Article III of the General Agreement (either by reason of general rules of treaty interpretation or through interpretation of Article III:8(b)), then a "conflict" would exist between the Subsidies Agreement and Article III of the General Agreement. By virtue of the General Interpretative Note, the provisions of the Subsidies Agreement would prevail.

5.171 The SCM Agreement permits Indonesia, as a developing country, to subsidize the luxury tax rate unless those subsidies are proven to cause adverse trade effects. Article III of the GATT 1994, on the other hand, would proscribe these subsidies on the ground that they denied national treatment under the terms of Article III:2. Adverse trade effects would not need to be proven. In other words, the SCM Agreement explicitly permits what Article III of the GATT 1994 would prohibit. Indonesia's obligations under the two provisions would be mutually exclusive. One simply could not apply the general prohibition of Article III:2 and, at the same time, provide Indonesia its explicit rights under the SCM Agreement regarding the proof of adverse effects. This falls squarely within the definition of "conflict" in the General Interpretative Note. Hence, the provisions of the SCM Agreement (an "Annex 1A Agreement") would prevail over Article III of the General Agreement.

5.172 Article III:4 of GATT 1994 also conflicts with the SCM Agreement insofar as it prohibits measures which the SCM Agreement does not prohibit. Take, for example, a law that provides assistance to an industry in a disadvantaged region (meeting the requirements Article 8.2(b) of the SCM

Agreement) or other "greenlight" subsidies. This subsidy is permitted by the SCM Agreement, but would violate Article III:4, if it applied. A similar conflict arises in the instant case, where the SCM Agreement, as Indonesia has demonstrated, permits the measures which complainants argue violate Article III:4. Also, even if complainants were correct, a conflict would exist and only the SCM Agreement would apply.

(f) The SCM Agreement defines subsidies and sets out all of the rights and obligations pertaining to them

5.173 Articles 1 through 9 of the SCM Agreement comprehensively set out the definitions of, disciplines on and remedies for subsidies. The SCM Agreement covers all subsidies. If a subsidy is one of the two types of subsidies identified in Article 3, it is a prohibited subsidy. If a subsidy is one of the four types of subsidies identified in Article 8, it is a non-actionable subsidy. If a subsidy is specific within the meaning of Article 2, but neither prohibited under Article 3 nor non-actionable under Article 8, it falls into the residual category of actionable subsidies.

5.174 Also, the Subsidies Agreement covers all remedies for subsidies, with Article 27 providing special and differential treatment of developing country Members. If a subsidy is a prohibited subsidy, a complainant must prove the existence of a prohibited subsidy and the remedy is that the Member "withdraw the subsidy without delay" (Article 4.7). If a subsidy is an actionable subsidy, including an otherwise prohibited subsidy granted or maintained by a developing country, a complainant must prove the existence of a subsidy within the meaning of Articles 1 and 2 and adverse effects to the complainant's interests through the use of that subsidy (Article 5). The remedy is that the Member "shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy." (Article 7.8). Procedures and remedies for certain non-actionable subsidies are set forth at Article 9.

(g) The definition of "subsidy" in the SCM Agreement is all-encompassing, contrary to the United States assertion

5.175 To support its argument that the definition of subsidy in the SCM Agreement is not all-encompassing, the United States cites Article 1.1 of the SCM Agreement as stating that the definition is "[f]or the purpose of this Agreement".

5.176 First, the United States' attempt to use this language to confine the definition ignores the fact that all WTO agreements are part of a unitary whole. The SCM Agreement is part of the family of WTO agreements. Article II:2 of the Agreement Establishing the World Trade Organization states that "[t]he agreements and associated legal instruments included in Annexes 1, 2 and 3 … are integral parts of this Agreement, binding on all Members." Prior to the entry into force of the WTO Agreements, no international legal definition of subsidy existed. There was no all-encompassing structure of definitions, disciplines and remedies, and the Subsidies Code applied to only a small number of GATT Contracting Parties. With the entry into force of the WTO agreements, the SCM Agreement's definition of subsidy became the sole definition of subsidy for the family of WTO agreements.

5.177 Second, the United States fails to (and cannot) provide an alternative definition of subsidy. Finally, the measures at issue clearly fall within the definition of "subsidy" set out at Articles 1.1(a)(1)(ii) and 2 of the SCM Agreement. (See Sections V.D.1 and VIII.A.1 and 2).

(h) Article VI:5 of the GATT 1994 Is Irrelevant and Serves to Limit a Complainant's Unilateral Remedy

5.178 The United States cites GATT Article VI:5 to support its argument that the SCM Agreement was not intended to be the exclusive remedy against measures that can be characterized as subsidies. (See Section V.E.3) However, Article VI:5 is irrelevant to this case. It has nothing to do with whether a

subsidy can be granted by the host country (i.e., whether the obligations of Article III of the General Agreement apply as well as those of the SCM Agreement) or, for that matter, with subsidies at all. Rather, it prevents the authorities of an importing country from double counting when imposing duties under domestic anti-dumping or countervailing duty laws.[180]

(i) The United States' interpretation of Article 32.1, footnote 56, of the SCM Agreement is flawed

5.179 The United States cites footnote 56 of Article 32 of the SCM Agreement as indicating that the drafters did not intend for the Agreement to be the exclusive remedy against measures within the Agreement's definition of subsidy (See Section V.E.3), and thus there is no "conflict" between the SCM Agreement and the General Agreement. This interpretation is incorrect. Article 32.1 and footnote 56 were taken verbatim from the Tokyo Round Subsidies Code, in which they appear as Article 19.1 and footnote 38. A companion article and footnote appear in the Tokyo Round Anti-Dumping Code. Only the reference to "dumping", as opposed to "subsidy", differs.[181] Thus, it is clear that the drafters of the Tokyo Round Codes considered that these articles and their footnotes applied to actions by authorities of importing countries under domestic countervailing duty or anti-dumping laws. In this context "other relevant provisions" of the General Agreement refers to other permissible actions by importing authorities, such as safeguard actions under Article XIX of the General Agreement, which are "appropriate" when the conditions for application of that remedy are satisfied.

5.180 There are two additional reasons why the United States' argument is flawed. First, the United States' argument ignores the significance of the words "relevant" and "where appropriate" in footnote 56:

> This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate. (Emphasis added.)

The United States ignores the very text it seeks to interpret. Other GATT provisions are not "relevant" and, moreover, action under other GATT provisions is not "appropriate" and therefore is precluded, because the measures at issue are clearly covered by the SCM Agreement, which also provides remedies for them.

5.181 Second, Article 32.1 itself states:

> No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement. (Emphasis added; footnote omitted.)

The words "as interpreted by this Agreement" confirm the supremacy of the SCM Agreement in defining and providing remedies for subsidies.

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[180]In situations in which the granting of a subsidy leads to an export price that is below "normal value" (the comparable price for the like product when destined for consumption in the home country's market), the authorities of the importing country could, absent Article VI:5, impose both anti-dumping and countervailing duties. Article VI:5 prevents this.

[181]The text of Article 16.1 of the Anti-Dumping Code and footnote 16 follow (with differing text, from Article 19.1 and footnote 38 of the Subsidies Code, included within brackets).

Article 16.1: "No specific action against dumping of exports from another Party [a subsidy of another signatory] can be taken except in accordance with the provisions of the General Agreement, as interpreted by this Agreement."

Footnote 16: "This is not intended to preclude action under other relevant provisions of the General Agreement, as [where] appropriate."

(j) Indonesia's right, as a developing country, to maintain domestic-content subsidies Is subject only to Indonesia's obligation not to cause serious prejudice to a like product.

5.182 Because Indonesia is a developing country Member, "[t]he prohibition of paragraph 1(b) of Article 3 shall not apply … for a period of five years … from the date of entry into force of the WTO Agreement [i.e., until 1 January 2000]" to its domestic-content subsidies (Article 27.3). Instead, Articles 5 through 7 apply. No Complainant has, as required by Article 6, demonstrated by positive evidence that the domestic-content subsidies result in "serious prejudice" to a like product. (See Section VIII.B.)

(k) The application to this dispute of Article III of the GATT 1994, as complainants advocate, would render the SCM Agreement meaningless

5.183 If Article III:2 were to proscribe actionable subsidies that are not proven to cause adverse effects, the provisions of the Subsidies Agreement regarding actionable subsidies would be rendered meaningless.

(1) Virtually all subsidies are intended to, and actually do, benefit only domestic products

5.184 Under the SCM Agreement, with regard to an actionable subsidy, a complainant must prove both the existence of a subsidy within the meaning of Articles 1 and 2 and adverse effects to the complainant's interests through the use of that subsidy (Article 5). In contrast, according to Article 3.8 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) as well as long-standing GATT practice, a measure infringing upon Article III:2 of the General Agreement is proscribed outright. Under Article III:2, an imported product shall not be subject to an internal tax in excess of that applied to a like domestic product. A complainant need not prove adverse effects to its interests resulting from that measure.

5.185 By definition, subsidies discriminate against like products, both domestic and imported, that do not receive the subsidy. To the extent that a subsidy is not provided to an imported product, which is virtually always the case, the subsidy would violate the national treatment requirement of Article III if that obligation were applicable.

(2) Under complainants' interpretation, Indonesia's luxury tax subsidies would be condemned solely because of their discriminatory nature and the European Communities and United States would not have to show serious prejudice

5.186 The subsidy provided under the 1993 Incentive Programme benefits passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60 per cent. In contrast, imported passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60 per cent are subject to a non-subsidized luxury tax rate that is in excess of the subsidized rate. Under the February 1996 National Car Programme, a 1500cc Timor S515 that meets the applicable local content level is not subject to the luxury tax, whereas a similar imported car would be subject to a non-subsidized luxury tax rate in excess of the subsidized rate.

5.187 If Article III:2 were applied instead of the SCM Agreement, Indonesia's luxury tax subsidies would be condemned solely because of their inherently discriminatory nature. The European Communities and the United States would not have to meet the SCM Agreement's requirement of proving serious prejudice.

(l) Conversely, Indonesia's interpretation does not render Article III useless, as complainants maintain, but confines it appropriately

5.188 Indonesia's interpretation that subsidies that meet the criteria of Articles 1 and 2 of the SCM Agreement are governed solely by the SCM Agreement is the only reasonable interpretation of the relationship between subsidies and Article III that would not render crucial provisions of the SCM Agreement meaningless. Moreover, contrary to Complainants' assertions, Indonesia's interpretation does not render Article III useless, but confines Article III to its appropriate sphere.

(1) A "conflict" exists - Article III of the General Agreement and the SCM Agreement are mutually exclusive and cannot be applied simultaneously; the obligations of the SCM Agreement are not additional, supplementary or complementary to Article III of the GATT 1994

5.189 According to the Panel in European Communities-Regime for the Importation, Sale and Distribution of Bananas, a "conflict" exists when:

(i) mutually exclusive GATT 1994 and Annex 1A Agreement obligations clash; and

(ii) a rule in one agreement prohibits what a rule in another agreement explicitly permits. Obligations are mutually exclusive when a Member cannot comply with both obligations at the same time.[182]

5.190 A "conflict" does not exist when rules in an Annex 1A Agreement provide for different or complementary obligations in addition to those in GATT 1994 because the Annex 1A and GATT 1994 obligations "can both be complied with at the same time without the need to renounce explicit rights or authorizations."[183]

5.191 Contrary to the assertions of the European Communities and Japan (See Sections V.E.1 and 2), Indonesia's GATT 1994 and SCM Agreement obligations are mutually exclusive because they cannot "both be complied with at the same time without the need to renounce [the] explicit right[] or authorization[]" to maintain the subsidies at issue absent serious prejudice to a like product. Furthermore, Article III would "prohibit" what the SCM Agreement "permits". The SCM Agreement specifically does not prohibit developing countries from granting a subsidy involving differential internal tax treatment on products. On the other hand, Article III:2 of GATT 1994 prohibits such differential tax treatment on products. Thus, a conflict clearly exists in the instant case.[184]

5.192 In Bananas III, the Panel specifically addressed the type of conflict which exists in the instant case in an example dealing with the relationship between Article XI and the Agreement on Textiles and Clothing (ATC):

> Article XI:1 of GATT 1994 prohibits what Article 2 of the ATC permits in equally explicit terms. It is true that Members could theoretically comply with Article XI:1 of

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[182]European Communities-Regime for the Importation, Sale and Distribution of Bananas (22 May 1997), WT/DS27/R/USA, 321, para. 7.159.

[183]Id. at para 7.160 (emphasis added).

[184]The European Communities and Japan also argue that the Subsidies Agreement does not explicitly authorize or permit Indonesia to apply discriminatory measures prohibited by Article III. As discussed, the measures at issue are not prohibited by Article III. The European Communities emphasizes the word "explicitly", implying that the Subsidies Agreement is not explicit enough. Yet the Subsidies Agreement is explicit enough that the EC itself admits that "Indonesia is … authorised to grant 'subsidies' under certain conditions." Those conditions are the absence of serious prejudice to a like product and they are met in the instant case.

> GATT, as well as with Article 2 of the ATC, simply by refraining from invoking the right to impose quantitative restrictions in the textiles sector because Article 2 of the ATC authorizes rather than mandates the imposition of quantitative restrictions. However, such an interpretation would render whole Articles or sections of Agreements covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A which were negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994.[185]

5.193 Contrary to Japan's assertion (See Section V.E.1(3)(c)), the relationship between Article III and the SCM Agreement is analogous to the relationship between Article XI and the ATC - a conflict exists regardless of whether Indonesia "could theoretically comply with" both Article III and the SCM Agreement "simply by refraining from invoking the right" to maintain the subsidies at issue absent serious prejudice to a like product. This is because the SCM Agreement "authorizes rather than mandates" maintenance of such subsidies. Finding that a conflict does not exist "would render" the provisions of the SCM Agreement regarding actionable subsidies "meaningless."

5.194 Furthermore, such a finding would "run counter to the object and purpose" of the SCM Agreement. Special and differential treatment of developing country Members is one of the objects and purposes of the Subsidies Agreement as evidenced by Article 27, which details that treatment, and by the language of Article 27.1 ("Members recognize that subsidies may play an important role in economic development programmes of developing country Members.").

5.195 The Panel in Bananas III recognized that "many agreements listed in Annex 1A … were negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994." Indonesia's right to maintain the subsidies at issue absent serious prejudice to a like product is precisely this type of right. It "differ[s] substantially from those of the GATT 1994" and it is part of the compromise negotiated between the developed and the developing countries.

5.196 The DSU prohibits the diminishment of Indonesia's right to maintain the subsidies at issue absent serious prejudice to a like product. "Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." (DSU Article 3.2.) Furthermore, the DSU not only prohibits the nullification or impairment of Indonesia's benefits, it prohibits the impedance of an objective of the Subsidies Agreement expressed in Article 27.1 ("Members recognize that subsidies may play an important role in economic development programmes of developing country Members".). "All solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements … shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements" (DSU Article 3.5).

5.197 The United States wrongly criticizes the Panel in Bananas III and Indonesia for not fully supporting the proposition that a conflict exists if obligations are not mutually exclusive. (See Section V.E.3). First, as discussed above, the obligations are mutually exclusive. Furthermore, the negotiating history of the SCM Agreement supports the view that a conflict exists where a "right" granted by one Agreement is "precluded" by a provision in another Agreement. Annex 1A Agreements, including the SCM Agreement, were "negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994."[186] The opposite view, as discussed above,

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[185] European Communities-Regime for the Importation, Sale and Distribution of Bananas (22 May 1997), WT/DS27/R/USA, 321, n. 403 (emphasis added).

[186] See European Communities-Regime for the Importation, Sale and Distribution of Bananas (22 May 1997), WT/DS27/R/USA, 321, n. 403.

"would render whole Articles or sections of Agreements covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A."[187]

(2) Paragraph 8(b) of Article III of the GATT 1994 is inapposite, except clarifying that Article III applies to discriminatory internal taxes on like products

5.198 Article III applies to discriminatory internal taxes on like products. The import duty subsidies are border measures, not internal measures, and therefore are outside the scope of Article III. (See Section V.F.1). The luxury tax subsidy is provided exclusively to producers or assemblers of automobiles and therefore is allowed under Article III:8(b) and is in accordance with Italian Discrimination Against Imported Agricultural Machinery.[188] The European Communities's and Japan's arguments regarding the interpretation of Article III:8(b) in United States-Measures Affecting Alcoholic and Malt Beverages[189] and Canada-Certain Measures Concerning Periodicals[190] are addressed in Section V.D.2. Moreover, even if the Panel finds that the luxury tax subsidy is not allowed under Article III:8(b), there is still no like product in the instant case. In quoting the report of the Sub-Committee of the Havana Conference, the European Communities itself recognizes that there must be a like product. Article III:8(b) was redrafted "in order to make it clear that nothing in Article [III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes."[191]

(m) Complainants' assertion that the SCM Agreement cannot be *lex specialis* because, if it were, generally available and Article 8 subsidies would not be constrained, is incorrect

5.199 The example made by the United States (See Section V.E.3(a)(2)) involves differential internal taxation subject to Article III and is irrelevant to the instant case. The import duty subsidies are not internal measures (See Section V.F.1.), the luxury tax subsidy is allowed under Article III:8(b) and there are no like products involved in the instant case.

(n) Even if the United States example were relevant, the point the United States seeks to advance is incorrect as a matter of law-the SCM Agreement addresses generally available and other Article 8 subsidies

5.200 Articles 1 through 9 of the SCM Agreement are comprehensive and explicit in setting out the definitions of, disciplines on and remedies for subsidies. The absence of an SCM Agreement remedy for non-specific subsidies, such as the one described by the United States, does not indicate that the SCM Agreement fails to provide an all-encompassing structure of remedies. Instead, this absence is part of that all-encompassing structure of remedies. The detail and explicitness of the remedy provisions of the SCM Agreement indicate that this result was intended by the drafters. In particular, the remedy provisions of Article 9 clearly do not apply to non-specific subsidies (Article 8.1(a)), only to other non-actionable subsidies (Article 8.1(b)). In any event, the United States example is irrelevant in the instant case because the measures at issue are actionable subsidies.

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[187] See id.

[188] Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60.

[189] United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206.

[190] Canada-Certain Measures Concerning Periodicals (30 June 1997), WT/DS31/AB/R.

[191] Report of Committees and Principal Sub-committees, United Nations Conference on Trade and Employment, held at Havana, Cuba from 21 November 1947 to 24 March 1948, ICITO I/8 (September 1948) at 66, para. 69 (emphasis added).

(o) Japan's and the United States' claims that Indonesia's measures violate Article III:2, second sentence are incorrect

5.201 Japan's and the United States' claims that Indonesia's measures violate Article III:2, second sentence are incorrect. The SCM Agreement is lex specialis and, in the alternative, insofar as a conflict exists, controls the resolution of this dispute, including claims under Article III:2.

(p) Japan's view that Indonesia's argument renders the General Interpretive Note meaningless is incorrect

5.202 Japan argues that "Indonesia's *'lex specialis'* theory would render the General Interpretative Note completely unnecessary and would severely weaken the GATT's fundamental obligations". (See Section V.E.1). Japan has mischaracterized Indonesia's position.

5.203 Indonesia's *lex specialis* argument does not "render the General Interpretative Note completely unnecessary." Rather, Indonesia's argument is supported by the General Interpretative Note. Because a "conflict" exists, the General Interpretative Note mandates that the provisions of the Subsidies Agreement "prevail to the extent of the conflict." Nor do any of Indonesia's arguments "severely weaken the GATT's fundamental obligations." As discussed above, Indonesia's interpretation that subsidies that meet the criteria of Articles 1 and 2 of the SCM Agreement are solely governed by the SCM Agreement is the only reasonable interpretation of the relationship between subsidies and Article III that would not render the SCM Agreement meaningless. This interpretation does not "severely weaken" Article III, but confines Article III to its appropriate sphere.

(q) Parts and components are not "indirectly" taxed in excess of like domestic goods

5.204 Parts and components are not "indirectly" taxed in excess of "the like domestic goods". First, there are hardly any "like" parts and components. Second, importers of these parts and components continue to pay the tax in a direct manner and in the amounts and at the rates they have been paying for years. Not receiving benefits received by another company does not at all, either directly or indirectly, increase the tax on parties that do not receive the benefit.

E. Rebuttals to Indonesia's general response to the claims raised under Article III of GATT 1994

1. Rebuttal arguments of Japan

5.205 The following are **Japan's** arguments rebutting Indonesia's general defence to the claims raised under Article III of GATT 1994:

5.206 Indonesia argues that GATT Article III does not apply to this dispute. That view is wrong, however.

5.207 Regarding the luxury tax exemption, while Indonesia has not made other counter-arguments, such as those it has made concerning the import duty exemption. Therefore, it is undisputed that the local content requirement, at least in connection with the luxury tax exemption, constitutes a *prima facie* violation of GATT Article III:4 by treating domestic parts and components more favourably than like imports and the only question is whether the application of GATT Article III:4 to the luxury tax exemption is denied by virtue of the SCM Agreement.

5.208 Indonesia argues that its measures in question are actionable subsidies under the SCM Agreement, and specifically that they are subsidies contingent on the use of domestic products that would be prohibited by SCM Article 3.1(b) but are made actionable instead by virtue of Article 27.3. There is no dispute that Indonesia's discriminatory tax policies fall within the SCM Agreement's

definition of "subsidy" and they are actionable on a transitional basis under part III of the SCM Agreement. The only implication of this analysis is that, under the SCM Agreement, such subsidies are subject to the remedial provisions stipulated by Article 7, just like other subsidies including tax exemptions on domestic products actionable under the SCM Agreement, instead of Article 4, which provides the extremely expeditious procedures for prohibited subsidies. Therefore, the issue is whether the national treatment obligations of GATT Article III also apply to actionable subsidies.

5.209 Indonesia further argues that the national treatment obligations of GATT Article III do not apply to actionable subsidies, regardless of their nature, contending that such subsidies are governed solely by the SCM Agreement. In order to support that position, Indonesia mentioned four main arguments in its First Submission: the SCM Agreement is the *lex specialis* for "subsidies" within its definition; applying GATT Article III:2 to "subsidies" would reduce the SCM Agreement to inutility; GATT Article III and the SCM Agreement "conflict" with each other; and GATT Article III:8(b) should be "re-thought" in light of the SCM Agreement.

5.210 None of Indonesia's arguments have merit. Both GATT Article III and the SCM Agreement are applicable to the National Car Programme, there is no "conflict" between them, and GATT Article III prohibits the Indonesian measures. To accept Indonesia's argument, that is, to fail to apply GATT Article III:2 to "subsidies" would render one of the GATT's core provisions meaningless. Under Indonesia's interpretation, discriminatory imposition of internal taxes would be allowed in the name of "subsidy", but that would deprive Article III:2 of all life and purpose, because its sole function is to prohibit the discriminatory imposition of internal taxes. The following discussion demonstrates the flaws in the arguments made by Indonesia to support its incorrect theory of the relationship between GATT Article III and the SCM Agreement.

(a) Indonesia's *lex specialis* argument does not have any merit

5.211 Indonesia argues that "[t]his dispute involves subsidies and so is governed by the [SCM] Agreement, and not by the [GATT] or the [TRIMs Agreement]". Indonesia further argues that the SCM Agreement "is the *lex specialis* and the WTO conformity of the programmes must be assessed pursuant to the provisions of only this Agreement". (See Section V.D.)

(1) Indonesia's *lex specialis* argument is unsupported

5.212 Indonesia's *lex specialis* argument lacks any legal foundation. Indonesia essentially concedes this by failing in its First Submission to cite a single textual provision in support of its assertion that only the SCM Agreement applies to discriminatory tax breaks and other subsidy measures. This failure is unsurprising, of course, because there simply is no WTO rule that provides for specific agreements, such as the SCM Agreement, to apply to the complete exclusion of general WTO obligations, such as national treatment. The lack of textual support alone is enough to reject Indonesia's position[192], but it is only compounded by the further absence from Indonesia's arguments of any citation to the drafting history, a Panel decision, or even a treatise in its support.

(2) Indonesia's *lex specialis* argument is wrong

5.213 Indonesia's *lex specialis* argument is also wrong. It is inconsistent with the text of the WTO Agreements.

[192]See Vienna Convention on the Law of Treaties, art. 31; See also, United States - Standards for Reformulated and Conventional Gasoline ("US - Gasoline"), WT/DS2/AB/R, adopted on 20 May 1996, pp. 16-17.

5.214 As mentioned, no WTO rule provides for specific agreements to apply to the complete exclusion of general WTO obligations. To the contrary, the WTO Agreements expressly provide for a different - and much narrower - rule of law. Specifically, the General Interpretative Note to Annex 1A of the Agreement Establishing the WTO (the "General Interpretative Note") provides:

> In the event of a conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A [of the WTO Agreement], the provision of the other agreement shall prevail to the extent of the conflict.

5.215 The existence of the General Interpretative Note thoroughly undermines Indonesia's *lex specialis* argument. The General Interpretative Note explicitly specifies the consequences if a "conflict" should arise between the GATT and certain other agreements, including the SCM Agreement, and it provides for preemption only "to the extent of the conflict." But if the SCM Agreement were the *lex specialis* that applied to the complete exclusion of the GATT, as Indonesia argues, then no "conflict" could ever occur between the two. It is obvious that the WTO Membership, by adopting the General Interpretative Note, formally acknowledged the possibility of "conflict". Thus, the General Interpretative Note, by its very existence, disproves Indonesia's *lex specialis* theory.

5.216 In addition, Indonesia's theory is disproved by the existence of footnote 56 to the SCM Agreement, which specifies that the SCM Agreement does not "preclude action under other relevant provisions of GATT 1994, where appropriate." As with the General Interpretative Note, footnote 56 definitively shows that the SCM Agreement does not apply to the complete exclusion of the GATT.[193]

5.217 Indonesia asserts that the SCM Agreement creates the "sole definition of subsidy for the family of WTO Agreements". However, there is no reason to ignore the plain language of Article 1.1 of the SCM Agreement, which expressly states that the definition is "for the purpose of this Agreement". One should interpret that article in good faith in accordance with the ordinary meaning to be given to its terms, as the Vienna Convention guides us to do.

5.218 Indonesia also claims its "right as a developing country to maintain domestic-content subsidies" absent serious prejudice to a like product. As mentioned already, the measures in question are not prohibited under the SCM Agreement, but made actionable on a transitional basis by virtue of SCM Article 27.3. However, this does not mean that developing countries are granted rights for exemption not only from SCM Article 3.1(b) but also from all other WTO provisions, including GATT Article III. In the context of discriminatory imposition of internal taxes, the measures in question are at the same time subject to GATT Article III.

(3) Indonesia's *lex specialis* argument has seriously damaging implications for the WTO system

5.219 If adopted, Indonesia's *lex specialis* argument would create loopholes in the GATT large enough to undermine the WTO's fundamental purpose of trade liberalization. In Indonesia's view of the WTO system, sanitary measures, technical standards, and entire categories of other measures would be largely exempted from the GATT and other general WTO disciplines. This result would occur, perversely, despite the facts that such measures were undeniably subject to the GATT before the Uruguay Round and that the clear purpose of the Uruguay Round was to strengthen - not weaken - multilateral disciplines.

5.220 The damage to the WTO system that would result from adoption of Indonesia's *lex specialis* argument is well illustrated by this case, since it would excuse Indonesia's violations of GATT

[193]Vienna Convention on the Law of Treaties, art. 26.

Articles I:1, X:1, and X:3, although nothing about the SCM Agreement comes anywhere close to waiving the MFN obligation, excusing Indonesia's failure to publish its programmes, or allowing it to administer its programmes unreasonably and partially.

(b) The SCM Agreement would not be reduced to inutility by Article III:2 of GATT

5.221 As noted by the Appellate Body and previous Panels, under general rules of treaty interpretation, one must give meaning and effect to all terms of a treaty and must not "adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[194] Indonesia invokes this principle in an attempt to prove that GATT Article III:2 does not apply to the National Car Programme, contending that application of Article III:2 would reduce the entire SCM Agreement to inutility. (See Section V.D.2). That argument is not only wrong, but backwards, and it should be rejected.

5.222 In fact, the SCM Agreement will continue to impose a variety of substantive and procedural disciplines on subsidies and countervailing measures regardless of the applicability of GATT Article III:2. There exist various subsidies which are subject to the SCM Agreement and are not proscribed by GATT Article III:2. For example, exempting domestic enterprises from certain internal taxes or charges, such as registration taxes, would not violate GATT Article III:2, when those taxes or charges are not applied in connection with imported products. However, such measures still fall into the scope of Article 1(a)(1)(ii) and Article 2.1 of the SCM Agreement and therefore these measures are subject to the disciplines of the SCM Agreement to their fullest extent.

5.223 Further, the SCM Agreement is not meaningless, even though GATT Article III, as a whole, applies to subsidies. The text of GATT Article III supports this observation, because the "subsidies" covered by GATT Article III:8(b) are not prevented by GATT Article III, but they may still be subject to the provisions of the SCM Agreement. Thus, it is plainly wrong to say that the SCM Agreement would be reduced to inutility if the Panel rules that GATT Article III:2, or the entire GATT Article III, applies to this case.

5.224 By contrast, GATT Article III:2 would be reduced to inutility if one accepted Indonesia's view of the SCM Agreement. Under that view, SCM Article 27.3 grants developing country Members a licence to impose discriminatory taxes on imported goods in clear contravention of GATT Article III:2. That view would further lead to an absurd conclusion that even developed country Members could engage in such discriminatory taxation, provided only that such discrimination was not contingent on the use of domestic over imported products, since nothing in the SCM Agreement prohibits such kinds of subsidies. It should be apparent that Indonesia's approach would eviscerate GATT Article III:2. All discriminatory internal taxation that had previously been regarded as violations of GATT Article III:2 would be suddenly recast as "subsidies" exempt from GATT Article III:2 disciplines. There would be no GATT Article III:2, because its sole function is to prohibit discriminatory internal taxes and they would all be exempt from its disciplines. The reasoning of the US - Malt Beverages Panel is exactly on point; that Panel rejected an argument like Indonesia's, declaring that "such an interpretation would virtually eliminate the prohibition in Article III:2 of discriminatory internal taxation by enabling contracting parties to exempt all domestic products from indirect taxes."[195]

5.225 Thus, the Appellate Body's warning that WTO provisions cannot be construed in a manner that deprives them of all force and effect precludes giving the SCM Agreement such a broad construction as

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[194]Appellate Body Report on US - Gasoline, p. 23; Appellate Body Report on Japan - Taxes on Alcoholic Beverages ("Japan - Alcoholic Beverages II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted on 1 November 1996, p. 12.

[195]See Panel Report on United States - Measures Affecting Alcoholic and Malt Beverages ("US - Malt Beverages"), DS23/R, adopted on 19 June 1992 (BISD 39S/206), para. 5.12.

to essentially repeal GATT Article III:2.[196] There is no danger of GATT Article III:2 reducing the SCM Agreement to inutility, but, as US - Malt Beverages recognized, adoption of Indonesia's argument would most certainly have that effect on GATT Article III:2.[197]

5.226 Other considerations also strongly dictate that the SCM Agreement must be construed to avoid this result. First, WTO cases that have addressed potential areas of conflict or overlap between WTO Agreements have favoured application of each agreement in accordance with its terms, rather than allowing one agreement to override another unnecessarily.[198] Second, numerous Panels over the years have recognized GATT Article III:2's critical importance both in its own right and in maintaining the effectiveness of Articles I (MFN) and II (tariff bindings).[199] Finally, there is no doubt that before the Uruguay Round Article III:2 prohibited discriminatory internal taxes and it would be perverse to construe a Uruguay Round Agreement in a manner that undermined an essential GATT discipline.

(c) GATT Article III does not "conflict" with the SCM Agreement

5.227 Indonesia also argues that the SCM Agreement conflicts with GATT Article III:2 and, per the General Interpretative Note, the SCM Agreement prevails in the conflict. That argument cannot be supported because there is no such conflict.

5.228 The Bananas III Panel construed the term "conflict" in the General Interpretative Note to include both cases of "mutually exclusive" obligations and cases where the GATT prohibits what an Annex 1A Agreement "explicitly permits," but not to cases where the two agreements provide for "different or complementary obligations." As the United States has observed, the Bananas III Panel construed the term "conflict" rather broadly. (See Section V.E.3). A finding that a "conflict" arises only where two agreements establish "mutually exclusive" obligations would be more in keeping with the drafting history of the General Interpretative Note (See Section V.E.1) and with earlier decisions that have sought to minimize potential conflicts between WTO agreements.[200] Even if one accepts the broad view of "conflict" from Bananas III, however, there is no "conflict" between the SCM Agreement and GATT Article III:2.

(1) The obligations of GATT Article III:2 and the SCM Agreement are not "mutually exclusive"

5.229 It is so clear that a Member may comply with the obligations of both GATT Article III and the SCM Agreement simply by not engaging in tax discrimination that Indonesia does not even seriously argue that the two are "mutually exclusive." Indonesia's does state that its "obligations under the two provisions would be mutually exclusive," but that cannot be regarded as a serious argument, because Indonesia did not (and could not) identify a single obligation of the SCM Agreement that requires

[196]See, e.g., Appellate Body Report on Japan - Alcoholic Beverages II, p.12.

[197]Panel Report on US - Malt Beverages, para. 5.12.

[198]Panel Report on Canada - Certain Measures Concerning Periodicals ("Canada - Periodicals"), WT/DS31/R, adopted on 30 July 1997, as modified by the Appellate Body, paras. 5.17-5.18. Appellate Body Report on Canada - Periodicals, WT/DS31/AB/R, adopted on 30 July 1997, p. 18.

[199]See, e.g., Panel Report on US - Malt Beverages, paras. 5.9, 5.12.

[200]See, e.g., Report of the Appellate Body on Canada Periodicals, p. 18. The WTO Secretariat presented its views on the concept of "conflict" between two international agreements in connection with the negotiation of the Multilateral Agreement on Investment. The WTO Secretariat stated that, in the strict sense of the term, a conflict of law arises where an act obligated under one agreement is prohibited under another. The WTO Secretariat also differentiated the concept of "conflict" from the concept of "overlap." "Relationship of Proposed MAI Provisions to the WTO - Note by the WTO Secretariat," DAFFE/MAI/RD(96)37 (Japan Exhibit 68, p.2). See also "The Relationship between the MAI and the WTO Agreements (Note by the Chairman)," DAFFE/MAI/(96)21 (Japan Exhibit 69).

conduct in violation of GATT Article III:2. Instead, it appears that Indonesia has confused the two prongs of Bananas III.

(2) The SCM Agreement does not "explicitly permit" tax discrimination in violation of GATT Article III:2

5.230 Indonesia's entire "conflict" argument depends on a finding that the SCM Agreement "explicitly permits" violations of Article III:2. But Indonesia fails to point the Panel to any such "explicit" language in the text. It would be impossible to do so. There simply is no language in the SCM Agreement that "explicitly permits" tax discrimination in violation of GATT Article III. The Textiles and Clothing Agreement explicitly authorized an exemption from the obligation to eliminate quantitative restrictions provided by GATT Article XI. Lacking any language in the SCM Agreement, equivalent to that under Articles I and II of the ATC, one cannot jump to the conclusion that the relationship between Article III and the SCM Agreement is "analogous to the relationship between Article XI and the ATC."

5.231 Lacking textual support, Indonesia nevertheless soldiers on by advancing a lengthy, elaborate, and rather convoluted argument about "actionable subsidies."

5.232 But still, nothing about Indonesia's argument shows that the SCM Agreement authorizes - explicitly or implicitly - "actionable subsidies" that violate GATT Article III:2. Indonesia concludes that "the SCM [Agreement] specifically does not prohibit developing countries from granting a subsidy involving differential internal tax treatment on products and ..., on the other hand, Article III:2 of GATT 1994 prohibits such differential internal tax treatment on products", and that this situation is "conflict". (See Section V.D.). Indonesia appears to be attempting, *sub silentio*, to stretch the definition of "explicitly permits". Indonesia would have the Panel believe that something the SCM Agreement "does not prohibit" is "explicitly permitted". Silence on tax discrimination can never mean "explicit permission", however. Therefore, the Panel should reject Indonesia's attempt to equate silence with "explicit permission".

5.233 The Indonesian argument seems to stem from a misunderstanding of Article 27.3 of the SCM Agreement. By its terms, SCM Article 27.3 provides developing country Members a temporary exemption from one obligation of the SCM Agreement, specifically, from SCM Article 3.1(b)'s prohibition of subsidies conditioned upon the use of domestic over imported goods. For developing country Members, during the five year transitional period, subsidies conditioned upon the use of domestic over imported goods are not deemed to be prohibited subsidies under Part II of the SCM Agreement, but are still actionable subsidies under Part III by virtue of Article 27.3. However, are actionable subsidies "explicitly permitted" to ignore GATT Article III? The answer is obviously negative. As demonstrated so far, GATT Article III does and should apply to subsidies under the SCM Agreement, including actionable subsidies. There is no reason to read an exemption from SCM Article 3.1(b) as an exemption from GATT Article III, or from any other WTO obligation. To the contrary, exceptions from GATT principles have traditionally been interpreted narrowly by GATT and WTO panels, and as already discussed, footnote 56 to the SCM Agreement provides that the SCM Agreement does not "preclude action under other relevant provisions of GATT 1994, where appropriate."

(3) The SCM Agreement and GATT Article III:2 create "different or complementary" obligations

5.234 The Panel should recognize that the SCM Agreement and GATT Article III:2 create "different or complementary obligations". As described by the Bananas III Panel, two provisions are "different or complementary", and do not conflict, if "both can be complied with at the same time without the need to renounce explicit rights or authorizations". GATT Article III:2 and the SCM Agreement can both be complied with and Indonesia has failed to show that such compliance would require it to renounce any "explicit rights".

5.235 It should be recalled here that what triggers the luxury tax exemption is not merely the use of a domestic product (i.e., parts and components) by a domestic producer, it is the sale of a domestic product (i.e., an automobile) with domestic content to the final consumer. We therefore do not have here only the type of discrimination addressed by Article 3.1(b) of the SCM Agreement (i.e., a subsidy to a producer contingent upon use of a domestic product), but also a type of discrimination governed only by GATT Article III:2 (i.e., internal tax discrimination between imported and domestic products). This highlights the fact that GATT Article III and SCM Article 3.1(b) have clearly different purposes, coverage, and remedies.

5.236 Further, with regard to remedies, the SCM Agreement allows both dispute settlement procedures under Article 4 or Article 7 and countervailing measures in accordance with Part V of the Agreement, while remedies for violations of GATT Article III:2 are provided under GATT Article XXII and Article XXIII. In this respect, Indonesia attaches too much emphasis to the higher burden of proof under the SCM Agreement. However, Indonesia's proposition that the SCM Agreement is more favourable to defending parties than GATT Article III in terms of remedial procedures, and thus provides defending parties some procedural rights, is questionable. The remedial process under Article 7 of the SCM Agreement is much more expeditious than those under the Dispute Settlement Understanding. Complaining parties are required to prove adverse trade effects but they can secure remedies under Article 7 of the SCM Agreement much earlier than in the case of a claim concerning the infringement of the GATT obligations under the DSU. In other words, complaining parties bear the burden of proving adverse trade effects in exchange for a more expeditious remedy. Indonesia also stresses that, under Article 7 of the SCM Agreement, the only remedy required is to eliminate "the adverse effects". However, we do not see any substantial difference between the obligations to eliminate the adverse effects and those to bring the measures into conformity with the GATT obligations. It should also be noted that under Article 7 of the SCM Agreement "appropriate steps to remove the adverse effects" have to be taken within 6 months from the date of adoption of the recommendations by the DSB, only 2/5 of the 15 months guideline for the "reasonable period of time" to implement the DSB recommendations stipulated by Article 21.3 of the DSU. Therefore, even though Article III of the GATT 1994 is applicable, complaining parties may choose to resort to Article 7 of the SCM Agreement, as the United States and the European Communities do in this case.

(4) "Conflict" should be narrowly interpreted

5.237 In keeping with the fundamental objective and purpose of the WTO system - trade liberalization - WTO cases that have addressed potential areas of conflict and overlap between the WTO agreements have favoured application of each agreement in accordance with its terms to the maximum extent possible, rather than unnecessarily allowing one agreement to override another.[201]

5.238 Given that under the WTO system, waivers and exceptions "have to be interpreted narrowly"[202], the waiver of the prohibition under Article 3.1(b) of the SCM Agreement cannot reasonably be interpreted as a license to violate any and all other obligations under the WTO agreements. Japan's claim under Article III of GATT 1994 is not that the Programmee provides a prohibited subsidy, but that it violates national treatment, including Indonesia's obligation under GATT Article III:2 to tax domestic and imported like products at the same rate. If the WTO Members had intended to waive the

[201] See, e.g., Report of the Appellate Body on Canada - Periodicals, page 19.

[202] As noted in the GATT panel report on US - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada, provisions that constitute "an exception to basic principles of the General Agreement had to be interpreted narrowly." BISD 38S/30, para. 4.4, adopted 11 July 1991. See also Norway - Procurement of Toll Collection Equipment, GPR DS2/R, para. 4.5, adopted 13 May 1992 ("Since Article V:16(3) [of the Government Procurement Agreement] was an exceptions provision, its scope had to be interpreted narrowly"); Canada - Import Restrictions on Ice Cream and Yoghurt, BISD 36S/68, para. 59, adopted 4 December 1989 (The panel "noted, as had previous panels, that exceptions were to be narrowly interpreted.").

obligations under GATT Article III:2 entirely for developing countries, they would have done so explicitly, given that "[t]he MFN requirement in Article I, and also tariff bindings under Article II, would become ineffective" without enforcement of the Article III:2 prohibition on discriminatory tax measures, including discriminatory tax exemptions.[203]

5.239 The drafting history of the term "conflict" in the General Interpretative Note in the "third track" negotiating group also confirms that the term suggests an irreconcilable difference. The initial discussion on the relationship between GATT 1994 and the other WTO agreements occurred during the drafting of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") in the "third track" negotiating group chaired by Mr. Julio Lacarte. The delegation of Canada then submitted on 14 October 1993 a proposal entitled "Conflict of Substantive Provisions" that included the addition of the following "Headnote to Annex 1A in the MTO Agreement":

> In the event of a conflict between a provision of the GATT (1993) and a provision of another agreement in Annex 1A, the provision of the other agreement shall take precedence to the extent of the inconsistency."[204]

5.240 At the session of 19 October 1993, the delegation of Japan proposed to delete the term "inconsistency" and replace it with the term "conflict". Other delegations approved this amendment, and it was incorporated in a working paper dated 6 December 1993 prepared by the secretariat to record the results of this session and to facilitate future discussions among the negotiating group.[205] The delegations that addressed this amendment at the session generally concurred that it was intended to clarify the limited number of instances in which the Note would apply. Whereas "inconsistency" was open to a broad interpretation, "conflict" referred only to irreconcilable differences between an obligation under GATT 1994 and an obligation under another WTO agreement, such that the provisions of the two agreements were mutually exclusive and could not both be enforced at the same time.

(d) GATT Article III:8(b) has never excused tax discrimination and should not be "re-thought" to excuse it now

(1) GATT Article III:8(b) has never excused tax discrimination

5.241 Article III:8(b) provides that Article III "shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article ...."

5.242 As is evident from the textual reference to "payments . . . derived from the proceeds of internal taxes," the scope of Article III:8(b) is limited to direct payments to producers. Other measures that may be characterized as "subsidies," such as discriminatory tax breaks for domestic products, are not covered.

5.243 This plain understanding of Article III:8(b) was confirmed by the GATT Panel in US - Malt Beverages.[206] That Panel unequivocally rejected the argument that discriminatory tax breaks were "subsidies" protected by Article III:8(b), declaring that such an argument was contrary to the text, "context, declared purpose and drafting history of Article III."[207] The drafting history could hardly be more clear about this point; the Havana Conference rejected an alternative to Article III:8(b) proposed by the Cuban delegate that would have expressly permitted "the exemption of domestic products from

[203] US - Malt Beverages, paras. 5.9, 5.12.
[204] Canadian Proposal "Conflict of Substantive Provisions" dated 14 October 1993 (Japan Exhibit 64).
[205] Draft prepared by the GATT Secretariat dated 6 December 1993 (Japan Exhibit 65).
[206] Panel Report on US - Malt Beverages, paras. 5.7-5.12.
[207] Id. at para. 5.9.

internal taxes as a means of indirect subsidization. . . ."[208] This evidence from the drafting history confirms the plain text of Article III:8(b) in showing that it is limited to direct payments to producers. Discriminatory tax breaks for products have never been covered by Article III:8(b), and are inconsistent with GATT Article III:8(b). The US - Malt Beverages decision was followed by the GATT Panel in US - Tobacco and it was reaffirmed in Canada - Periodicals, by the Appellate Body which declared that Article III:8(b) "was intended to exempt from the obligations of Article III only the payment of subsidies which involve the expenditure of revenue by a government."[209]

5.244 Therefore, it is beyond doubt that the well-settled understanding of Article III:8(b) is that it covers direct payments of subsidies, but not discriminatory tax breaks. Indonesia does not dispute this. Instead, it admits that its position is inconsistent with the prevailing understanding of Article III:8(b) by advocating a "re-thinking" of that Article. (See Section V.D.)

5.245 Also, even if the discriminatory tax breaks could be considered as "subsidies" under GATT Article III:8(b), they are not directed "exclusively to domestic producers". The direct beneficiaries of the luxury tax exemption are consumers, not the producer of National Cars or producers of its parts and components.[210]

(2) GATT Article III:8(b) should not be "re-thought" to excuse tax discrimination

5.246 Indonesia argues that GATT Article III:8(b) should be "re- thought" to exempt "all subsidies identified in Article 1 of the SCM Agreement" from the obligations of GATT Article III. (See Section V.D). In other words, Indonesia argues that the SCM Agreement's definition of "subsidy" should be read into Article III:8(b). Because the SCM Agreement's definition of "subsidy" includes foregoing "government revenue that is otherwise due", Indonesia argues that this Panel should reject US- Malt Beverages.

5.247 It is Indonesia's argument that should be rejected. The SCM Agreement itself rejects the notion that its definition of "subsidy" should be applied to other WTO Agreements. SCM Article 1.1 expressly states that the definition of "subsidy" is provided "[f]or the purpose of this Agreement." There is no suggestion anywhere in the WTO text that the SCM definition of "subsidy" should be applied to GATT Article III.

5.248 Indonesia's argument is also undermined by the fact that the Appellate Body reaffirmed US - Malt Beverages in Canada - Periodicals.[211] If the Appellate Body considered that the scope of Article III:8(b) had to be "re-thought" in light of the SCM Agreement, it could have and should have done so in Canada - Periodicals. But it did not "re-think" Article III:8(b); it reaffirmed the accepted understanding. Faced with this glaring flaw in its argument, Indonesia argues weakly that Canada did not argue for application of the SCM Agreement in that case. But what Canada did or did not argue in a previous case is wholly irrelevant here. What matters is that the Appellate Body has considered the scope of Article III:8(b) and has decided that it applies only to direct subsidy payments, not to

[208]Id. at para. 5.11.

[209]Panel Report on United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco, DS44/R, adopted on 4 October 1994, para. 109 & note; Report of the Appellate Body on Canada - Periodicals, pp. 31-33 (emphasis added).

[210]See Panel Report on Italian Agricultural Machinery, para.14 (holding that Article III:8(b) does not apply to payments granted to purchasers of agricultural machinery, because such payments cannot be regarded as subsidies to the producers of the machinery). See also European Economic Community - Payments and Subsidies paid to Processors and Producers of Oilseeds and related Animal-Feed Proteins ("EEC - Oilseeds"), L/6627, adopted on 25 January 1990, 37S/86, para.137 (holding that subsidy payments that economically benefit oilseed processors, and not only oilseed producers, are not subsidies paid "exclusively to domestic producers" under Article III:8(b)).

[211]Appellate Body Report on Canada - Periodicals, pp. 32-34.

discriminatory tax breaks. Indonesia's position is at odds with the Appellate Body's interpretation of Article III:8(b), and it should be rejected.

5.249 Moreover, the rationale of US - Malt Beverages remains every bit as valid today as it was when adopted. It is still the case that including tax discrimination within the scope of Article III:8(b) is contrary to the text, context, declared purpose, and drafting history of Article III. It also remains true that "the prohibition of discriminatory internal taxes in Article III:2 would be ineffective if discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8(b)."[212] Thus, the Appellate Body's admonition against reducing WTO provisions to inutility precludes any "re-thinking" of Article III:8(b) that would render Article III:2 ineffective. And, once again, there is no reason whatsoever to believe that, by strengthening multilateral disciplines on subsidies, the Uruguay Round essentially repealed Article III:2's prohibition on discriminatory taxation. As stressed in the beginning of this Part, weakening Article III by abandoning its established interpretation and adopting Indonesia's proposed "re-thinking" would cause grave harm to the core WTO disciplines of MFN, tariff bindings, and national treatment.[213]

5.250 For all these reasons, the Government of Japan submits that there is no reason for the Panel to abandon a well-established and recently reaffirmed interpretation of a key GATT provision.

2. Rebuttal arguments of the European Communities

5.251 The following are the **European Communities'** arguments rebutting Indonesia's general response to the claims raised under Article III of GATT 1994:

(a) GATT Article III and the SCM Agreement are not mutually exclusive

5.252 Indonesia does not even attempt to argue that the tax incentives identified in Section III.B are consistent with GATT Articles III:2, first sentence, and III:4. Instead, Indonesia contends that those measures are “subsidies” within the meaning of the SCM agreement and, as such, not subject to GATT Article III but only and exclusively to the SCM Agreement.

5.253 The European Communities does not dispute that the measures at issue are subsidies. Indeed, the European Communities claims that those measures are “specific subsidies” within the meaning of the SCM Agreement which cause “serious prejudice” to its interests, contrary to Indonesia’s obligations under that Agreement. Nevertheless, the European Communities is of the view that GATT Article III and the SCM Agreement are not mutually exclusive and, therefore, can be applied simultaneously to the same measures.

(1) GATT Article III:8(b) confirms that Article III applies to subsidies

5.254 Article III:8(b) of GATT reads as follows:

> (b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

[212]Panel Report on US - Malt Beverages, para. 5.9.
[213]Id. paras. 5.9, 5.12.

5.255 Article III:8(b) does not create an exception to the other provisions of Article III. Rather, the purpose of Article III:8(b) is to clarify that the other provisions of Article III do not apply to certain types of subsidies.[214] Those subsidies which are not covered by Article III:8(b) are not contrary per se to the other provisions of Article III. Nonetheless, Article III:8(b) has the clear implication that measures not falling within that provision are not exempt from the other provisions of Article III simply because they can be characterized as "subsidies".

5.256 The use of the term "payment" in the phrase "payment of subsidies" clearly indicates that the scope of Article III:8(b) is limited to subsidies involving an actual transfer of funds from the Government to domestic producers. Exemptions or reductions from an indirect sales tax on products do not involve any such transfer of funds. Therefore, that type of subsidies is not covered by Article III:8(b). The same reasoning applies in the case of subsidies in the form of an exemption or reduction of import duties.

5.257 The drafting history of GATT provides further confirmation that Article III:8(b) was not intended to cover exemptions or reductions from indirect taxes on products. The Report of the Sub-Committee at the Havana Conference which examined this provisions noted that:

> This subparagraph was re-drafted in order to make it clear that nothing in [Article III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in [Article III] would override the provisions of Section C of Chapter IV [on subsidies][215].

5.258 Furthermore, the drafters of Article III explicitly rejected a proposal by Cuba at the Havana Conference to amend that Article to read:

> The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article [XVI].[216]

5.259 This view is also supported by the 1992 Panel Report on US - Measures Affecting Alcoholic and Malt Beverages. In that case, the United States argued that the application of a lower excise tax to small United States producers of beer was allowable as a subsidy under Article III:8(b). This defence was categorically rejected by the Panel:

> 5.12 The Panel found, therefore, that the expansive interpretation of Article III:8(b) suggested by the United States is not supported by the text, context, declared purpose

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[214]As noted by the Panel Report on United States - Measures affecting Alcoholic and Malt Beverages (adopted on 19 June 1992, BISD 39S/206, at para 5.8)

> "... in contrast to Article III:8 (a), where it is stated that 'this Article shall not apply to ... [government procurement]', the underlined words are not repeated in Article III:8 (b). The ordinary meaning of the text of Article III:8 (b), especially the words 'shall not prevent', therefore suggests that Article III does apply to subsidies, and that Article III:8(b) only clarifies that the product-related rules in paragraph 1 through 7 of Article III 'shall not prevent the payment of subsidies exclusively to domestic producers' [emphasis added by the Panel]

[215]Indonesia contends that neither previous GATT Panel Reports nor the Appellate Body Report on Canada - Certain Measures Concerning Periodicals (adopted on 30 June 1997, WT/DS 31/AB/R) have focused or analysed the last sentence of this citation. This is arguably true but irrelevant. That sentence confirms the proposition that Article III and Article XVI are not mutually exclusive: the mere fact that a measure is a subsidy falling within Article XVI does not exclude the application of Article III and, conversely, the application of Article III does not exclude the application of Article XVI.

[216]E/CONF.2/C.3/6, p.17; E/CONF.2/C.3/A/W.32, page 2.

> and drafting history of Article III, and if carried to its logical conclusion, such an interpretation would virtually eliminate the prohibition in Article III:2 of discriminatory internal taxation by enabling contracting parties to exempt all domestic products from indirect taxes. The Panel accordingly found that the reduced federal excise tax rates on beer are not covered by Article III:8(b).[217]

5.260 Indonesia contends that the Panel Report on US - Measures affecting Alcoholic and Malt Beverages was adopted under the GATT 1947 and that it is necessary to "re-think" the scope of Article III:8 (b) in light of the WTO Agreement, and in particular of the SCM Agreement. More precisely, according to Indonesia, "under the WTO, the 'payment of subsidies' language in Article III:8 (b) must refer to all subsidies identified in Article 1 of the Subsidies Agreement". (See Section V.D.)

5.261 Yet, in the recent case Canada - Certain measures concerning Periodicals[218], the Appellate Body has endorsed expressly the Panel Report on US - Measures Affecting Alcoholic and Malt Beverages, thus confirming that the interpretation of Article III:8 (b) of GATT made by that Panel remains still valid under GATT 1994.

5.262 The issue in dispute in Canada - Certain measures concerning Periodicals was whether the application by Canada Post of a reduced postal rate to certain domestic periodicals was a subsidy covered by Article III:8 (b). Following a careful examination of the text, the context and the drafting history of that provision in line with the analysis made in the preceding paragraphs, the Appellate Body concluded as follows:

> We do not see a reason to distinguish a reduction of tax rates on a product from a reduction in transportation or postal rates. Indeed, an examination of the text, context, and object and purpose of Article III:8(b) suggests that it was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government"[219] [emphasis added].

5.263 The Appellate Body then went on to express its agreement with the following passage of the Panel Report on US - Measures affecting Alcoholic and Malt Beverages:

> 5.10 Article III:8(b) limits, therefore, the permissible producers subsidies to 'payments' after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests can be balanced.[220]

5.264 Thus, contrary to the suggestions advanced by Indonesia, in Canada - Certain measures concerning Periodicals the Appellate Body made it very clear that a subsidy in the form of an exemption

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[217]Panel Report on United States - Measures affecting Alcoholic and Malt Beverages, adopted on 19 June 1992, BISD 39S/206, at para 5.12.

[218]Appellate Body Report on Canada - Certain Measures concerning Periodicals, adopted on 20 June 1997, WT/DS 31/AB/R.

[219]Id., at p. 34.

[220]Panel Report on United States - Measures affecting Alcoholic and Malt Beverages (adopted on 19 June 1992, BISD 39S/206, at para 5.10), reproduced in Appellate Body Report on Canada - Certain Measures concerning Periodicals, WT/DS 31/AB/R, p. 34.

or reduction of tax rates on a product does not fall within Article III:8(b). The Appellate Body Report on Canada - Certain measures concerning Periodicals cannot be explained away simply by saying that Canada did not raise the argument that the measures at issue were subsidies covered by the SCM Agreement. (See Section V.D). GATT Article III:8(b) cannot have different meanings depending on the arguments raised by the parties to a dispute. If the SCM Agreement had changed the meaning of GATT Article III:8(b), the Appellate Body should have taken into account that new meaning, even if it was not invoked by Canada.

(2) The SCM Agreement is not *lex specialis*

5.265 As a preliminary remark, the European Communities notes that it may be questionable whether the *lex specialis* principle qualifies as a "customary rule of interpretation of public international law" in the sense of Article 3.2 of the DSU. The defendant has not provided any evidence to that effect. Furthermore, the European Communities notes that such principle is nowhere mentioned in the Vienna Convention on the Law of the Treaties.

5.266 Assuming that the *lex specialis* rule was in fact a customary rule of public international law, the General Interpretative Note to Annex 1A would exclude its application between the GATT and the other Annex 1A Agreements. The clear intention of the WTO drafters was that the relationship between the GATT 1994 and the other Agreements included in Annex 1A should be governed only and exclusively by the rule contained in the General Interpretative Note to Annex 1A. The wording of that Note was carefully chosen so as to restrict the number of instances where the other Agreements included in Annex 1A would prevail over GATT 1994. (See Section V.E.1.) Those cautions would have been unnecessary if the drafters had envisaged the application of the *lex specialis* rule between GATT and the other Annex 1 Agreements.[221]

5.267 In any event, Indonesia has not shown that the SCM Agreement is the *lex specialis* in this dispute. Unlike GATT Article III:2, which is specifically concerned with indirect taxation, the SCM Agreement does not contain any rule dealing specifically with indirect taxes. Moreover, whilst virtually all measures falling within Article III:2 may be construed as "subsidies" within the meaning of Article 1 of the SCM Agreement, the opposite is clearly not true: most subsidies subject to the SCM Agreement do not fall within either Article III:2 or any of the other provisions of Article III. Thus, if the *lex specialis* principle was deemed applicable, Article III:2 and not the SCM Agreement would have to be considered as the relevant lex specialis with respect to the tax exemptions and reductions granted by

[221]The *lex specialis* rule has never been invoked by prior Panels or by the Appellate Body in order to decide on the relationship between GATT 1994 and another Agreement contained in Annex 1A. The Panel Reports on EC - Regime for the Importation, Sale and Distribution of Bananas, examined the relationship between the GATT, on the one hand, and the TRIMs Agreement and the Agreement on Import Licensing Procedures, on the other hand, exclusively in light of the General Interpretative Note, even though, having regard to the greater degree of specificity of the obligations they impose, the two latter agreements are arguably *lex specialis* with respect to the GATT. According to the Panel, those two agreements and the GATT were "equally applicable" to the measures at issue in the absence of a "conflict" within the meaning of the General Interpretative Note. (See e.g. WT/DS27/R/USA, adopted on 25 September 1997, at paras 7.152.- 7.158)

The Report of the Appellate Body in the same case (WT/DS27/AB/R, adopted on 25 September 1997, at para 204) hold that:

"Although Article X:3(a) of the GATT 1994 and Article 1.3 of the Licensing Agreement both apply, the Panel, in our view, should have applied the Licensing Agreement first, since this agreement deals specifically, and in detail, with the administration of importing licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3 (a) of the GATT 1994)" [emphasis added]

Thus, the Appellate Body ruled that "both" Article X of GATT and the Licensing Agreement applied to the measures and that the latter should have been applied "first", and not "instead of" GATT Article X, as the *lex specialis* rule would have required.

Indonesia. As will be shown below GATT Article III:4 and the SCM Agreement overlap. Some (but by no means all) measures covered by Article III:4 are also covered by the SCM Agreement. Thus, it cannot be said that any one of them is *lex specialis* with respect to the other.[222]

(3) The application of GATT Article III to subsidies does not render the SCM Agreement redundant

5.268 Indonesia's contention that virtually all subsidies other than subsidized import duties are contrary to GATT Article III is based on a gross misinterpretation of the scope of that provision. Moreover, it ignores that the remedies provided by the SCM Agreement are different from the remedies available in case of breach of the GATT.

5.269 Article 1 of the SCM Agreement identifies three different ways in which a Government can provide a subsidy[223]:

(i) by making a direct transfer of funds (e.g. grants, loans, an equity infusion);

(ii) by foregoing or non collecting government revenue that is otherwise due (e.g. fiscal incentives such as tax credits); and

(iii) by providing goods or services, or by purchasing goods.

5.270 Direct transfers of funds are not covered by GATT Article III:2, which is concerned only with the application of indirect taxes on products. Moreover, loans, grants or equity infusions are not "laws, regulations or requirements" which "affect" as such the internal sale, offering for sale, purchase, transportation, distribution or use of products.[224] For that reason, the granting of this category of subsidies cannot breach by itself GATT Article III:4. As shown by previous Panel Reports, this type of subsidies may be contrary to Article III:4 only to the extent that they are linked to a measure which affects the internal sale, purchase, use, etc. of domestic goods. For example, in Italian Agricultural Machinery[225], the Panel found that an Italian law providing special credit terms to farmers for the purchase of agricultural machinery conditional upon the purchase of machinery produced in Italy was, by virtue of that condition, contrary to GATT Article III:4. As discussed above, that subsidies in the

[222]The relationship between GATT Article III:4 and the SCM Agreement is similar to that between the GATT and the GATS as described by the Appellate Body in the following passage of its Report on EC - Regime for the Importation, Sale and Distribution of Bananas (WT/DS27/AB/R, adopted on 25 September 1997, at para 221):

"Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT and the GATS (...) In all such cases in this third category, the measure in question could be scrutinised under both the GATT 1994 and the GATS. However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular goods is scrutinized under the GATT 1996 or the GATS, or both, is a matter that can only be determined on a case-by-case basis".

[223]In addition, Article A.1 (a) (1) (iv) of the SCM Agreement refers to the hypothesis where a Government makes payments to a funding mechanism or entrusts or directs a private body to carry out one or more of the types of functions illustrated in (i) to (iii).

[224] E/CONF.2/C.3/6, p.17; E/CONF.2/C.3/A/W.32, p.2.

[225]Panel Report on Italian Agricultural Machinery, adopted on 23 October 1958, 7S/60.

form of direct transfer of funds are not caught by GATT Article III is further confirmed by GATT Article III:8(b).

5.271 The above considerations are equally applicable in the case of subsidies falling within category (iii), even if GATT Article III:8(b) does not refer to the provision of goods and services to a domestic producer. Thus, for instance, the provision of raw materials by the Government at a subsidized price would not be contrary to either Article III:2 or Article III:4, because it does not affect as such the internal sale, offering for sale, etc of goods. On the other hand, the provision by the Government of, for example, services of transportation or distribution at subsidized rates only for domestic goods would be contrary to Articles III:4[226] and/or III:2.

5.272 Category (ii) includes, in essence, three different types of subsidies: subsidies granted in respect of indirect taxes on products; subsidies granted in respect of import duties; and subsidies granted in respect of direct taxes.

5.273 If the taxes are indirect, GATT Article III:2 may apply. In contrast, subsidies granted in respect of direct taxes are not covered by Article III:2 which, to repeat, is concerned only with indirect taxes. Nor are those subsidies subject to GATT Article III:4. First, because direct taxes are not applied on "products" and therefore do not "affect" as such their sale, offering for sale, etc. Moreover, a reduction or exemption from a direct tax could never be considered to give "more favourable treatment" in the sense of Article III:4, given that foreign producers (and indirectly their products) are not subject to those taxes in the first place. Like the subsidies falling within the category (i), subsidies granted in respect of direct taxes may infringe Article III:4 only to the extent that they are linked to other conditions which favour the use, purchase, etc. of domestic products.

5.274 Subsidies granted in respect of import duties are not covered, in principle, by Article III since import duties are border measures. Nevertheless, this type of subsidies may violate Article III:4 where, as in the present dispute, its granting is conditional upon compliance with a measure, such as a local content target, which affects the internal use of products (see Section V.F.3).

5.275 In sum, whilst GATT Article III and the SCM Agreement may overlap in respect of certain measures, most subsidies covered by the SCM Agreement do not fall within the scope of GATT Article III.

5.276 Moreover, Articles 4 and 7 of the SCM Agreement provide specific remedies which are more rigorous for the subsidising Member than the ordinary remedies available under the DSU in case of breach of GATT Article III.

5.277 The importance of this difference is perfectly illustrated by the present dispute. If the Panel finds that Indonesia has violated Article III of GATT, Indonesia will be required "to bring the measure into conformity with" the GATT (cf. Article 19 of the DSU). In practice, this means that Indonesia will have to amend or repeal the measures, but only for the future.

5.278 In contrast, if the Panel found that those measures constitute subsidies which have caused "serious prejudice" to the interests of the EC, Indonesia would be required, in accordance with Article 7.8 of the SCM Agreement, to "withdraw" the subsidies or to "remove" its "adverse effects". This may imply the obligation for Indonesia not just to repeal or amend the measures but in addition to recover the

[226]Thus, for instance, in Canada - Certain measures concerning periodicals, the application by Canada Post of more favourable postage rates for domestic periodicals was found to violate Article III:4. (Panel Report WT/DS31/R, at paras 5.31-5.44, as modified by the Appellate Body Report, WT/DS31/AB/R, adopted on 20 June 1997, at pp. 32-35).

unpaid duties and taxes on motor vehicles which have already benefited from those exemptions, to the extent that those subsidies continue to cause "adverse effects".

(4) The non-application of GATT Article III:2 to subsidies would render GATT Articles III:2 and III:8(b) superfluous

5.279 Whilst, for the reasons explained above, the application of GATT Article III to subsidies would by no means render the SCM Agreement redundant, its non-application would reduce GATT Article III:2 to inutility. In effect, any measure falling within GATT Article III:2 can be construed as "revenue foregone" within the meaning of Article 1.1 (a) (1) (ii) of the SCM Agreement and therefore as a "subsidy".

5.280 As noted by the Panel Report on US - Measures affecting Alcoholic and Malt Beverages:

> ... As any fiscal burden imposed by discriminatory internal taxes on imported goods is likely to entail a trade-distorting advantage for import-competing domestic producers, the prohibition of discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8 (b).[227]
>
> ... carried to its logical conclusion, [the United States interpretation] would virtually eliminate the prohibition in Article III:2 of discriminatory internal taxation by enabling contracting parties to exempt all domestic producers from indirect taxes...[228]

5.281 Furthermore, Indonesia's *lex specialis* argument also would reduce to inutility GATT Article III:8(b). In fact, if the SCM was *lex specialis* with respect to Article III:2 whenever a subsidy is involved, there would be no need to clarify in the GATT that certain categories of subsidies are not covered by GATT Article III.

(5) The SCM Agreement has not modified the relationship between the rules on subsidies and the rules on national treatment which existed under GATT 1947

5.282 Under GATT 1947, there was no question that Article XVI was *lex specialis* vis-à-vis Article III to the extent that "subsidies" were concerned; or that there was a "conflict" between those two provisions simply because Article XVI did not prohibit certain types of measures that were prohibited by Article III.

5.283 Indonesia does not, apparently, dispute that under GATT 1947 Article III and Article XVI were not mutually exclusive. Yet, Indonesia contends that "all of that changed with the entry into force of the WTO". Indonesia gives two reasons for that "change". The first reason is that the SCM Agreement provides an "all encompassing structure of remedies" against subsidies. The second reason is that the SCM Agreement contains a definition of "subsidy". As will be shown below, both reasons are far from compelling.

5.284 Article XVI of GATT 1947 did contain also an "all encompassing structure of remedies applicable to subsidies", in the sense that it provided remedies with respect to all subsidies. Section A laid down a remedy for all "subsidies in general"; whereas Section B provided additional remedies for export subsidies. The remedies provided in Section A of Article XVI in respect of the type of subsidies at issue in this dispute are less rigorous for the subsidising Member than those provided in the SCM Agreement. But they are no less "encompassing". Formally, the relationship between the SCM

[227]Panel Report on United States - Measures affecting Alcoholic and Malt Beverages (adopted on 19 June 1992, BISD 39S/206, at para 5.9.

[228]Id., at para 5.12

Agreement and Article III of GATT 1994 is identical to the relationship between Article XVI of GATT 1947 and Article III of GATT 1947. The mere fact that the remedies against subsidies have been strengthened in the SCM Agreement is not a sufficient reason to conclude that Article III no longer applies to subsidies.

5.285 The fact that the SCM Agreement contains a definition of subsidies is also irrelevant. The absence of a definition of "subsidy" in GATT 1947 did not make Article XVI inapplicable, nor therefore prevented it from applying concurrently with Article III to the same measures. Furthermore, Article 1.1 of the SCM Agreement states very clearly that the definition of subsidy contained therein is only for the purposes of that Agreement.

(6) Article 32.1 *juncto* Footnote 56 of the SCM Agreement confirms that the SCM Agreement does not exclude the application of GATT Article III to subsidies

5.286 If, as claimed by Indonesia, the WTO Agreement had rendered GATT Article III inapplicable to subsidies, one would expect to find some indication in the SCM Agreement of the drafters' intention to introduce such a fundamental change with respect to the situation existing under GATT 1947. Yet, the SCM Agreement does not contain the slightest trace of such intention.

5.287 To the contrary, Article 32.1 juncto Footnote No 56 of the SCM Agreement indicates that the drafters of the WTO Agreement expressly envisaged the continued application of GATT Article III to subsidies covered by the SCM Agreement.

5.288 Article 32.1 of the SCM Agreement reads as follows:

> No specific action against a subsidy of another member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.

5.289 Footnote No 56 to this paragraph then states that:

> This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

5.290 The obvious purpose of Article 32.1 is to prevent Members from taking action against subsidies on the basis of GATT Articles VI (to the extent that its provisions concern subsidies) or XVI, independently from the more precise rules laid down in the SCM Agreement. GATT Article III is not a provision "interpreted" by the SCM Agreement but, instead, one of the "other relevant provisions" to which reference is made in footnote No 56. Thus, in conformity with that footnote the SCM Agreement does not preclude the Community from taking action under Article III against a subsidy covered by the SCM Agreement.[229]

[229]Article 32.1 and footnote No 56 of the SCM Agreement reproduce the wording of Article 19.1 of the Tokyo Round Code and footnote No 1 to that Article, with the only difference that the references in the latter agreement to "the General Agreement" have been replaced by references to the "GATT 1994". The official title of the Tokyo Round Code was "Agreement on the Interpretation and Application of Articles VI, XVI and XXIII of GATT". Moreover one of the recitals included in the Preamble to the Code referred expressly to the desire of the parties "to apply fully and to interpret the provisions of Articles VI, XVI and XXIII". Thus, it was indisputable that the provisions referred to in Article 19.1 of the Tokyo Round Code as being "interpreted" by the Code were Articles VI, XVI and XXIII; and that the "other relevant provisions" of GATT referred to in the footnote included *inter alia* Article III. During the last phases of the Uruguay Round, the title of the SCM Agreement was changed from "Agreement on the Interpretation and Application of Articles VI, XVI and XXIII" to the current one because it was thought that the SCM Agreement created rights and obligations which went beyond merely "interpreting" and "applying" those provided in GATT Articles VI and XVI (see Appellate

(7) Indonesia's interpretation would lead to an unjustified relaxation of the rules on tax discrimination existing under GATT 1947, contrary to the object and purpose of the WTO Agreement

5.291 The WTO Agreement is premised on the preservation of the level of trade liberalization already achieved under GATT 1947. This is apparent already from the Preamble to the WTO Agreement, which reads in pertinent part as follows:

> Resolved, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations,
>
> Determined to preserve the basic principles and to further the objectives underlying this multilateral trading system.

5.292 The same objective of preserving the GATT "acquis" also underlies the incorporation into GATT 1994 of the text of GATT 1947, together with all the legal instruments adopted under that agreement[230], as well as the provision made in Article XVI.1 of the WTO Agreement to the effect that the WTO shall be guided by the "decisions, procedures and customary practices" followed under GATT 1947, except as otherwise provided.

5.293 For that reason, the instances where the WTO Agreement permits measures which would have been contrary to GATT 1947 are few and exceptional. Such derogations have generally a temporary character and/or are restricted to areas where the GATT 1947 was not enforced *de facto* (e.g. the textile sector now covered by the Agreement on Textiles and Clothing) and/or where the applicability of the GATT 1947 was unclear or at least had been disputed by some Members (e.g. in the case of TRIMs now covered by the TRIMs Agreement or in the case of VERs and other "grey area" import restrictions now expressly subject to the Agreement on Safeguards).

5.294 In contrast, Indonesia's *lex specialis* argument would lead, if accepted by the Panel, to the permanent nullification of a basic GATT rule which was largely non controversial under GATT 1947 and which was never the subject of specific discussions during the Uruguay Round.

5.295 Under GATT Article III:2, first sentence, the application of an internal tax to an imported products "in excess of" that applied to a like domestic product is always prohibited. This prohibition is not conditional on a trade effects test nor is it qualified by a *de minimis* standard. As noted by the Appellate Body in Japan - Taxes on Alcoholic Beverages, "even the smallest amount of 'excess' is too much".[231]

Body Report on Brazil - Measures affecting desiccated Coconut, adopted on 20 March 1997, WT/DS22/AB/R, at p.17). Furthermore, unlike the Tokyo Round Code, the SCM Agreement has no Preamble. Article 32.1 and footnote No 56 were not adapted to take into account those changes, which has rendered their meaning somewhat less clear than in the Tokyo Round Code. Yet, there is no indication in the drafting history that the negotiators intended to give a different meaning to Article 32.1 and footnote No 56 from that which Article 19.1 and footnote No 1 to that Article had under the Tokyo Round Code. According to the EC's recollection of the negotiations, Article 32.1 and footnote No 56 were added to the Dunkel Text by the Secretariat, together with the other Final provisions, and adopted by the negotiators without discussion.

[230]See paragraph 1 of Annex 1A.

[231]Appellate Body Report on Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS 10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, at p. 23.

5.296 If the SCM Agreement excluded the application of Article III:2 to subsidies, tax discrimination between like products would no longer be prohibited[232]. Instead, the complainant would have to prove that the measure causes "adverse effects" to its interests.[233] Furthermore, if the tax exemption or reduction was granted to all domestic producers, it could not be considered as a "specific" subsidy within the meaning of Article 2 of the SCM Agreement and, therefore, would no be "actionable" at all.[234]

5.297 The consequences would be even less acceptable in the case of Article III:2, second sentence. In accordance with that provision, a Member is prevented from applying different taxes to two products which are "directly competitive or substitutable" so as to afford protection to its domestic production. Thus, for example, two previous Panels (one under GATT 1947[235] and one under GATT 1994[236]) have found that by applying a lower excise tax to local shochu than to imported whisky (a competing product) Japan afforded protection to its domestic production of shochu, thereby infringing GATT Article III:2, second sentence. If Indonesia's *lex specialis* argument prevailed, Japan could argue that the tax differential constitutes a subsidy to its domestic shochu producers, which is therefore subject to the SCM Agreement and not to GATT Article III. Yet, the SCM Agreement is concerned only with the "adverse effects" caused by a subsidy with respect to imports of a "like product". It provides no remedy in those cases where the subsidy causes "serious prejudice" to a competing importing product.[237] Thus, Indonesia's argument would have the consequence that a tax system which has already been condemned twice would have to be tolerated in the future.[238]

(b) There is no conflict between GATT Article III and the SCM Agreement

5.298 In the alternative, Indonesia argues that the Panel should find that there is a "conflict" in the sense of the General Interpretative Note to Annex 1 A between the SCM Agreement and GATT Article III.

5.299 As recalled pertinently by Japan (See Section V.E.1), the drafting history of that Note indicates clearly that the term "conflict" must be interpreted narrowly. The drafters distinguished consciously that notion from broader notions such as "inconsistency" or mere "difference". There was a general consensus among the negotiators that in practice the application of the rule laid down in the Note should be restricted to the very limited number of instances in which the obligations under the GATT and another Annex 1A agreement are truly irreconcilable. Clearly, the present case is not one of those instances.

5.300 As noted by the Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas, there is no "conflict" where, as in the present case:

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[232]Article 3.1 (b) of the SCM Agreement only prohibits subsidies contingent upon the use of domestic over imported goods but not subsidies which are granted only upon the production or sale of domestic products, to the exclusion of imported products.

[233]See Article 5 of the SCM Agreement.

[234]See Article 8.1 (a) of the SCM Agreement.

[235]Panel Report on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, adopted on 10 November 1987, BISD 34S/83.

[236]Panel Report on Japan - Taxes on Alcoholic Beverages, WT/DS8/R, WT/DS10/R, WT/DS11/R, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

[237]In addition, to the extent that the subsidy is granted to all Japanese shochu producers, Japan could argue that the subsidy is not "specific" within the meaning of Article 2 of the SCM Agreement.

[238]Indonesia might try to argue that the SCM Agreement is not *lex specialis* with respect to Article III:2, second sentence, but this would lead to an equally anomalous results: the remedy would be more rigorous in the case of discriminatory taxation between competing products than in the case of discriminatory taxation between like products.

> ... the rules contained in one of the Agreements listed in Annex 1A provide for different or complementary obligations in addition to those contained in GATT 1994.[239]

5.301 Instead, according to that Panel report, the concept of "conflict" is designed to deal with the following two situations:

> ... (i) clashes between obligations contained in GATT 1994 and obligations contained in Agreements listed in Annex 1A, where those obligations are mutually exclusive in the sense that a Member cannot comply with both obligations at the same time, and (ii) the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits[240][emphasis added].

5.302 None of these two situations occurs in the present case.

5.303 Clearly, Indonesia is not subject to two mutually exclusive obligations, because there is nothing in the SCM Agreement which requires Indonesia to grant the subsidies at issue.

5.304 Nor does the SCM Agreement "permit explicitly" what the GATT Article III prohibits. In cannot be considered that a provision in an Annex 1A Agreement "permits explicitly" what GATT prohibits unless it states in positive terms a right to do it (e.g. "Members may apply or maintain measure X"), as opposed to merely abstain from prohibiting it. In addition, there must be identity between the prohibited measures and the explicitly permitted measures. An incidental overlap between two provisions which focus on two different types of measures does not constitute a "conflict". As shown below, none of these two conditions is met in the present case.

5.305 By its own words, Article 27.3 of the SCM Agreement is limited to stipulate a temporary exception to the prohibition contained in Article 3.1 (b) of the same agreement in favour of developing Members. It does not "authorise explicitly" developing Members to deviate from any other obligation, either in the SCM Agreement, such as Article 5, or in other agreements, such as GATT Articles III:2 and III:4.

5.306 From the mere fact that Article 3 of the SCM Agreement does not prohibit a certain type of subsidies, it cannot be inferred *a contrario* that Members have an "explicit right" to grant that type of subsidies in violation of a different obligation contained in another agreement, such as GATT Article III. For instance, the fact that Article 3 of the SCM does not prohibit the granting of subsidies in the form of an exemption from an indirect tax only for domestic goods (irrespective of their local content level), does not mean that Members have been granted thereby an "explicit authorization" to tax imported products in excess of domestic like products, contrary to the prohibition contained in GATT Article III:2. By the same token, the fact that Article 3.1(b) *juncto* Article 27.3 of the SCM Agreement does not prohibit, on a temporary basis, the granting of local content subsidies by developing Members cannot be construed as an "explicit authorization" for those Members to violate GATT Articles III:2 and III:4.

5.307 Article 5 of the SCM Agreement lays down an obligation not to cause "adverse effects" through the granting of "actionable subsidies". Clearly, this does not amount to an "explicit authorization" to take any measure which may be characterized as an "actionable subsidy" and which does not cause "adverse effects", even if such measure is contrary to the provisions of GATT.

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[239]See e.g. Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas, adopted 25 September 1997, WT/DS27/R/USA, at para 7.155.

[240]Id., para 7.154.

5.308 Finally, Article 8 of the SCM Agreement provides that certain types of subsidies shall be considered as non-actionable. This means simply that those subsidies are non-actionable under Parts III or V of the SCM Agreement. It does not mean that Members have an "explicit right" to take measures which violate GATT Article III.

5.309 Furthermore, in the present case there can be no "conflict" because the required identity between the prohibited and the allegedly permitted measures does not exist. Article III prohibits measures which discriminate between imported and domestic products, whereas the measures allegedly permitted by the SCM Agreement are subsidies. These two categories of measures are conceptually different, even if certain individual measures may fall simultaneously within both categories. Given the lack of identity between the two categories of measures, it cannot be said that the SCM Agreement authorises "explicitly" what is prohibited by GATT Article III.

5.310 In EC - Regime for the Importation, Sale and Distribution of Bananas, the Panel elaborated on its interpretation of the notion of "conflict" in the Note by identifying as an example of such "conflict" the relationship between GATT Article XI:1 and Article 2 of the Agreement on Textiles and Clothing (the "ATC"):

> For instance, Article XI:1 of GATT prohibits the imposition of quantitative restrictions, while Article XI:2 of GATT contains a rather limited catalogue of exceptions. At the same time, Article 2 of the Agreement on Textiles and Clothing authorises the imposition of quantitative restrictions in the textiles and clothing sector, subject to conditions specified in Article 2:1-21 of the ATC. In other words, Article XI:1 of GATT prohibits what Article 2 of the ATC permits in equally explicit terms. It is true that Members could theoretically comply with Article XI:1 of GATT, as well as with Article 2 of the ATC, simply by refraining from invoking the right to impose quantitative restrictions in the textiles sector because Article 2 of the ATC authorises rather than mandates the imposition of quantitative restrictions. However, such an interpretation would render whole Articles or sections covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A which were negotiated to create rights and obligations which in parts differ substantially from those of the GATT 1994.[241]

5.311 The relationship of Article 2 of the ATC to GATT Article XI is readily distinguishable from the relationship of the SCM Agreement to GATT Article III:

- Article 2 of the ATC grants a positive right to do something, namely to maintain quantitative restrictions. On the contrary, the SCM Agreement does not confer a positive right to grant subsidies. Its only purpose is to create remedies against certain categories of subsidies.

- There is total identity between the measures prohibited by GATT Article XI and those authorized by Article 2 of the ATC (quantitative restrictions in both cases). The SCM agreement and GATT Article III, on the other hand, are concerned each with a different type of measures (subsidies and measures which do not afford national treatment to imported products, respectively), even if the two categories may overlap in respect of certain individual measures.

- According to the Panel, the application of GATT Article XI:1 to measures covered by Article 2 of the ATC would have rendered the latter Article "meaningless". In contrast,

[241] Id. at footnote No 390.

the application of Article III to subsidies does not render the SCM Agreement redundant. Quite to the contrary, its non-application would reduce GATT Articles III:2 and III:8 (b) to inutility.

- According to the Panel, the ATC was negotiated with the object and purpose to derogate from the GATT. In fact, that intention is set out explicitly in Article 1.1 of the ATC Agreement. In contrast, there is no indication either in the text or in the drafting history of the SCM Agreement that it was negotiated with the intention of derogating from the GATT rules on national treatment. Moreover, unlike in the case of the ATC Agreement with respect to GATT Article XI, there would be no apparent rationale for such derogation. In particular, given that such derogation would be, again unlike in the case of the ATC with respect to GATT Article XI, permanent and not just temporary.

5.312 The absence of a conflict between the SCM agreement and GATT Article III is further confirmed by Article 32.1 juncto footnote 56 of the SCM Agreement, which as already discussed admits expressly the possibility that action against subsidies may also be taken under other GATT provisions, including Article III.

5.313 To conclude, it must be recalled that the relationship of the SCM Agreement to GATT Article III is formally identical to the relationship of GATT Article XVI to GATT Article III. The SCM Agreement does not "permit explicitly" subsidies which are contrary to GATT Article III any more than Article XVI did under GATT 1947. Thus, to hold that there is a "conflict" between the SCM Agreement and GATT Article III would be tantamount to admitting that there was also an "internal conflict" within GATT 1947. Yet, it is clear that the only purpose of the General Interpretative Note to Annex 1A was to solve the potential conflicts between GATT and the new agreements on trade in goods negotiated during the Uruguay Round which build upon the provisions of GATT. It was not the purpose of the Note to solve any inherited "internal conflicts" within GATT itself which, somehow, would have gone unnoticed for almost 50 years.

3. Rebuttal Arguments of the United States

5.314 The following are the **United States'** arguments rebutting Indonesia's general response to the claims raised under Article III of GATT 1994:

(a) The tariff and tax incentives under the 1993 Programme and the National Car Programme violate Article III of GATT 1994

5.315 The tariff and tax incentives under the 1993 Programme and the National Car Programme violate Article III:4 of GATT 1994 because: (1) they each constitute regulations or requirements that "affect" the sale, purchase, transportation and distribution of imported and domestic automotive parts and subparts; (2) imported automotive parts and subparts are "like" domestic automotive parts and subparts; and (3) they each discriminate against imported automotive parts and subparts. In addition, the tax incentives under the National Car Programme violate Article III:2, first sentence, of GATT 1994, because they result in the imposition of taxes on imported products that are in excess of those applied to like domestic products. Alternatively, these tax incentives violate Article III:2, second sentence, of GATT 1994 because: (1) imported passenger cars and domestic passenger cars are directly competitive or substitutable products that are in competition with each other; (2) the directly competitive or substitutable imported or domestic passenger cars are not similarly taxed; and (3) the dissimilar taxation is applied so as to afford protection.

5.316 Indonesia has not disputed any of these conclusions that make up the elements of a violation of Article III:2 and Article III:4. Instead, Indonesia argues that Article III does not apply to the tax incentives because: (1) these incentives constitute "subsidies"; and (2) the SCM Agreement overrides

Article III. In addition, and notwithstanding a ruling of the Appellate Body to the contrary, Indonesia argues that the tariff incentives are not governed by Article III:4 because they constitute "border measures". As the United States will demonstrate, not only are both arguments wrong as a matter of law, but, if accepted, they would have far-reaching and dangerous implications for the world trading system.

(b) Indonesia's argument that the SCM Agreement overrides Article III is unspported by the text of the SCM Agreement and GATT 1994, would result in the effective repeal of Article III:2, and is inconsistent with the negotiating history of the Uruguay Round, established principles of public international law, and WTO jurisprudence

5.317 In the case of the tax incentives provided under the 1993 Programme and the National Car Programme, Indonesia does not dispute that the measures violate Article III. Instead, it argues that Article III is inapplicable because the measures constitute subsidies, and, thus, according to Indonesia, are governed solely by the provisions of the SCM Agreement. According to Indonesia, because, under Article 27.3 of the SCM Agreement, Indonesia has a time-limited exemption from the prohibition against the use of local content subsidies contained in Article 3.1(b) of that agreement, only the provisions of the SCM Agreement apply. Any other result, according to Indonesia, results in a "conflict" within the meaning of the General Interpretative note to Annex 1A of the Marrakesh Agreement Establishing the World Trade Organization ("WTO Agreement"), because Article III prohibits what Article 27.3 allegedly permits. Indonesia's argument is wrong for a variety of reasons.

(1) Indonesia's argument is unsupported by the text of the SCM Agreement and GATT 1994

5.318 Indonesia's argument is premised on the existence of what it refers to as "an all-encompassing definition of subsidies" in the SCM Agreement that applies across the WTO agreements. However, the definition in the SCM Agreement is not "all-encompassing". When one looks at the text of the SCM Agreement, as one must under the Vienna Convention on the Law of Treaties ("Vienna Convention"), Article 1.1 states very clearly that the definition of "subsidy" contained therein is "For the purpose of this Agreement ...." In other words, the definition of "subsidy" is limited to the SCM Agreement.

5.319 Second, Indonesia's argument is also premised on what it refers to on page 91 of its first submission as "an all-encompassing structure of remedies ... ". Again, however, there is no such structure. Consider again the actual text of the treaty. Article 32.1 of the SCM Agreement provides as follows:

> No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.

Moreover, Article 32.1 contains a footnote 56, which reads as follows:

> This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

5.320 There can be no clearer indication that the drafters did not intend that the SCM Agreement be the exclusive remedy against a measure that happens to fall within that agreement's definition of a subsidy.

5.321 Indonesia argues that the complainants' interpretation of note 56 is wrong because they somehow ignore the words "relevant" and "appropriate". According to Indonesia, because the measures at issue are covered by the SCM Agreement, other GATT provisions are neither "relevant" nor "appropriate".

5.322 This is a classic example of tautological reasoning that assumes the answer to the question posed. According to Indonesia, because the SCM Agreement is *lex specialis*, no other provision of GATT can be "relevant" or "appropriate" within the meaning of note 56.

5.323 However, it is Indonesia that ignores the text of note 56, and essentially renders that provision superfluous, in violation of established principles of treaty interpretation. Indeed, if the SCM Agreement truly were *lex specialis*, there would be no reason for note 56.

5.324 Other provisions support the conclusion that the SCM Agreement was not intended to be the exclusive mechanism for challenging measures that can be characterized as subsidies. For example, Article VI:5 of GATT 1994 provides as follows:

> No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.

Article VI:5 recognizes that export subsidies may be characterized as a problem of dumping or subsidization, and simply precludes Members from imposing both remedies in the case of a single act of subsidization. Article VI:5 belies Indonesia's claim that the remedies in the SCM Agreement are exclusive or all-encompassing.

5.325 More generally, it has long been recognized that the GATT provisions that deal explicitly with subsidies are not the only provisions that are relevant to subsidies. In this regard, the following statement by Prof. John Jackson is worth noting:[242]

> However, there are certain measures in other articles of GATT [other than Article XVI] that bear on the freedom of a nation to subsidize and that offer a measure of remedy for a GATT member that is harmed by another's subsidy. Four other articles in particular must be related to Article XVI. These are Article VI on anti-dumping and countervailing duties, Article XIX regarding increases of imports that threaten serious injury (the "escape clause"), Article XXIII regarding nullification and impairment, and Article III regarding national treatment.

5.326 In short, Indonesia's argument is contradicted by the text of the relevant agreements, and must be rejected for that reason.

(2) Indonesia's argument would result in the effective repeal of Article III:2

5.327 Aside from the fact that Indonesia's *lex specialis* argument ignores the text of the relevant agreements, the flaws in its argument can best be appreciated when one considers how Indonesia's theory operates with respect to Article III:2 of GATT 1994.

5.328 In this case, Indonesia argues that the tax discrimination in favour of Indonesian motor vehicles is a subsidy because it constitutes foregone government revenue within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. According to Indonesia, because this tax discrimination constitutes a subsidy, it can be remedied only under the SCM Agreement.

5.329 However, consider the consequences of Indonesia's argument. Suppose that a Member discriminates against imports across the board, so that all domestic products are taxed at one rate, and all imported products are taxed at a higher rate. Assume also that no local content requirements are involved. Based on Indonesia's logic, this tax discrimination constitutes a subsidy in the form of

[242] J. Jackson, World Trade and the Law of GATT, § 15.4, page 377 (1969) (Emphasis added).

revenue foregone that is provided to all producers of domestic products and that can be remedied only under the SCM Agreement. Yet, when one turns to the SCM Agreement, one finds that there is no remedy. This is because under the SCM Agreement, a subsidy that is available to all domestic products is not specific within the meaning of Article 2 of the SCM Agreement, and, as such, is non-actionable under Article 8.1(a) of the SCM Agreement.

5.330 Thus, the consequence of Indonesia's argument is that Article III:2 effectively has been repealed and Members are free to engage in economy-wide tax discrimination against imported products. Article III:2 no longer applies, because it has been overridden by the SCM Agreement, but the SCM Agreement provides no redress because the "subsidy" is non-actionable.

5.331 There is not the slightest bit of evidence that the Uruguay Round negotiators intended such a dramatic and dangerous outcome. Moreover, the drafting history of GATT 1947 indicates that the drafters expressly rejected such an outcome. In particular, during the Havana negotiations, the drafters of Article III rejected the following proposal by Cuba:

> The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in cases covered under Article XVI.

The absurd consequences of Indonesia's argument reveal exactly how erroneous that argument is.

(3) Indonesia's argument is contradicted by the Uruguay Round negotiating history

5.332 In light of the manifestly absurd results generated by Indonesia's argument, one should consider the negotiating history of the TRIMs Agreement and the SCM Agreement. While we are talking about Article III of GATT 1994 at the moment, Indonesia has argued that the TRIMs Agreement imposes no additional substantive obligations, but instead merely interprets Article III (See Section VI.D). The United States does not agree with Indonesia's characterization of the TRIMs Agreement, but, for the sake of argument, let us assume that Indonesia is correct.

5.333 Indonesia cites to a report of the Chairman of the Negotiating Group on Trade-Related Investment Measures (See Section VI.D). MTN.GNG/NG12/W/27 (19 July 1990). The report contained a bracketed Chairman's text, Article A2(c)(iii) of which read as follows:

> (c) An investment measure is "applied" when:
>
> ....
>
> (iii) it is a condition for, or a factor in determining eligibility for, receipt of an advantage from a contracting party or avoiding withdrawal of an advantage.

A bracketed footnote 2 to clause (iii) further provided the following:

> An advantage can include the provision of a subsidy, and attention will be paid to the negotiations in the Negotiating Group on Subsidies to ensure no conflict.

5.334 As Indonesia correctly notes, the question of whether TRIMs would include "incentive-based" measures, including measures that could be characterized as subsidies, was a bone of contention during the RIMs negotiations, as reflected by the brackets around the above-quoted language.

5.335 However, Indonesia leaves the drafting history at that, and fails to mention what happened thereafter. In the so-called Dunkel Draft, issued in December, 1991, the TRIMs Agreement appeared in what was, for substantive purposes, its final form. MTN.TNC/W/FA, page N.1 *et seq* (United States Exhibit 26). In the Dunkel Draft, paragraph 1 of the Illustrative List of TRIMs covered, as does its counterpart in the final TRIMs Agreement, TRIMs "compliance with which is necessary to obtain an advantage ... ." Thus, the battle over the inclusion of incentive-based measures had been resolved in favour of their inclusion, albeit by using different language from that in the Chairman's draft.

5.336 In addition, the notification requirements and transitional arrangements contained in Article 5 of the TRIMs Agreement also had reached their final form in the Dunkel Draft. Under Article 5 of the Dunkel Draft, countries had 90 days in which to notify existing non-conforming TRIMs, and were granted a period of time in which to eliminate them. Developing countries had five years, while least-developed countries had seven years. In addition, countries were precluded from introducing new non-conforming TRIMs.

5.337 Now let us turn to the version of the SCM Agreement in the Dunkel Draft, and, in particular, Article 27. MTN.TNC/W/FA, pages I.33-35 (United States Exhibit 27). There one finds no exemption for developing country Members from the prohibition in Article 3.1(b) against the use of local content subsidies. Instead, Article 27.3 of the Dunkel Draft consisted of what ultimately became Article 27.4, the provision dealing with developing country Member phase outs of export subsidies.

5.338 Thus, in the Dunkel Draft, to the extent there was a "conflict" between the SCM Agreement, Article III:4, and the TRIMs Agreement, the "conflict" was exactly the opposite of the "conflict" alleged by Indonesia. Under the draft SCM Agreement, developing country Members were prohibited from using local content subsidies, but under the TRIMs Agreement, developing country Members could use such subsidies for a limited period of time, provided that they notified them in a timely manner.

5.339 Of course, as Indonesia correctly notes, the negotiators were aware of the overlap between the TRIMs Agreement and the SCM Agreement, and they subsequently proceeded to deal with it. On December 15, 1993, the Trade Negotiating Committee issued a draft Final Act. In the draft SCM Agreement, a new provision appeared, Article 27.2bis. MTN/FA II-13, page 32 (United States Exhibit 28). This provision, which ultimately was renumbered as Article 27.3, granted developing and least developed country Members a time-limited exemption from the prohibition against local content subsidies in Article 3.1(b) of the SCM Agreement.

5.340 With the addition of Article 27.2bis, the "conflict" between Article III:4, the TRIMs Agreement, and the SCM Agreement in the Dunkel Draft was eliminated. In the case of developing and least developed Members, those TRIMs that were permitted by Article 5 of the TRIMs Agreement during the transition period no longer were prohibited by the SCM Agreement.

5.341 What this drafting history shows is that it was not the intent of the negotiators that the SCM Agreement override Article III:4 or the TRIMs Agreement. Instead, as was the case under GATT 1947, there was to be overlapping, if not identical, treatment of local content incentives under these different regimes.

5.342 What this drafting history also highlights is that the "conflict" alleged by Indonesia in this case is an artificial one. If Indonesia had notified its pre-WTO TRIMs in accordance with the provisions of Article 5.1 of the TRIMs Agreement, they would have been protected under both the TRIMs Agreement and the SCM Agreement. As for Indonesia's post-WTO TRIMs, it was never the intention of the drafters to permit such measures under Article III:4 or the TRIMs Agreement, even though they might be temporarily exempt from the special remedies of the SCM Agreement.

(4) Indonesia's argument is inconsistent with established principles of public international law

5.343 Indonesia cites the report of the panel in the Bananas III case for the proposition that a "conflict" exists where a rule in one agreement prohibits what a rule in another agreement explicitly permits.[243] However, Indonesia's reliance on Bananas III is misplaced for several reasons.[244]

5.344 First, neither the Bananas III panel nor Indonesia cites any support for the proposition that a "conflict," within the meaning of public international law, can exist in a situation where a rule in one agreement explicitly permits what a rule in another agreement prohibits, The absence of any citation is due to the fact that the rule under public international law is clear: a conflict exists only in situations where obligations are mutually exclusive; i.e., "when two (or more) treaty instruments contain obligations which cannot be complied with simultaneously." 7 Encyclopedia of Public International Law (North-Holland 1984), page 468.

5.345 Moreover, even assuming for purposes of argument that the statement by the Bananas III panel is correct, there still is no conflict between the rules of Article III and the rules of the SCM Agreement. This is because, as previously noted, footnote 56 of the SCM Agreement expressly contemplates that subsidy practices may be actionable under other relevant provisions of GATT 1994.

5.346 In addition, again assuming for purposes of argument that the statement by the Bananas III panel was correct, there is no conflict because the SCM Agreement does not "explicitly permit" local content subsidies. Indeed, all that Article 27.3 does is to exempt developing country Members, for a period of time, from the prohibition of Article 3.1(b). More generally, to the extent that "permit" is a synonym for "authorize," the authority to provide subsidies does not flow from the SCM Agreement, but instead from a Member's sovereignty. The SCM Agreement simply specifies the circumstances under which one Member that has suffered adverse trade effects may seek redress against subsidies provided by another Member. In addition, the SCM Agreement also prohibits certain types of subsidies, and provides a remedy against them, because they are considered to be presumptively distortive and a cause of adverse trade effects.

5.347 In addition, simply as a textual matter, it is impossible to conclude that a time-limited exemption from a prohibition (which is what Article 27.3 provides) constitutes a positive conferral of an "explicit right" to do something.

5.348 Finally the fact that the SCM Agreement may not prohibit a certain type of subsidy cannot be construed as the conferral of an explicit right to violate a different obligation contained in a different WTO agreement. For example, as the United States demonstrated at the first meeting of the Panel, an exemption only for domestic products from an indirect tax would be a non-specific (generally available) subsidy under the SCM Agreement. As such, it would be a non-actionable subsidy. However, the fact that such a subsidy is not prohibited by, or even actionable under, the SCM Agreement does not mean that Members are "explicitly permitted" to tax imported products in excess of domestic like products in violation of Article III:2. Likewise, the fact that developing country Members are temporarily exempted from the prohibition in Article 3.1(b) does not mean that they are "explicitly permitted" to violate Article III:2 and Article III:4.

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[243]European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R, Report of the Panel, as modified by the Appellate Body, adopted on 25 September 1997, para. 7.159.

[244]Among other things, the panel's statement concerning the definition of a "conflict" was *dicta* inasmuch as the panel found that no conflict existed. Unfortunately, because this aspect of the panel report was not appealed, the Appellate Body was not presented with the opportunity to correct the panel's error.

5.349 Finally, it must be emphasized that under public international law "[t]here is a presumption against conflicts in that parties do not normally intend to incur conflicting obligations". 7 Encyclopedia of Public International Law (North-Holland 1984), page 470. This presumption flows logically from the basic maxim *ut res magis valeat quam pereat*, a principle that is embodied in the Vienna Convention, and which requires that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in the context of the treaty and in the light of its object and purpose. More specifically, what this means is the following[245]:

> When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted.

As discussed above, Indonesia's argument utterly fails to comply with this fundamental principle, because the Indonesian argument would render Article III:2 a nullity.

5.350 Two corollary principles flow from this fundamental principle. First, the burden is on Indonesia, as the party alleging a conflict, to demonstrate convincingly that a conflict exists. Indonesia has failed to satisfy this burden.

5.351 Second, the Panel must, to the extent possible, interpret the relevant provisions so as to avoid a conflict. As discussed below, existing WTO jurisprudence provides a vehicle for avoiding a conflict.

(5) Existing WTO jurisprudence recognizes that the subject matter of the WTO agreements can overlap

5.352 Existing WTO jurisprudence recognizes that the subject matter of the WTO agreements can overlap. The Appellate Body acknowledged this point most recently in Bananas III, where it stated the following[246]:

> The second issue is whether the GATS and the GATT 1994 are mutually exclusive agreements. The GATS was not intended to deal with the same subject matter as the GATT 1994. The GATS was intended to deal with a subject matter not covered by the GATT 1994, that is, with trade in services. Thus, the GATS applies to the supply of services. It provides, *inter alia*, for both MFN treatment and national treatment for services and service suppliers. Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994 and the GATS. However, while the same

[245] 1966 Yearbook of the International Law Commission, Vol. II at 219; See also, United States - Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, Report of the Appellate Body adopted 20 May 1996, pages 24-25 ("One of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."); and Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996), pages 11-12.

[246] European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997, para. 221 (footnote omitted).

> measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis. This was also our conclusion in the Appellate Body Report in Canada - Periodicals.

5.353 Like the relationship between GATT 1994 and GATS discussed in Bananas III, the coverage of Article III and the SCM Agreement overlap, but the focus of each is different. The focus of the SCM Agreement is on subsidies, which in the context of this case, happen to be specific (or actionable) because their receipt is made contingent on the basis of discrimination against imported goods. By contrast, the national treatment provisions of Article III focus on the discrimination.

5.354 This difference in focus can be appreciated by considering the remedy applicable to prohibited subsidies under the SCM Agreement. Under Article 4.7 of the SCM Agreement, if a panel finds a measure to be a prohibited local content subsidy, the panel must "recommend that the subsidizing Member withdraw the subsidy without delay".[247] A panel is not allowed to recommend that the subsidizing Member eliminate the local content contingency of the subsidy.

5.355 More generally, if a Member were to violate Article III:4 by making use of domestic inputs a condition for the receipt of a subsidy, the measure would continue to be a violation of Article III:4 if the subsidy element were replaced with some other form of incentive or disincentive. On the other hand, if the local content aspect of a subsidy were dropped, the subsidy would continue to be subject to the SCM Agreement, although the nature of the relevant discipline under the SCM Agreement might be affected.

5.356 Thus, the Panel can avoid a “conflict” by simply recognizing that Article III and the SCM Agreement have overlapping coverage, but a different focus. In so doing, the Panel will have complied with its obligation under public international law principles to avoid interpreting Article III and the SCM Agreement in a manner that gives rise to a conflict.

(6) GATT and WTO Panels and the Appellate Body have not relied on the concept of *lex specialis* to determine that one WTO agreement takes precedence over another

5.357 In response to a question from the Panel concerning GATT/WTO panel reports, the **United States** stated that the concept of *lex specialis* had been discussed in the following reports.

5.358 In EEC Restrictions on Imports of Apples from Chile, L/5047, Report of the Panel adopted 10 November 1980, BISD 27S/98, although the term *lex specialis* was not used, the European Communities argued that with respect to Chile's claim under Article I of GATT 1947, the European Communities "action, being a quantitative restriction, should be examined in connection with the most-favoured-nation type commitment contained in Article XIII." Para. 3.2. The panel agreed with the European Communities. Para. 4.1. However, this case involved the relationship between different provisions of a single agreement, GATT 1947, as opposed to the relationship between different agreements.

5.359 In European Economic Community - Restrictions on Imports of Dessert Apples - Complaint by Chile, L/6491, Report of the Panel adopted 22 June 1989, BISD 36S/93, the same issue arose, and this time the European Communities did invoke expressly the concept of *lex specialis*. Para. 5.2. As in the

[247]Under Article 1.2 and Appendix 2 of the DSU, Article 4.7 is a special or additional rule or procedure that prevails over the general rules of the DSU.

prior case, the panel agreed with the European Communities, stating as follows: "[Article XIII] deals with the non-discriminatory administration of quantitative restrictions and is thus the *lex specialis* in this particular case." Para. 12.28. Again, however, this case involved the relationship between different provisions of a single agreement.

5.360 In Panel on Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies, L/6304, Report of the Panel adopted 22 March 1988, BISD 35S/37, Canada argued that Article III of GATT 1947 was not relevant to the case because Article XVII contained the only obligation related to state trading. Para. 3.47. The EEC argued in response that Article XVII was not a *lex specialis* exempting state-trading from all other provisions of GATT 1947. Para. 3.48. The panel declined to reach the issue because it already had found that the measures in question violated Article XI. Para. 4.26. In dicta, however, the panel opined that Article III:4 was also applicable to state-trading enterprises, at least in certain situations. Id. Although the panel did not address the issue, this case, too, involved the relationship between different provisions of a single agreement.

5.361 In Bananas III, the concept of *lex specialis* was raised in several different ways. European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA, Report of the Panel, as modified by the Appellate Body, adopted 25 September 1997. First, the panel ruled that Article XIII:2(d) was *lex specialis* vis-à-vis Article XIII:1. Para. 7.75. This issue involved the relationship between different paragraphs of a single article of a particular agreement.

5.362 In Bananas III, the concept of *lex specialis* also was raised in connection with the relationship between (1) the Licensing Agreement and Article XIII; and (2) the TRIMs Agreement and Article III. The issue relating to the Licensing Agreement was described as follows:

> The Complaining parties did not consider the concept of *lex specialis* to be relevant in this instance regarding the relation between the Licensing Agreement and Article XIII of GATT. Two separate agreements were involved, each of which were given equal force under the Marrakesh Protocol unless there was conflict between their provisions. Since there was no conflict between the provisions at issue, it was entirely permissible to assert a breach of Article XIII obligations in tandem with the Licensing Agreement violations discussed above. Para. 3.14.

5.363 The issue relating to the TRIMs Agreement was described as follows:

> Second, Article 2.1 also made it clear that a Member did not cede any of its rights under Article III by raising a claim under the TRIMs. Thus, a Member was not restricted to arguing that a measure violated the TRIMs Agreement when there was an independent argument under Article III. Such measures were covered by both the TRIMs and the GATT, and not only by the TRIMs Agreement as *lex specialis*. Para. 445.

5.364 In resolving these issues concerning the relationship between GATT 1994 and the Annex 1A agreements, the panel did not rely on the concept of *lex specialis*. Instead, the panel relied on the General Interpretative Note to Annex 1A of the WTO Agreement, the note that deals with conflicts between GATT 1994 and the other Annex lA agreements. Paras. 7.157-7.163. The United States will not reiterate its prior arguments concerning this aspect of the Bananas III report, but instead emphasizes the following points. First, if the panel had thought that the concept of *lex specialis* governed the relationship between GATT 1994 and the other Annex 1A agreements, there would have been no need to resort to the General Interpretative Note. Second, if the concept of *lex specialis* operated in the manner suggested by Indonesia, the General Interpretative Note would be superfluous, because there can be no conflict where, by virtue of *lex specialis*, a single agreement controls.

5.365 The concept of *lex specialis* also was invoked in the Bananas III appeal. WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997. The European Communities challenged the panel's particular application of Article 1.3 of the Licensing Agreement, arguing that Article 1.3 is *lex specialis* for the administration of import licensing procedures, while Article X:3(a) of GATT 1994 is *lex generalis* for the administration of all "laws, regulations, decisions, and rulings ...". Para. 32. In response, the complainants argued that only in the event of a conflict between GATT 1994 and a provision of another Annex 1A agreement (such as the Licensing Agreement) would the provision of the latter agreement prevail. Para. 70.

5.366 The Appellate Body concluded that Article X:3(a) and Article 1.3 both applied in the sense that both provisions gave rise to separate and distinct obligations. Para. 204. However, the Appellate Body stated that the panel should have applied the Licensing Agreement first

> since this agreement deals specifically, and in detail, with the administration of import licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3(a) of the GATT 1994. Id.

The Appellate Body did not find that one agreement trumped the other on the basis of *lex specialis*.

5.367 Finally, the concept of *lex specialis* was invoked by the United States in EC Measures Concerning Meat and Meat Products (Hormones), WT/DS26/R/USA, Report of the Panel circulated 18 August 1997, for the proposition that the panel should begin its analysis with the SPS Agreement. Para. IV.5. Without expressly endorsing the United States invocation of *lex specialis*, the panel decided to first examine claims raised under the SPS Agreement. Para. 8.42. The panel's decision on this particular point was not raised on appeal. WT/DS26/AB/R, Report of the Appellate Body circulated 16 January 1998.

5.368 Thus, while the concept of *lex specialis* has been invoked from time to time, in no instance has a panel or the Appellate Body relied on this concept to determine that one WTO agreement trumps another. To the contrary, such relationships have been resolved by applying the General Interpretative Note, which deals with conflicts between GATT 1994 and other Annex 1A agreements. As the United States previously has demonstrated, however, there is no conflict between the provisions of GATT 1994 and the SCM Agreement.

5.369 With respect to Japan's point regarding the General Interpretative Note, Indonesia fails to rebut Japan's argument. Japan's argument, as the United States understands it, is that if the SCM Agreement truly were *lex specialis*, it would control automatically, whether or not a "conflict" existed, and there would be no need for the General Interpretative Note. Put differently, to the extent that there is a rule of *lex specialis* in the WTO Agreement, it is found in the General Interpretative Note.

(7) Whether Indonesia's argument is characterized as *lex specialis* or conflict, if accepted, it would render Article III:2 of GATT 1994 a nullity

5.370 Whether Indonesia's argument is characterized as one based on *lex specialis* or "conflicts", Indonesia has not been able to explain how, under its argument, Article III:2 of GATT 1994 does not become a nullity. Likewise, Indonesia has not offered a scintilla of evidence that the Uruguay-Round negotiators intended such an outcome.

(8) Indonesia's erroneous assertion regarding the specificity of subsidies indicates that Indonesia was well aware of the flaws in its argument

5.371 Finally, on the subject of *lex specialis* and "conflicts", the United States would like to elaborate with respect to the question of whether or not most subsidies are specific. By way of background, one

of the most troubling aspects of Indonesia's arguments is the statement that: "The purpose of most subsidies is to provide financial assistance to a targeted industry or a small group of industries." (See Section V.D.2(c).)

5.372 The reason why this sentence was so troubling is as follows. Several members of the United States interagency team working on this dispute have spent most of their careers in the subsidies/countervailing duty area and are considered as experts in the area. In particular, they were intimately involved in the development and evolution of the so-called "specificity test" under the United States countervailing duty law, and one member of the team can claim, with some justification, to be the author of Article 2.1 of the SCM Agreement. While there is no global "census" of all government measures that satisfy the SCM Agreement's definition of "subsidy", these individuals knew, based on their experience, that most subsidy programmes are not, in fact, targeted to a small group of industries. Instead, most subsidy programmes involve the provision of small amounts of financial assistance to numerous industry groups or sectors. The very reason for a specificity test is to avoid having to subject such programmes to unilateral or multilateral subsidy remedies.

5.373 Moreover, these types of generally available subsidy programmes do not show up in notifications to the SCM Committee, because, under Article 25.2 of the SCM Agreement, only specific subsidies must be notified. Likewise, since the specificity test became firmly established as a part of the United States countervailing duty law in the mid-'80's, these types of generally available subsidy programmes also have largely disappeared from countervailing duty proceedings, because petitioning domestic industries know that the U.S. investigating authorities will find such programmes to be non-specific and, thus, non-countervailable. In other words, the specific subsidies that show up in notifications to the SCM Committee or countervailing duty proceedings are only the "tip of the subsidies iceberg".

5.374 Thus, the members of the United States team were troubled by the above-quoted sentence by Indonesia. The United States team concluded that Indonesia must have inserted the sentence in question for a reason, and the task was to determine what that reason was. Ultimately, the riddle was solved by asking and answering the following series of questions:

Question	Why would Indonesia make an assertion regarding the specificity of subsidies that is, at worst, inaccurate and, at best, unsupported by empirical evidence?
Answer	Indonesia does not want the Panel to think about non-specific subsidies.
Question	Why does Indonesia not want the Panel to think about non-specific subsidies? What is it about non-specific subsidies that makes them different from specific subsidies?
Answer	Non-specific subsidies are non-actionable by virtue of Article 8.1(a).
Question	Why is the non-actionability of non-specific subsidies relevant to Indonesia's argument that the SCM Agreement overrides provisions of GATT 1994?
Answer	It must be the case that if the SCM Agreement trumps GATT, then measures currently considered to be violative of one or more provisions of GATT 1994 would become permissible if characterized as non-specific subsidies.
Question	What types of measures would be most likely to become permissible if characterized as non-specific subsidies?
Answer	Discriminatory tax measures that violate Article III:2.

5.375 The upshot of all this is that with respect to Indonesia's argument concerning the supremacy of the SCM Agreement, the United States suspects that Indonesia was aware of the fatal flaw in its theory (i.e., the fact that, under its theory, Article III:2 becomes a nullity) long before the complainants had discovered it. Indonesia's assertion regarding the alleged specificity of most subsidies was simply a smokescreen intended to divert the Panel's attention from the consequences of Indonesia's argument.

5.376 In the final analysis, whether or not most subsidies are specific is not relevant to this dispute. What is relevant is the fact that if Indonesia's argument is accepted, any Member will be able to construct and maintain a tax system that discriminates against imports without running afoul of its obligations under Article III:2. All that a Member has to do is ensure that the beneficiaries of such a system constitute a sufficiently large segment of the economy so as to render the system non-specific. Under Indonesia's theory, if the system is non-specific, it is not actionable under the SCM Agreement and Article III:2 no longer applies.

(9) Indonesia's assertion that it would not have signed the WTO Agreement if Article III applied to local content subsidies is legally irrelevant and factually suspect

5.377 At bottom, Indonesia's argument that the SCM Agreement overrides Article III is based on its claim that neither Indonesia nor any other developing country would have signed the WTO Agreement if Article III continued to apply to local content subsidies. Although Indonesia has yet to make this assertion in writing, one of Indonesia's representatives made the assertion in his oral presentation at the first meeting of the Panel.[248] However, this assertion is legally irrelevant and factually suspect.

5.378 As a matter of law, it is irrelevant that a Member, with the benefit of hindsight, feels that it may have made a bad bargain, because neither panels nor the Appellate Body have the authority to renegotiate the bargains reflected in the text of the WTO agreements. As the Appellate Body has stated, panels and the Appellate Body must respect the balance of rights and obligations reflected in the language of the WTO agreements.[249] More recently, in the India Mailbox case, the Appellate Body chastized a panel for attempting to read into the TRIPS Agreement words that are not there based on the "legitimate expectations" of Members.[250] In that case, the Appellate Body stated the following:[251]

> The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended.

5.379 As demonstrated above, when the principles of Article 31 of the Vienna Convention are applied, Indonesia's alleged "conflict" disappears. The fact that Indonesia wishes that Article III and the SCM Agreement said something other than what they in fact say is legally irrelevant.

5.380 In addition, the fact of the matter is that Indonesia did benefit from the last minute insertion of Article 27.3 into the text of the SCM Agreement, and the evidence suggests that Indonesia is well aware of the nature and the value of this benefit.

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[248]The written version of Indonesia's statements differ from the oral presentations, and, unfortunately, panels do not prepare transcripts of their meetings. However, the members of the United States delegation distinctly recall Indonesia making the assertion in question.

[249]United States - Measure Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/AB/R, Report of the Appellate Body adopted 23 May 1997, page 19.

[250]India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R, Report of the Appellate Body issued 19 December 1997, para. 45.

[251]Id.

5.381 Because Indonesia is temporarily exempt from the prohibition in Article 3.1(b), there has been little discussion in this case regarding the procedures in Article 4 of the SCM Agreement for challenging prohibited subsidies. It is appropriate at this point to recall what those procedures are. Suffice it to say that the process under Article 4 is rapid - very rapid.

5.382 Under Article 4.4 of the SCM Agreement, a complainant may request the establishment of a panel within 30 days of the request for consultations, as opposed to the standard period of 60 days under Article 4.7 of the DSU. Under Article 4.6 of the SCM Agreement, a panel is to circulate its final report to all Members within 90 days of the date of the composition and the establishment of the panel's terms of reference, with no provision made for extensions. Under Article 12.8 of the DSU, a panel normally has six months (180 days) within which to issue its report, but may take up to nine months (270 days).

5.383 Under Article 4.8 of the SCM Agreement, following the issuance of a panel report, the DSB must adopt the report (or one of the parties must notify its decision to appeal) within 30 days, as opposed to the standard period of 60 days under Article 16.4 of the DSU. If a report is appealed, under Article 4.9 of the SCM Agreement, the Appellate Body normally must issue its report within 30 days of the notice of appeal, but may take up to 60 days. Under Article 17.5 of the DSU, the Appellate Body normally has 60 days in which to issue its report, but may take up to 90 days.

5.384 Finally, under Article 4.7 of the SCM Agreement, if a measure is found to be a prohibited subsidy, the subsidizing Member must withdraw the subsidy "without delay." By contrast, under Article 21.3 of the DSU, a Member has "a reasonable period of time" in which to comply with a DSB recommendation or ruling, the benchmark for which, pursuant to Article 21.3(c), is 15 months from the date of adoption of a panel or Appellate Body report.

5.385 What all of this means is that if Indonesia had not been exempted by Article 27.3 from the prohibition of Article 3.1(b) and the remedies of Article 4, this Panel would not be here. If the complainants in this case, including the United States, had been able to bring a complaint under Article 3.1(b) and Article 4, and assuming that a panel was composed on the same day as this Panel was (30 July 1997), the panel would have issued its ruling on the Article 3.1(b) claim no later than 28 October 1997.[252] Indonesia would have filed its appeal no later than 27 November 1997.[253] Indonesia would have filed its appellant submission on 2 December, and the complainants in this case would have filed their appellee submissions on 9 December.[254] The oral hearing before the Appellate Body would have taken place on 12 December, and the Appellate Body's report would be due on 27 December.[255] The panel and Appellate Body reports would be adopted by the DSB no later than 22 January 1998, the next scheduled meeting of the DSB. Following adoption, Indonesia then would have to withdraw the subsidies "without delay" under Article 4.7 of the SCM Agreement. While the phrase "without delay" has yet to be construed, presumably it must mean a time period far shorter than the "reasonable period of time" referred to in Article 21.3 of the DSU or the six-month period for withdrawal set forth in Article 7.9 of the SCM Agreement with respect to adverse effects cases. Thus, if Article 3.1(b) and Article 4 of the SCM Agreement were applicable to the Indonesian subsidies, the complainants could expect a withdrawal of the subsidies some time in the first half of 1998.

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[252]Although this issue has never been definitively decided, presumably an Article 3.1(b) claim would have to be pursued separately from other claims if the complainant wished to take advantage of the accelerated timetable of Article 4.

[253]It would be Indonesia appealing, of course, because there is no question that the subsidies in question fall under Article 3.1(b).

[254]Annex 1 (Timetable for Appeals), Working Procedures for Appellate Review, WT/AB/WP/3 (28 February 1997).

[255]Id. Again, because there is no question that the Indonesian subsidies fall under Article 3.1(b), there would be no need for the Appellate Body to extend its deadline of 30 days.

5.386 As things now stand, however, the Panel has indicated that it will not be issuing its report until the end of April 1998. Even then, in all likelihood, the issuance of the report simply will trigger an appeal by Indonesia that will further delay the withdrawal of the measures in question. Once the Appellate Body rules in complainants' favour and the Panel and Appellate Body reports are adopted by the Dispute Settlement Body, then if it is impracticable for Indonesia to comply immediately, Indonesia will have a "reasonable period of time" in which to bring its measures into conformity with its obligations.[256] In short, the measures in question may not be withdrawn until some time in 1999.[257]

5.387 In the view of the United States, Indonesia has received quite a bargain. If Indonesia were subject to Article 3.1(b) and Article 4, we would be very close to the point at which the parties would be discussing the timing of Indonesia's withdrawal of its local content subsidies. However, because Indonesia is exempt from those provisions, the parties will not reach that stage until some time in late 1998.

5.388 Moreover, the evidence indicates that Indonesia understands full well the nature of the benefits it enjoys by virtue of its exemption from the expedited procedures for prohibited subsidies. Throughout the history of this dispute, officials of both Indonesia and TPN repeatedly have made statements to the public and the press that the National Car Programme is not in any jeopardy, because by the time the WTO dispute settlement process runs its course, the objectives of the National Car Programme will have been accomplished and TPN (or Kia Timor, depending on who one believes) will be firmly established as a bona fide (albeit subsidized) auto producer.[258] Recently, even officials from Kia Motors have taken up the refrain, stating that it will "take at least from two to three years for the WTO to come up with mediation-crafted measures".[259]

5.389 Moreover, when one steps back a bit, it is clear that at a minimum, Indonesia is no worse off than it was before the entry into force of the WTO Agreement. Under GATT 1947, the tax incentives in question were prohibited by Article III:2 and Article III:4, and also were actionable under the serious prejudice provisions of Article XVI. Because of Article 27.3, however, nothing has really changed in that regard. The tax incentives continue to be prohibited by Article III:2 and Article III:4 of GATT 1994 and continue to be subject to a serious prejudice claim under the SCM Agreement. Thus, it is incredible for Indonesia to claim, as it has via Dr. Makarim, that it would not have signed the WTO Agreement if it had known that its local content subsidies would be subject to Article III. If that truly were Indonesia's belief, then it would not have been a Contracting Party of GATT 1947.

5.390 In summary, the Panel should be extremely sceptical of assertions by Indonesia that it somehow got a raw deal by signing on to a package under which local content subsidies are prohibited by virtue of Article III. As discussed above, Indonesia benefits from being temporarily exempt from the accelerated procedures of Article 4 of the SCM Agreement. At a minimum, it is no worse off than it was under GATT 1947.

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[256]With respect to the United States claim of serious prejudice, under Article 7.9 of the SCM Agreement, Indonesia would have six months in which to withdraw the subsidies or remove the adverse effects.

[257]The United States assumes that Indonesia will abide by its commitment to the IMF to withdraw the measures once the DSB has ruled against it.

[258]"RI to Finish Car Program by '99", Jakarta Post, 23 April 1997 (US Exhibit 14, p. 105); "Indonesia Preparing Team to Defend Nat'l Car Policy at WTO", ANTARA, 9 May 1997 (US Exhibit 14, p. 117); "Astra, Indomobil Roped in to Speed Up Timor Car Project," Business Times (Singapore), 16 May 1997 (US Exhibit 14, p. 121); "Bumpy Road Ahead for Motoring Plan", South China Morning Post, 8 June 1997 (US Exhibit 14, p. 132) (quoting a TPN official as stating that the WTO dispute "will not impact our activities. The WTO takes time."); and "Timor in Trouble at WTO and at Home", Business Times (Singapore), 25 June 1997 (US Exhibit 14, p. 144) ("Jakarta is gambling that it has time on its side.").

[259]"Timor President's Resignation Won't Affect Kia in Indonesia", Asia Pulse, 4 November 1997 (US Exhibit 24, p. 25).

(c) The tax incentives under the 1993 Programme and the National Car Programme are not protected by Article III:8(b) of GATT 1994

5.391 Indonesia appears to argue that the tax incentives provided under the 1993 Programme and the National Car Programme are protected by Article III:8(b) because the tax "subsidies" are received by producers or assemblers of automobiles. (See Section V.D.) This argument misses the point, and misstates the meaning of Article III:8(b) and the precedents relating thereto.

5.392 Insofar as Article III:4 is concerned, Article III:8(b) provides that the provision of a subsidy exclusively to a producer of a like domestic product and not to a foreign producer does not violate the non-discrimination requirements of Article III:4. However, insofar as Article III:4 is concerned, in the case of Indonesia's tax incentives, the imported products discriminated against through the local content requirements are automotive parts and subparts, not finished automobiles. Thus, the fact that these tax incentives may constitute subsidies to purchasers of Indonesian automotive parts and subparts (i.e. producers of finished automobiles or finished parts) does not excuse the discriminatory treatment accorded to imported automotive parts and subparts.[260]

5.393 Moreover, Article III:8(b) does not insulate the Indonesian tax incentives from the requirements of Article III:2. In the Canada Periodicals case, the Appellate Body affirmed that Article III:8(b) "was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government".[261] In so ruling, the Appellate Body quoted with approval the following passage from the United States - Malt Beverages case:[262]

> Article III:8(b) limits, therefore, the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.

5.394 Indonesia's tax incentives do not involve the expenditure of revenue by Indonesia. For that reason, also, they are not protected by Article III:8(b). Indonesia's argument to the contrary is that the introduction of the SCM Agreement effectively has amended the scope of Article III:8(b). This is nothing more than a recycled version of Indonesia's "conflicts" argument, which the United States has addressed previously and exposed as a specious argument that is unsupported by the text of the agreements, their drafting history, public international law principles, and WTO jurisprudence.

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[260]Italian Agricultural Machinery, L/833, Report of the Panel adopted 23 October 1958, BISD 7S/60, 64, para. 14.

[261]Canada - Certain Measures Concerning Periodicals, WT/DS31/AB/R, Report of the Appellate Body adopted 30 July 1997, page 34.

[262]Id. quoting from BISD 39S/206, para. 5.10, adopted 19 June 1992.

F. Additional arguments regarding the claims under Article III:4 of GATT 1994 pertaining to the tariff measures

1. Specific response by Indonesia

5.395 In addition to its general response concerning all of the claims under Article III of GATT 1994, **Indonesia** makes a specific response with respect to the claims that the tariff measures at issue violate Article III:4 of GATT 1994. The following are **Indonesia's** arguments in this regard:

(a) The customs import duties schedules for automotive companies using differing levels of domestic content are consistent with Article III:4 of GATT 1994 because the schedules are border measures which are not subject to Article III:4 of GATT 1994 and are subsidies Indonesia is permitted to maintain

5.396 Customs duties are, by definition (Article I:1 of GATT 1994), "imposed on or in connection with importation" and hence are border measures rather than internal regulations. Therefore they are not covered by Article III:4 (or any of Article III) of GATT 1994 which, as the title to the Article itself notes, is limited to "National Treatment on Internal Taxation and Regulation."[263]

5.397 As previously discussed, under the 1993 Incentive Programme, the level of the import duty imposed on imported automobiles and automotive parts is set by reference to the proportion of parts and components produced in Indonesia that are used in each particular automobile model. Similarly, under the February 1996 national car programme, producers designated as producers of a national car and meeting the criteria for that programme are exempt from import duties on imported parts and components. Both programmes grant exemptions from customs import duties, which are - irrefutably - border measures. There can be no serious argument that internal regulation is involved. Therefore, Article III of the General Agreement, including Article III:4, is inapplicable.

5.398 This conclusion is not affected by the Report of the Panel in Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140, which is the leading GATT decision regarding local content regimes. In FIRA corporate undertakings to purchase goods of Canadian origin became part of the conditions under which each proposed investment was approved, and derogations therefrom could be legally enforced. This legal obligation to purchase domestic goods was a "requirement" affecting the internal sale of a product and thus was within the scope of Article III:4. No border measures were involved.

5.399 For similar reasons the Report of the Panel in EEC-Regulation on Imports of Parts and Components (16 May 1990), BISD 37S/132, is inapposite. There, suspension by the European Communities of an anti-dumping circumvention proceeding depended on the undertaking of the Japanese respondent companies to change their sourcing from imported parts and materials to parts and materials produced in the European Communities. Neither the "advantage" found by the Panel (suspension of an EEC administrative proceeding) nor the undertaking to use EEC goods was a border measure. The same is true with respect to the Report of the Appellate Body in European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (9 September 1997). As the Appellate Body stated:

> 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 European Communities procedures and requirements for the distribution of import licences for imported bananas among

[263]The United States' argument that the import duty incentives are within the scope of Article III:4 (See SectionV.C.3 and V.F.4) is simply wrong.

> eligible operators within the European Communities are within the scope of this provision. Id. at para. 211 (emphasis added).

The "advantage" within the scope of Article III:4 was the distribution of licences among eligible operators (an internal measure) and not the border measure (the licensing requirement) itself.

5.400 In the instant case, there is no classic local content requirement obligating a company to purchase locally.[264] All automotive companies are free to choose where to source automotive parts and components. Each company makes a corporate decision about whether it wishes to benefit from the subsidization of customs import duties granted to those choosing to use specified levels of domestically produced parts and components.[265]

(b) Indonesia's customs import duties subsidy does not involve a "requirement" necessary to "secure an advantage" within the scope of Article III:4 of GATT 1994

5.401 Complainants erroneously contend that Indonesia's subsidized customs import duties are within the scope of Article III: 4 of the General Agreement. They claim that the issue is "not the reduction of duties, as such, but conditioning such reduction on the purchase of domestic parts and components."

5.402 The flaw in complainants' position is fundamental - the scope of Article III is limited to internal laws, regulations and requirements; subsidized customs import duties are border measures, not internal laws, regulations or requirements. No WTO or GATT precedent supports expanding the scope of Article III to cover border measures. Indeed, the precedents Complainants cite – Italian Machinery,[266] EEC – Parts and Components[267], EEC–Oilseeds[268], Bananas III[269] and FIRA[270] - disprove their contention.

5.403 Italian Machinery involved credit facilities available only to purchasers of domestic tractors - clearly internal measures. The Panel's identification of the scope of Article III was simple and unambiguous: "… the intention of the drafters of [Article III of the General] Agreement was clearly to treat imported products in the same way as the like domestic products once they had been cleared through customs."[271]

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[264]The United States Government officially acknowledges this in the April 1997 report entitled Indonesia's Automotive Market Summary prepared by the United States Department of Commerce (see Indonesia Exhibit 11) The Department declares that "local content requirements are not explicit" in the 1993 Incentive Programme.

[265]Even the United States recognizes that Indonesia's system of sliding tariff rates is not a local content regime as that term has been understood and used in the WTO and the GATT. During the 26 October 1989 meeting of the Uruguay Round negotiating group on TRIMs, the United States defined local content as "a barrier that could not be overcome no matter how much better an imported product might be." (MTN.GNG/NG12/13 at para. 43.) The Indonesian subsidy programmes, unlike the undertakings in FIRA or EEC-Parts and Components, do not present a barrier that cannot be overcome. Each company can choose whether it is in its commercial interest to source a certain amount locally and pay one rate of duty on imported parts or to source less in Indonesia and pay a different duty rate.

[266]Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60.

[267]EEC-Regulation on Imports of Parts and Components (16 May 1990), BISD 37S/132.

[268]European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (25 January 1990), BISD 37S/86.

[269]European Communities-Regime for the Importation, Sale and Distribution of Bananas (9 September 1997), WT/DS27/AB/R.

[270]Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140.

[271]Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60, 64, para. 11 (emphasis added).

5.404 EEC - Parts and Components involved: (i) "anti-circumvention duties" imposed on finished products assembled in the European Communities (not on imported parts); and (ii) the suspension of European Communities administrative proceedings where companies agreed to limit their use of imported parts. Both clearly are internal measures, not border measures. After stating that the European Communities's "anti-circumvention duties" were neither conditioned upon the importation of a product nor imposed at the time of importation, the Panel said: "the imposition of 'ordinary customs duties' for the purpose of protection is allowed unless they exceed tariff bindings. … By contrast, internal taxes that discriminate against imported products are prohibited."[272]

5.405 Oilseeds involved payments to processors of domestic oilseeds. The principle the European Communities believes relevant appears to be that "… the exposure of a particular imported product to a risk of discrimination constitutes, by itself, a form of discrimination."[273] Once again, as the first emphasized portion of the quote demonstrates, the measure at issue was an internal measure affecting a product that already had been imported, not a border measure.

5.406 What of Bananas III? There, too, the Appellate Body expressly declared:

> 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 European Communities 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.[274]

The "advantage" within the scope of Article III:4 was the distribution of licences among eligible operators, something that occurred after importation and thus was an internal measure. The "import licensing requirement, as such", - the border measure - was not addressed because, as a border measure, it could not be within the scope of Article III.

5.407 Lastly, the FIRA decision, addressed at pages 99 to 100 of Indonesia's First Submission, provides Complainants no succour. In this, the leading GATT decision regarding local content regimes, the Panel found that corporate undertakings to purchase goods of Canadian origin, an internal requirement, were within the scope of Article III:4.[275] As in the other cases Complainants cite, no border measure was involved.

5.408 Complainants have not pointed to any precedent declaring that Article III applies to border measures. They cannot. No such precedent exists because Article III applies only to measures regarding imported goods that have cleared customs.

5.409 What of the linkage of the level of customs import duties to the level of domestic content? Rather than seeking to transform a border measure into an internal measure so as to apply Article III, the proper approach is to analyze whether this domestic content subsidy is consistent with Indonesia's obligations, as a developing country, under the SCM Agreement.

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[272]European Economic Community-Regulation on Imports of Parts and Components (16 May 1990), BISD 37S/132, 192, para. 5.4.

[273]European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (25 January 1990), BISD 37S/86, 125, para. 141 (first emphasis added).

[274]European Communities-Regime for the Importation, Sale and Distribution of Bananas (9 September 1997), WT/DS27/AB/R, 85, para. 211 (emphasis added).

[275]Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140.

2. Rebuttal of Japan to Arguments of Indonesia

5.410 **Japan** argues, in rebuttal to Indonesia's response to the claim under Article III:4 pertaining to the tariff measures, that the February 1996 programme violates GATT Article III:4 and cannot escape review as a purported "border measure" or "voluntary measure." The following are **Japan's** rebuttal arguments in this regard:

(a) The February 1996 programme violates GATT Article III:4

5.411 The February 1996 programme waives payment of the 35 per cent luxury tax and import duties of up to 65 per cent on automotive parts and components in connection with the National Car, conditioned on the National Car meeting certain local content requirements. Thus, it creates strong incentives for the National Car manufacturer to favour Indonesian parts and components over like imported parts and components, in clear violation of GATT Article III:4. (See Section V.C.1.)

(b) Indonesia's "border measure" defence has no merit

5.412 Regarding the local content requirement in connection with the import duty exemption, Indonesia argues that it is a "border measure," because "[c]ustom duties are, by definition (Article I:1 of the General Agreement), 'imposed on or in connection with importation.'" Indonesia further argues that it follows that such a measure cannot be an "internal regulation" subject to Article III:4. However, both the text of GATT Article III:4 and the GATT/WTO precedent cases disprove this assertion.

(1) The text of GATT Article III:4 shows that it applies to "all" measures "affecting" conditions of internal sale

5.413 First, the text of GATT Article III:4 provides that the Article shall be applied "in respect of all laws, regulations and requirements affecting [imports'] internal sale, offering for sale, purchase, transportation, distribution or use." Nothing in the text requires such laws, regulations, and requirements to affect only wholly internal matters, or in other words, not to have any connection whatsoever with the border. Nor is there any textual basis for the rigid distinction that Indonesia has attempted to draw between "border measures" and "internal measures". Rather, Article III:4, by its terms, applies to "all" measures "affecting [imports'] internal sale, [etc.]," regardless of how Indonesia chooses to describe its measures for purposes of these proceedings.[276]

5.414 In the instant case, the issue is not the reduction of import duties as such. The Government of Japan is not challenging the duties of up to 65 per cent that Indonesia maintains on imports of automotive parts and components. Instead, the issue here concerns the incentives, including the import duty incentive, created by Indonesia to encourage the purchase of domestic automotive parts and components over like imports. Providing an Indonesian automaker with incentives to purchase domestic parts and components clearly "affects" the conditions of "internal sale." Moreover, what is encouraged by this measure is a purely internal activity (i.e. purchase of domestic parts and components), which has little connection with "borders." Thus, regardless of whether the incentives involve "border measures" such as import duties, they "affect" conditions of internal sale for imported automotive parts and components and are covered by the plain text of GATT Article III:4.

5.415 It should likewise be noted that, in connection with the luxury tax exemption, the issue for purposes of Article III:4 is not the luxury tax exemption as such. The discriminatory luxury tax

[276]Indonesia seems to rely on the title of GATT Article III, underscoring the word "internal" in the title language "National Treatment on Internal Taxation and Regulation." However, the Government of Indonesia makes mistakes in interpreting the title, as is obvious from the text of GATT Article III:4. A regulation is subject to GATT Article III:4 if it affects conditions of internal sale.

exemption as such violates Article III:2. What matters for purposes of Article III:4 is the local content requirements which must be satisfied to obtain the luxury tax exemption. By creating incentives to purchase Indonesian parts and components, the local content requirements accord Indonesian products more favourable treatment than like imported products, in violation of Article III:4.

(2) The GATT/WTO precedents also show that GATT Article III:4 applies to "border measures" that affect conditions of internal sale

5.416 Indonesia's argument is also inconsistent with the long-standing construction of Article III:4 that has been accepted by GATT and WTO panels since 1958. The early GATT precedent in Italian Discrimination Against Imported Agricultural Machinery, which has been cited approvingly many times since, stated that Article III:4 applies to laws "affecting internal sale, purchase, etc." and not only to laws "governing the conditions of sale or purchase." The Panel further elaborated, "the selection of the word 'affecting' would imply that the drafters of the Article intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or 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."[277]

5.417 Other, more recent decisions are even more directly on point in specifically holding that measures involving "border measures" and "affecting" the conditions of "internal sale" or purchase fall within the coverage of GATT Article III:4. For example, the Panel in United States - Section 337 of the Tariff Act of 1930 held that the "fact that Section 337 is used as a means for the enforcement of United States patent law at the border does not provide an escape from the applicability of Article III:4."[278]

5.418 This conclusion was most recently reaffirmed by both the Panel and the Appellate Body in EC - Regime for the Importation, Sale and Distribution of Bananas ("Bananas III").[279] In that case, the European Communities argued, to both the Panel and the Appellate Body, that the measure at issue was a border measure, not an internal measure subject to GATT Article III:[280], but that argument was not accepted. Instead, the Panel found that the European Communities' measures violated GATT Article III:4 in that they affected internal sales conditions, by allocating a certain portion of the licences required to import bananas at a reduced duty rate exclusively to operators who marketed certain quantities of domestic bananas. The Panel expressly held that "border measures may be within the purview of the national treatment clause" of Article III:4.[281] It further stated, "if the mere fact that the European Communities regulations .... include or are related to a border measure such as a licensing requirement would mean that the Article III cannot apply, it would not be difficult to evade the GATT national treatment obligation."[282] The Panel's finding was examined and upheld by the Appellate Body.[283] Thus, it is clear that the Panel and the Appellate Body Report on Bananas III rejected an argument identical to Indonesia's in a very similar context.

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[277]Panel Report on Italian Discrimination Against Imported Agricultural Machinery ("Italian Agricultural Machinery"), L/833, adopted on 23 October 1958, 7S/60, 64, para.12. (Emphasis in original.)

[278]Panel Report on United States - Section 337 of the Tariff Act of 1930 ("US - Section 337"), L/6439, adopted on 7 November 1989, BISD 36S/345, 385-386, para. 5.10. See also Panel Report on EEC - Regulation on Imports of Parts and Components, L/6657, adopted on 16 May 1990, BISD 37S/132, 197.

[279]Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas ("Bananas III"), WT/D2S7/R/USA, adopted on 25 September 1997, as modified by the Appellate Body. Appellate Body Report on Bananas III, WT/DS27/AB/R, adopted on 25 September 1997.

[280]Panel Report on Bananas III, paras. 4.265-4.271. Appellate Body Report on Bananas III, paras, 33-36.

[281]Panel Report on Bananas III , para. 7.176.

[282]Id., para. 7.177.

[283] Appellate Body Report on Bananas III, paras. 209-211.

5.419 Indonesia's curious attempt to claim that the Appellate Body's report in Bananas III supports its position not only fails, but undercuts the heart of its argument. Indonesia quotes the Appellate Body as stating:

> 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 European Communities 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.

But, far from supporting Indonesia's position, this quotation highlights its error. The quotation demonstrates that GATT Article III:4 does in fact apply to measures, such as Indonesia's import duty incentive, that "affect" internal sales conditions for imports regardless of whether such measures also have some relationship with the border. Indeed, the Appellate Body's statement so undercuts Indonesia's position and supports Japan's that it may be reformulated easily to apply to this case as follows:

> At issue in this case is not whether any import duty, as such, is within the scope of Article III:4, but whether Indonesia's requirements which encourage internal purchase of domestic automotive parts and components within Indonesia are within the scope of this provision.

5.420 The other two cases cited by Indonesia likewise fail to support its argument. While it may be true, as Indonesia says, that the measures at issue in Canada - Administration of the Foreign Investment Review Act were not border measures, nothing about that decision supports the alleged interpretation that any measure related to border measures cannot be subject to GATT Article III:4. That Panel simply did not address this issue. Finally, as for EEC - Regulation on Imports of Parts and Components, Indonesia's assertion that the measures at issue there did not involve border measures is simply incorrect. The "advantage" found by that Panel to violate Article III:4 concerned the suspension of proceedings under the anti-circumvention provision of the anti-dumping legislation, which, contrary to Indonesia's characterization, obviously implicates border measures. In fact, the European Communities argued in that dispute that the measures "were not internal measures within the meaning of [GATT Article III]"[284], which the Panel rejected.

5.421 Therefore, Indonesia's "border measure" defence is inconsistent with both the plain text of Article III:4 and its well-established understanding.

(c) Indonesia's "voluntary measure" defence has no merit

5.422 Indonesia also seems to argue that, since the measures at issue in this case are not mandatory measures but measures with which the company may comply voluntarily to obtain a benefit, they are not covered by GATT Article III:4 (see Section V.F.1). However, that argument does not have any merit.

5.423 Indonesia's argument is inconsistent with the firmly established interpretation of GATT Article III:4 that has been affirmed by many GATT/WTO panels. These decisions establish that where compliance with a certain measure is necessary to secure an "advantage," such a measure is covered by GATT Article III:4. For example, the Panel in Italian Agricultural Machinery found inconsistent with GATT Article III:4 an Italian law that created voluntary incentives for farmers to purchase domestic agricultural machinery by providing special credit terms to farmers for the purchase of domestic

[284]Panel Report on EEC - Parts and Components, para.3.43.

machinery, but not for imports.[285] Other similar examples include the Panel Report on EEC - Parts and Components[286] and the recent Panel and Appellate Body Reports on Bananas III.[287]

5.424 The well-established conclusion that GATT Article III:4 covers not only mandatory measures but also voluntary measures is reinforced by the Illustrative List of the TRIMs Agreement, which explicitly provides that "TRIMs that are inconsistent with .... [GATT Article III:4] include those .... compliance with which is necessary to obtain an advantage ...." (See also Section VI.A.)

3. Rebuttal of European Communities to arguments of Indonesia

5.425 The **European Communities** argues, in rebuttal to Indonesia's response to the claim under Article III:4 pertaining to the tariff measures, that import duty relief contingent on local content requirements violates GATT Article III:4 and cannot escape review as a purported "border measure" or "voluntary measure". The following are **the European Communities'** rebuttal arguments in this regard:

5.426 Indonesia argues that Article III:4 does not apply to the measures mentioned in numbers (v) and (vi) of part (b) of the European Communities' claims (See Section III.B), because they are border measures.

5.427 The European Communities would agree that the application of a reduced or zero customs duty rate on imports of automotive parts and components is a "border measure" which, if applied in isolation, would fall outside the scope of GATT Article III:4. In the present case, however, the granting of that tariff advantage is conditional upon the motor vehicles into which the imported parts and components are assembled reaching a certain percentage of local content. In order to reach that percentage, local assemblers must use local parts and components instead of imported ones. Therefore, it is indisputable that the measure "affects" the internal use within Indonesia of parts and components within the meaning of GATT Article III:4.

5.428 It is a well established principle that GATT Article III:4 does not apply only to "mandatory" measures but also where compliance with a certain measure (such as the local content targets at issue in the present case) is necessary in order to secure an advantage or benefit (such as the possibility to import inputs at a reduced or zero rate). As noted by the Panel Report on EEC - Regulation on Imports of Parts and Components:

> ... the comprehensive coverage of 'all laws, regulations or requirements affecting [emphasis added by the Panel] the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, such as those examined by the FIRA Panel .... but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute 'requirements' within the meaning of that provisions[288]" [emphasis added].

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[285]Panel Report on Italian Agricultural Machinery, paras. 11-12. See para. 3.07 above.

[286]Panel Report on EEC - Parts and Components, para. 5.21. See para. 3.11 above.

[287]Panel Report on Bananas III, para. 7.178. Appellate Body Report on Bananas III, paras. 211- 214. See paras. 3.09-3.10 above.

[288]Panel Report on European Communities - Regulation on imports of Parts and Components, adopted on 16 May 1990, 37S/132, 197, para 5.21. This principle has been applied also by other Panels. Thus, the Panel Report on Italian discrimination against Imported Agricultural Machinery (adopted on 23 October 1958, BISD 7S/60, 64, para 12) found that an Italian law providing especial credit terms to farmers for the purchase of agricultural machinery conditional on the purchase by the farmers of Italian machinery was contrary to Article III:4. Similarly, the Panel Report on EEC - Payments and subsidies paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins (adopted on 25 January 1990, BISD 37S/86, 124-125) concluded

5.429 The "advantage" in question may consist of a benefit granted with respect to a border measure, such as for instance a tariff exemption or reduction. This has been confirmed by the recent Panel reports on EC - Regime for the Importation, Sale and Distribution of Bananas.[289]

5.430 One of the measures in dispute in that case were the so-called "operator category rules" for the allocation of licences to import of "third country" bananas at lower tariff rates within a tariff quota. In accordance with those rules, 30 per cent of the tariff quota was reserved for operators who had marketed during a preceding three-year period bananas of European Communities origin or of traditional ACP sources.

5.431 The Panel found that the requirement to market bananas of European Communities origin afforded more favourable treatment to those bananas than to like imported bananas and therefore violated Article III:4 of GATT. In reaching this conclusion the Panel rejected expressly an argument submitted by the European Communities to the effect that the measures were border measures and as such not subject to Article III:4. The Panel restated the view of a previous (unadopted) Panel Report dealing with the same matter that

> "... 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:[290]".

5.432 The situation is identical in the present case. In order to obtain the right to import parts and components at a lower rate of duty, the assemblers of motor vehicles are required to use (and purchase previously if they do not manufacture them internally) domestic parts and components, thereby affording more favourable treatment to those parts and components than to like imported parts and components.

5.433 The findings of the Panel Reports on EC - Regime for the Importation, Sale and Distribution of Bananas with respect to the operator category rules were upheld by the Appellate Body on appeal.[291] Indonesia misreads the findings of the Appellate Body. The obvious meaning of the passage of the Appellate Body report cited by Indonesia in its submission (See Section V.F.1) is that while, in principle, import licensing requirements are not within the scope of Article III:4, the requirements applied by the European Communities went "far beyond the mere import licence requirements needed to administer the tariff quota" and affected the "internal sale, offering for sale... etc" of bananas. By the same token, in the present case, the local content targets go beyond what is necessary to apply a tariff reduction/exemption and affect the internal use of parts and components within the meaning of Article III:4.

4. Rebuttal of United States to arguments of Indonesia

5.434 The **United States** argues that Indonesia's argument that Indonesia's tariff incentives do not violate Article III:4 of GATT 1994 because they are "border measures" has been rejected by the Appellate Body. The following are the **United States'** arguments in this regard:

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that the payment by the Community of subsidies to the processors of oilseeds who purchased oilseeds of Community origin was contrary to Article III:4.

[289]See e.g. Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/GTM, WT/DS27/R/HND, adopted on 25 September 1997, at paras 7.171-7.182, 7.216-7.219 and 7.244-7.250.

[290]Id. at para 7.179, quoting the Panel Report on EEC - Import regime for Bananas, issued on 11 February 1994 (not adopted), DS 38/R, para 146.

[291]Appellate Body report on EC - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R, adopted on 27 September 1997, at para 211.

5.435 Indonesia argues that the tariff incentives under the 1993 Programme and the National Car Programme do not violate Article III:4 of GATT 1994 because Article III:4 does not address "advantages" that are conferred in the form of border measures. According to Indonesia, "There can be no serious argument that internal regulation is involved. Therefore, Article III of the General Agreement, including Article III:4, is inapplicable.".

5.436 To the contrary, there can be no serious argument that internal regulation is not involved. Indonesia's argument consists of a discussion of panel decisions that found violations of Article III:4, but that did not involve border measures. From this, Indonesia concludes that Article III:4 does not cover advantages conferred in the form of border measures.

5.437 This is a classic non sequitur. The fact that these panels were not dealing with border measures does not prove that advantages conferred in the form of border measures are not covered by Article III:4. All it proves is that these panels did not address the question.

5.438 However, the Appellate Body has addressed and rejected the very argument advanced here by Indonesia. In Bananas III, in connection with the European Communities's licensing regime, the European Communities argued that (1) the panel erred in finding the licensing regime to be an internal measure subject to Article III:4, and not a border measure, and (2) the panel misunderstood the notion of internal measures in GATT 1994.[292] However, the Appellate Body flatly rejected this argument. Of particular relevance is the following discussion of the Appellate Body regarding hurricane licences[293]:

> Hurricane licences allow for additional imports of third-country (and non-traditional ACP) bananas at the lower in-quota tariff rate. Although their issuance results in increased exports from those countries, we note that hurricane licences are issued exclusively to European Communities producers and producer organizations, or to operators including or directly representing them. We also note that, as a result of the European Communities practice relating to hurricane licences, these producers, producer organizations or operators can expect, in the event of a hurricane, to be compensated for their losses in the form of "quota rents" generated by hurricane licences. Thus, the practice of issuing hurricane licences constitutes an incentive for operators to market European Communities bananas to the exclusion of third-country and non-traditional ACP bananas. This practice therefore affects the competitive conditions in the market in favour of European Communities bananas ... .
>
> For these reasons, we agree with the Panel that the European Communities practice of issuing hurricane licences is inconsistent with Article III:4 of the GATT 1994.

5.439 Like the hurricane licences in Bananas III, the tariff incentives provided by Indonesia may constitute border measures. However, the manner in which they are awarded constitutes an incentive to favour Indonesian automotive parts and subparts over imported parts and subparts, thereby affecting the competitive conditions in the Indonesian market in favour of Indonesian parts and subparts. As such, they violate Article III:4.

VI. CLAIMS UNDER THE TRIMS AGREEMENT

A. Claims Raised by Japan

6.1 **Japan** argues that the National Car Programme (see Section III.A) violates Article 2 of the TRIMs Agreement. The following are **Japan's** arguments in support of this claim:

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[292]Id. at para. 33.
[293]Id. at para. 213-214.

6.2 Article 2:1 of the TRIMs Agreement provides that "no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994." The issues before this panel, therefore, are twofold: (i) whether or not the National Car Programme is a "TRIM", and (ii) whether or not it violates either of the relevant GATT articles. As we have demonstrated, the exemption from the luxury tax and the import duty on the basis of local content is in violation of Article III:4. Consequently, the second of the above has been met, and the focus of the analysis here is on the first of the two issues.

1. Indonesia's Programmes are "TRIMs" as defined in the TRIMs Agreement

6.3 There is no doubt that Indonesia's programmes constitute "investment measures related to trade".[294] First, in the context of GATT/WTO, a "measure" is interpreted broadly. For example, in the case of GATS, it is expressly stated that "'measure' means any measure by a Member, whether in the form of law, regulation, rule, procedure, decision, administrative action, or any other form".[295] In light of the usage of the term within the context of the TRIMs Agreement, the notion of a "measure" should be interpreted similarly. Government regulations requiring certain local content to obtain an exemption from a luxury tax or specifying levels of import duty thus constitute "measures" within the meaning of the TRIMs Agreement.

6.4 Second, Indonesia's programmes are all "trade-related investment measures". The National Car Programme has been established specifically "with a view to supporting the development of the automotive industry."[296] The central aspect of the National Car Programme is to develop the domestic manufacturing capability of automobiles and automotive parts and components. The fact that the Programme includes "investment measures" is also obvious from the fact that one of its implementing regulations is entitled "Investment Provisions for Realization of the National Automobile Industry."[297] The Programme indeed impacts on the automobile industry in Indonesia where foreign-owned manufacturers are actively participating. Furthermore, these are all "trade-related" since the Programme is conditioned on local contents requirements and thus naturally affects trade.

6.5 Indonesia has essentially confirmed this point in prior meetings of the WTO Committee on Trade-Related Investment Measures. In the Minutes of the Meeting Held on 30 September and 1 November 1996, the representative of Indonesia stated:

> [T]he National Car Programme was intended to bring about major structural changes in the Indonesian automotive sector so that it could develop into a world standard industry ... . These policies were expected to encourage car companies to increase their local content, resulting in a rapid growth of investments in the automotive component industry. (Emphasis added)[298]

6.6 In addition, the Illustrative List in the Annex to the TRIMs Agreement, paragraph 1, specifically includes local content requirements as TRIMs that are inconsistent with Article III:4:

> TRIMs that are inconsistent with the obligation of national treatment provided for in [Article III:4] include those ...compliance with which is necessary to obtain an advantage, and which require:

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[294]TRIMs Agreement Article 1.

[295]94 GATS Article XXVIII(a).

[296]Government Regulation No. 36/1996 (Japan Exhibit 25), preamble.

[297]Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No.01/SK/1996 (Japan Exhibit 29).

[298]G/TRIMS/M/5 (Japan Exhibit 63), para. 24, 27 November 1996.

(a) the purchase or use by an enterprise of products of domestic origin ... specified in terms of a proportion of volume or value of its local production ....

Indonesia's measures, which are contingent on compliance with local content requirements, thus clearly constitute prohibited TRIMs as set forth in the Illustrative List.

6.7 Furthermore, Japan considers that any TRIMs which violate GATT Article III, including both Article III:2 and Article III:4, are inconsistent with Article 2.1 of the TRIMs Agreement. Japan believes that the February 1996 Programme violates GATT Article III, is a "trade-related investment measure", and thus violates TRIMs Article 2.1.

2. Even if Indonesia's measures were deemed to constitute a subsidy, it is nonetheless also a TRIM

6.8 Indonesia claims that the measure is a "subsidy" rather than a "TRIM".[299] However, the concepts of a TRIM and subsidy are not mutually exclusive. Nothing in the text, objective or purpose of the TRIMs Agreement would support the contention that a TRIM is no longer a TRIM simply because the local administering authority prefers to call it a subsidy rather than a TRIM.

3. Indonesia cannot enjoy the benefit of the transitional period

6.9 Nor can Indonesia enjoy the benefit of the five-year transitional period for developing countries stipulated in TRIMs Agreement, Article 5.2, in light of Indonesia's failure to comply with its notification and standstill obligations. The TRIMs Agreement, Article 5.2 requires notification for Members to benefit from the transitional period, and Article 5.4 imposes a standstill obligation during the period. Indonesia has complied with neither provision. First, there is no notification. Indonesia submitted a notification on 23 May 1995[300], which specifies certain automotive related measures, but the notification was withdrawn in October 1996.[301] Second, even if the notification had not been withdrawn, its content is irrelevant to the National Car Programme. While the measures appeared in the notification may be tangentially related to the National Car Programme, the Programme itself was not specified in the notification. Moreover, the National Car Programme, which was introduced in 1996, could have never been notified in the notification, which was due within 90 days after the date of entry into force of the WTO Agreement (i.e., 1 January 1995) and was actually made by Indonesia in May 1995. Therefore, Indonesia cannot enjoy the benefit of the transitional period under Article 5.2. of the TRIMs Agreement.

B. Claims Raised by the European Communities

6.10 The **European Communities** claims that Indonesia has violated its obligations under Article 2.1 of the TRIMs Agreement, as the following measures (See Section III.B) are TRIMs inconsistent with Article III of GATT 1994:

(1) the exemption from the Sales Tax on Luxury Goods of locally manufactured combines, minibuses, vans and pick-ups with more than 60 per cent local content;

(2) the exemption from the Sales Tax on Luxury Goods of locally manufactured sedans and stations wagons of less than 1,600 cc with more than 60 per cent local content;

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[299]See Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia Addendum (G/TRIMS/N/1/IDN/1/Add.1) (Japan Exhibit 18); SUBSIDIES / Replies to Questions posed by JAPAN Concerning the Updating Notification of INDONESIA (G/SCM/Q2/IDN/9) (Japan Exhibit 20), 2.(iii).

[300]Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia (G/TRIMS/N/1/IDN/1) (Japan Exhibit 17).

[301]Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia Addendum (G/TRIMS/N/1/IDN/1/Add.1) (Japan Exhibit 18).

(3) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Indonesia by Pioneer Companies meeting certain local content requirements;

(4) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Korea by "overseas producers" meeting certain counter-purchasing obligations;

(5) the grant of duty relief to parts and components used in the assembly of motor vehicles (or of other parts and components for the assembly of motor vehicles) in Indonesia based on the finished vehicles (or the parts and components) meeting certain local content requirements; and

(6) the exemption of import duties for parts and components used for the assembly of National Cars in Indonesia by Pioneer Companies meeting certain local content obligations.

6.11 The following are the **European Communities'** arguments in support of this claim:

6.12 Article 2.1 of the TRIMs Agreement provides that:

> Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT.

6.13 The notion of TRIM ("Trade Related Investment Measure") is not defined in the TRIMs Agreement. Nevertheless, the Annex to the TRIMs Agreement contains what Article 2.2 of that Agreement describes as:

> An Illustrative List of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI.

6.14 The above measures are "investment measures" because they are specifically designed to promote investment into the automotive sector with the purpose of achieving "full manufacturing" of motor vehicles in Indonesia. Further, the measures are "trade related" because they encourage the use of domestic parts and components over imported ones. Finally, as demonstrated above, the measures are inconsistent with Article III:4 and, in some cases, also with Article III:2, first sentence.

6.15 The above analysis is confirmed by the Illustrative List annexed to the TRIMs Agreement. Indeed, the measures at issue fall squarely within the category defined in Item 1 (a) of the Illustrative List, which reads as follows:

> 1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those [....] 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 [...] in terms of a proportion of volume or value of its local production.

6.16 Article 5.2 of the TRIMs Agreement provides a temporary derogation from the obligation contained in Article 2 in respect of TRIMs which were in force at least 180 days before the entry into force of the WTO Agreement and which have been duly notified by the Member concerned within 90 days from the entry into force of the WTO Agreement, as required by Article 5.1 of the TRIMs

Agreement. In the case of developing country Members, such as Indonesia, this temporary derogation has a duration of five years.

6.17 On 23 May 1995, Indonesia made a notification under Article 5.1 of the TRIMs Agreement[302]. This notification, however, does not entitle Indonesia to invoke the temporary arrangement provided in Article 5.2 with respect to the measures at issue.

6.18 In the first place, Indonesia's notification was made more than 90 days after the entry into force of the WTO Agreement. Accordingly, it does not constitute a valid notification under Article 5.1.

6.19 Moreover, Indonesia's notification covered only the measures provided in Decree 645/93. The tax benefits provided in Government Regulation 36/96 and the incentives granted under the National Car Programme were introduced by Indonesia only after the entry into force of the WTO Agreement. For that reason, they were not, and could not have been, notified under Article 5.1.

6.20 On 28 October 1996 (i.e. immediately before the first round of consultations with the Community took place) Indonesia withdrew formally its notification. Allegedly because, based on a further analysis of the measures concerned, it had concluded that the measures were not TRIMs[303]. In reality, however, the obvious reason for withdrawing the notification was Indonesia's belated realisation that the notification would not only fail to provide the expected immunity for the notified measures, but, in addition, would represent an open admission that both the notified measures and the non-notified ones are contrary to Articles III:4 of GATT and 2 of the TRIMs Agreement.

C. Claims raised by the United States

6.21 The **United States** claims that Indonesia's system of tariff and tax incentives and the government-directed $690 million loan to TPN (See Section III.C) are inconsistent with Article 2 of the TRIMs Agreement. The following are the **United States'** arguments in support of this claim:

6.22 Indonesia's system of tariff and tax incentives and the government-directed $690 million loan to TPN are based upon the achievement of designated local content targets and, as such, discriminate against imported automotive parts (and subparts) in favour of their domestic counterparts. In addition to violating Article III:4 of GATT 1994, these measures also violate Article 2 of the TRIMs Agreement.

6.23 Article 2 of the TRIMs Agreements, in pertinent part, states the following:

> 1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III … of GATT 1994.
>
> 2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 … is contained in the Annex to this Agreement.

6.24 Paragraph 1(a) of the Illustrative List, in turn, provides as follows:

> 1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or

[302] G/TRIMS/N/1/IDN/1, dated 1 June 1995.
[303] G/TRIMS/N/1IDN/1/Add.1, dated 31 October 1996.

> 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 ... . (emphasis added).

6.25 The tariff and tax incentives provided by Indonesia fall squarely within the example of a TRIM in paragraph 1(a) of the Illustrative List. The tax and tariff incentives under the 1993 Programme and the National Car Programme require, within the meaning of Article 1(a) of the Illustrative List, "the purchase or use by an enterprise of products of domestic origin or from any domestic source ...". "Compliance" with these requirements "is necessary to obtain an advantage" within the meaning of Article 1 of the Illustrative List. As such, these incentives fall squarely within the Illustrative List. Under both the 1993 programme and the National Motor Vehicle programme, in order to obtain the "advantage" of tariff or tax reductions or exemptions, an "enterprise" must "comply" with the requirement to "use . . . products of domestic origin". Likewise, the provision of the government-directed $690 million loan to TPN was based on TPN's status as a participant in the production of a "national motor vehicle", a status which, in turn, was based on compliance with the requirement to satisfy the local content requirements for a "national motor vehicle". Therefore, the tariff and tax incentives and the provision of the government-directed $690 million loan constitute TRIMs that are prohibited by Article 2.1 of the TRIMs Agreement.

6.26 With respect to the 1993 programme, Indonesia, as a developing country, could have taken advantage of the notification and transitional arrangements of Article 5 of the TRIMs Agreement. Paragraphs 1 and 2 of Article 5 provide, in pertinent part:

> 1. Members, within 90 days of the date of entry into force of the WTO Agreement [i.e., by 31 March 1995], shall notify the Council for Trade in Goods of all TRIMs they are applying that are not in conformity with the provisions of this Agreement. Such TRIMs of general or specific application shall be notified, along with their principal features.
>
> 2. Each Member shall eliminate all TRIMs which are notified under paragraph 1 … within five years [of the date of entry into force of the WTO Agreement] in the case of a developing country Member ... . (footnote omitted).

6.27 Indonesia did notify, pursuant to Article 5.1, that portion of the 1993 programme providing tariff incentives. However, that notification was untimely, because it was made on 23 May 1995, well after the deadline for notifying TRIMs under Article 5.1 had closed.[304] Moreover, the notification did not cover that portion of the 1993 programme providing tax incentives.[305] Subsequently, Indonesia withdrew that portion of its notification pertaining to the tariff incentives for motor vehicles.[306] As a

[304]G/TRIMS/N/IDN/1 (1 June 1995).
[305]Id.
[306]G/TRIMS/N/IDN/1/Add. 1 (31 October 1996).

result, Indonesia has not notified any of the TRIMs described above, and, thus, is ineligible to take advantage of the transitional arrangements in Article 5.2.[307]

D. Response by Indonesia to Claims under the TRIMs Agreement

6.28 **Indonesia** argues, in response to the claims under the TRIMs Agreement, that the TRIMs Agreement interprets Article III of the GATT 1994, and adds no new obligations; thus it cannot alter the fact that Article III is not applicable. The following are **Indonesia's** arguments in this regard.

1. Summary

6.29 At the start of the Uruguay Round negotiations, the United States, the European Communities, Japan and other developed countries had grand plans for an agreement that would broadly discipline investment measures. Throughout the negotiations, however, the developed countries' efforts were countered by virtually all developing countries. To avoid the absence of any agreement at all, the agreed-upon TRIMs text provides that the type of local content measure found to be inconsistent with Article III of the General Agreement in Canada-Administration of the Foreign Investment Review Act (7 February 1994), BISD 30S/140, (as well as another type of measure previously found to be inconsistent with Article XI) should also be proscribed as a TRIM. In other words, to be a TRIM, a measure must be inconsistent with GATT Articles III or XI.

6.30 Article 2.1 of the TRIMs Agreement states:

> Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994. (Emphasis added.)

The TRIMs Agreement does not add any new obligations; it merely interprets Article III. This was recognized in the Report of the Panel on European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA (22 May 1997), which declares at paragraph 7.185:

> In considering these arguments, we first examine the relationship of the TRIMs Agreement to the provisions of GATT. We note that with the exception of its transition provisions the TRIMs Agreement essentially interprets and clarifies the provisions of Article III (and also Article XI) where trade-related investment measures are concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment-related matters. (Emphasis added; footnote omitted.)

6.31 As demonstrated (See Section V.D), Indonesia's luxury tax subsidy is not inconsistent with Article III of the General Agreement. Therefore, the TRIMs Agreement is not germane to this dispute.

2. The TRIMs "Illustrative List" cannot alter the fact that Article III is inapplicable

6.32 Complainants seek to use the TRIMs Illustrative List as the tail to wag the Article III dog, claiming that the Indonesian measures fall within the scope of paragraph 1(a) of the List and hence are TRIMs.

[307]Of course, Indonesia could not have notified its TRIMs under the National Motor Vehicle programme, because Indonesia did not introduce those TRIMs until after the 90-day notification window of Article 5.1 had closed.

6.33 During the Uruguay Round negotiations, the United States clearly indicated the subordinate nature of the Illustrative List. The official minutes of the 10-11 July 1989 meeting of the TRIMs negotiating group record the following exchange:

> One participant asked for clarification on the nature of and the role that would be assigned to "illustrative lists"; were they only concepts within the framework of the negotiations, would they remain illustrative rather than definitive in any final agreement and would they be open-ended so that they could be added to at a later stage? ... The representative of the United States said that the lists should be purely illustrative. Disciplines should be based on general criteria such as the inherently trade distorting nature of TRIMs and illustrative lists could then be drawn up with specific examples of TRIMs that were subject to specific disciplines. In that way any new measure that was devised could still be caught by the discipline even if it did not appear on an illustrative list.[308]

6.34 The United States, the European Communities, Japan and other developed countries had extensive negotiating goals for the TRIMs Agreement, but at the end of the negotiation the parties could not even agree upon basic definitions such as "investment" measure and "trade-related." The only "general criteria" that survived the negotiating process and was reflected in the final text of the TRIMs Agreement was that a TRIM must be inconsistent with the obligations of either Article III or XI of the General Agreement. In sum, because the luxury tax subsidy is not inconsistent with Article III, it cannot be proscribed by the TRIMs Agreement.

3. Subsidies are governed by the subsidies agreement and are not within the scope of the TRIMs Agreement

6.35 One of the many fundamental issues on which there were major differences of opinion among the participants in the Uruguay Round TRIMs negotiating group was whether subsidies were governed solely by the Subsidies Agreement or also could be considered to be an "incentive" or a "condition for receipt of an advantage" and thus governed by the TRIMs Agreement. The United States and Japan argued that subsidies could also be TRIMs. Argentina, Hungary, India, the Nordics, the Philippines (for ASEAN), Poland and others disagreed.[309] So did the European Communities, which included the following in its 13 November 1989 submission to the TRIMs negotiating group:

[308]MTN.GNG/NG12/11 at para. 55 (emphasis added).

[309]Argentina and other developing countries declared that "any suggestion that investment measures themselves, including incentives, should be prohibited is not only inappropriate but unrealistic and unacceptable." MTN.GNG/NG12/W/25 at para. 4 (emphasis added). Hungary "...wanted it spelled out that a TRIMs agreement would not establish different disciplines on investment incentives or subsidies to those agreed to in the Subsidies Negotiating Group." MTN.GNG/NG12/22 at para. 7. India said that it could not be presumed that investment measures constitute a form of subsidization. MTN.GNG/NG12/W/18 at para. 52. The Nordics declared explicitly that "incentives" were covered by the Subsidies Agreement, not the TRIMs Agreement. MTN.GNG/NG12/W/23 at para. 10. They also said "there appeared to be a consensus emerging in the Group ... that incentives lay outside the ambit of this Group and remedies to their adverse trade effects could be found in GATT disciplines on subsidies." MTN.GNG/NG12/14 at para. 100. According to the Philippines, "incentives contingent upon investment measures should be outside the scope of the TRIMs negotiations." MTN.GNG/NG12/20 at para. 2. Poland said that incentives linked to TRIMs are subsidies and should be disciplined by GATT Article XVI and the Subsidies Agreement. MTN.GNG/NG12/14 at para. 75.

> [G]overnment incentives, including subsidies, are being addressed in the Negotiating Group on Subsidies; such incentives are therefore not the subject of the current negotiations on TRIMs.[310]

6.36 The disagreement remained throughout the life of the negotiating group. In the "Chairman's Report on the Status of Work in the Negotiating Group" (MTN.GNG/NG12/W/27), the paragraph and accompanying footnote asserting that subsidies could be TRIMs was in brackets, thereby signifying lack of agreement with the proposition.[311] In its 1997 Report to the WTO Council for Trade in Goods, the TRIMs Committee stated: "[d]iffering views continue to be expressed on issues such as ... the relationship of the provisions of the [TRIMs] Agreement to those of other WTO agreements, including the Agreement on Subsidies and Countervailing Measures and the Agreement on Agriculture."[312] Even the United States has acknowledged that "[o]ther issues that appear to require additional follow [sic] include: ... the relationship of the TRIMs Agreement with the Agreement on Subsidies and Countervailing Measures."[313]

6.37 The foregoing clarifies that no consensus exists that subsidy measures also are subject to the disciplines (whatever they might be) of the TRIMs Agreement. The luxury tax reductions and exemption under the 1993 Incentive Programme and the February 1996 national car programme are not TRIMs; they are subsidies. They are governed by and subject to the disciplines of the Subsidies Agreement.

4. Customs import duty subsidies are not within the scope of the TRIMs Agreement

6.38 The TRIMs Agreement merely interprets Article III of the General Agreement. It does not add new obligations. Therefore, where, as here, Article III is not applicable, the TRIMs Agreement is not applicable. The "Illustrative List," therefore, is irrelevant. Customs duty subsidies are governed by the Subsidies Agreement and are not within the scope of the TRIMs Agreement.

5. Indonesia has not violated the TRIMs Agreement: The TRIMs Agreement does not apply - it adds no new obligations, but merely puts a gloss on Article III of GATT 1994

(a) The TRIMs Agreement, unlike the SCM Agreement, is not *lex specialis*; it neither defines "TRIM" nor sets forth special remedies

6.39 The TRIMs Agreement differs substantially from the SCM Agreement. Unlike the SCM Agreement, which is *lex specialis* for this dispute, the TRIMs Agreement is not *lex specialis* for this or, for that matter, any dispute. This is because the TRIMs Agreement:

- first, does not define "TRIM" (in fact, it does not contain even a limited definition of "TRIM"); and

- second, does not set forth special remedies for measures found to be TRIMs (in fact, it sets forth no remedies at all).

To Indonesia's knowledge, these facts concerning the TRIMs Agreement are not in dispute.

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[310]MTN.GNG/NG12/W/22 at para. A.3.

[311]See id. at para. A2(c)(iii) and note 2.

[312]G/L/193 (15 October 1997) at para. 5.

[313]"United States Paper on WTO Agenda" para. C.4, reprinted in Inside US Trade at 10 (18 April 1997).

(b) The TRIMs Agreement does not establish a "new balance of rights and obligations"; rather, it merely elaborates on the FIRA Panel's decision regarding the coverage of Article III of GATT

6.40 The United States asserts that the TRIMs Agreement establishes a "new balance of rights and obligations," and that Indonesia ignores it (See Section VI.E.3). These allegations are unfounded. It should go without saying that any contract, memorandum of understanding or trade agreement establishes a "balance of rights and obligations". The real question, however, is: what was agreed to? Indonesia has demonstrated conclusively that the developing countries successfully countered the developed states' drive to increase the scope of what became the TRIMs Agreement.

6.41 As Indonesia has demonstrated, the TRIMs Agreement was conceived of and drafted in order to further specify the application of Article III of the GATT to trade-related investment measures. No provision of the TRIMs Agreement brings Indonesia's subsidies within the scope of the Agreement.

6.42 In further specifying Article III, the TRIMs Agreement elaborates on the decision of the Panel in Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1994), BISD 30S/140. The United States, in discussing this fact, attempts to undercut Indonesia's argument by focusing on the word "essentially" in the following passage from paragraph 7.185 of Bananas III:

> the TRIMs Agreement essentially interprets and clarifies the provisions of Article III (and also Article XI) where trade-related investment measures are concerned.

The United States asserts that "essentially" indicates that the TRIMs Agreement must cover other items (See Section VI.E.3). But the United States ignores, as it must, the very next sentence from the Panel report, which clarifies that the Panel did not use "essentially" to indicate that the phrase following it is false or incomplete:

> Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment-related measures.

This quotation pretty much sums it up. It is a precise statement of Indonesia's position.

6.43 Thus, the United States, in its arguments, runs afoul of the very criticism it levies against Indonesia. It is complainants, not Indonesia, that come before this Panel seeking to revisit and rewrite the TRIMs Agreement by having the Panel adopt interpretations explicitly rejected during the negotiations.

6. Japan is in Error; the Government most certainly does not view the National Car Programme as an investment programme

6.44 The two measures which make up the National Car Programme are subsidies. This has been the consistent view of Indonesia since this dispute began. When the measures initially were introduced, the Indonesian Government, on the basis of an incomplete and unsound analysis of the legal nature of the subsidies under the WTO Agreements, notified them as TRIMs. Upon a more exacting legal analysis, the Government realized its mistake, withdrew its TRIMs notification and notified the measures as subsidies.

6.45 From time to time, some Indonesian officials have referred to the measures as relating to industrial development, trade, investment, etc. These references do not and cannot alter the nature of the measures. Nor do the statements of various officials from competing bureaucracies change the Government's position that the measures are subsidies. As demonstrated, the measures are subsidies to

a domestic industry to encourage its development. Alternative descriptions or characterizations cannot alter this fact.

7. The underlying decree, rules and regulations, and Indonesia's statements to the Committee on TRIMs establish that the National Car Programme does not involve a TRIM

6.46 Japan claims that because one implementing decree[314] contains the word "investment" in its title (which, according to Japan, means that it addresses the measure as an investment measure), the subsidy must be a TRIM. This is incorrect. Of the large number of regulations and decrees regarding the National Car Programme, Japan selected a single regulation on the basis of its heading. Japan then arbitrarily affixed the designation "key" to that single regulation and, finally, promoted it to the rank of evidence that the National Car Programme is an "investment measure."

6.47 The seminal regulation for the February 1996 measure is Presidential Instruction No. 2/1996 of 19 February 1996. It simply instructs two Ministers, the Minister of Industry & Trade (MIT) and the Minister of Finance (MOF), to perform detailed activities. It also charges the Minister for the Mobilization of Investment Funds/Chairman of the Investment Coordinating Board (BKPM) with the very general task of "safeguarding" the development of the national car industry.

6.48 On 19 February 1996, the same day that Presidential Instruction No. 2/1996 was issued, both MIT and MOF issued their implementation decrees. MIT implemented the Presidential Instruction by issuing Decree No. 31/MPP/SK/2/1996; MOF issued implementing Decree No. 82/KMK.01/1996.[315]

6.49 The BKPM implementing regulation appeared eight days later, on 27 February 1996. BKPM had to wait until further implementing regulations were issued by the two principal ministries before ascertaining what secondary supporting regulation was appropriate for it to promulgate. The principal implementing regulation (supplementing the two decrees cited above) was issued by MIT's Director General for the Metal, Machinery & Chemical Industries (Decree No. 002/SK/DJ-ILMK/II/1996), appointing a Pioneer Motor Vehicle Industrial Enterprise. Only after the Director General issued this decree did BKPM issue the Investment Provisions for the Realization of the National Automobile Industry. Even then, on closer scrutiny, the "Investment Provisions" turn out to be merely a rehash of the earlier MIT Decree (No. 31/MPP/SK/2/1996).

6.50 Why did BKPM have to issue a regulation at all? It had to issue the regulation because TPN is a Domestic Capital Investment Company (a PMDN), and all PMDN companies operate under the auspices of BKPM. BKPM Decree No. 01/SK/1996 is not a "key implementing regulation." It is merely an administrative and procedural regulation that could not be issued prior to the MIT and MOF decrees. Moreover, it simply repeats another Ministerial decree. Again, the February 1996 national car measure is a subsidy and Complainants' misrepresentations do not bring it under the TRIMs Agreement.

6.51 Japan similarly misuses Indonesia's presentation at the 30 September 1996 meeting of the Committee on TRIMs. At this meeting, Indonesia responded to questions posed by the delegation of Japan and mentioned at least seven objectives of the National Car Programme:

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[314]Decree of the State Minister for the Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No. 01/SK/1996 regarding Investment Regulations within the Framework of the Realization of the Establishment of the National Automobile Industry (27 February 1996).

[315]MIT and MOF had been in close coordination with the Office of the President in the planning and drafting of the regulations giving birth to the national car. That is why their implementing regulations appeared the same day as the regulation they are intended to implement.

- to improve the competitiveness of local companies and strengthen overall industrial development;

- to promote the competitiveness of Indonesia's automotive production;

- to develop the capacity of multiple-source auto parts and components;

- to encourage the development of the automotive industry and the automotive component industry;

- to bring about major structural changes in the Indonesian automobile industry;

- to encourage the transfer of technology and contribute to large-scale job creation; and

- to encourage car companies to increase their local content, resulting in a rapid growth of investment in the automobile component industry.

6.52 Like Japan's selective use of Indonesia's regulations to buttress its assertion that Indonesia's national car policy is an investment measure, Japan again has acted arbitrarily here. It has chosen one of the seven objectives to carry its allegation that the February 1996 national car measure is a TRIM and, even then, its conclusion does not reflect the facts.

6.53 The single sentence used by Japan as evidence that the national car measure is a TRIM is in item 4 of page 2 of Indonesia's response:

> These policies are expected to encourage car companies to increase their local content, resulting in a rapid growth of investments in the automotive component industry.

But Japan's interpretation even of this one (of seven) goals is inaccurate. The expectation and, therefore, the objective is directed toward car companies increasing their local content. The measure is a subsidy conditioned upon the increasing use of local content. The "rapid growth of investments" is not an objective of the national car measure; it is only a side product of such objective.

8. <u>The measures are not investment measures but subsidies granted to an automaker to use domestic parts and components</u>

6.54 The Indonesian measures are not investment measures, but subsidies granted to an automaker to use domestic parts and components, for the following reasons:

1. The subsidies are granted by the Minister of Finance.

2. The regulating authority over the automaker vests with the Minister of Industry and Trade.

3. The involvement of the Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Coordinating Board is purely administrative and is required only because the automaker happens to be a domestic capital investment company.

4. The considerable number of regulations providing and implementing the subsidy do not once refer to "investments".

5. Although subsidies may at times indirectly affect investment decisions of the recipient of the subsidy or other parties, these decisions are not the object, but rather the unintended result, of the subsidy. Indeed, increased investment indirectly results from many subsidies.

6. Moreover, even if the TRIMs Agreement did apply, the subsidies are not inconsistent with Article III of GATT 1994.

9. The measures are not TRIMs that violate Article III:2 of GATT 1994

6.55 The government measures are not TRIMs. Specific subsidies by definition discriminate between products benefiting from the subsidies and those that do not. If GATT Article III:2 and Article III:4 were applied every time a specific subsidy came up, virtually all actionable subsidies granted by developing countries would be undone by GATT Articles III:2 and III:4 and the TRIMs Agreement. Article 32.1 of the SCM Agreement unequivocally provides that GATT actions against subsidies are to be resolved under the SCM Agreement. It is the SCM Agreement that deals with actionable subsidies under Art. 27.3, not the GATT.

10. The TRIMs Agreement is not *lex specialis* to any dispute

6.56 Unlike the SCM Agreement, the TRIMs Agreement is not *lex specialis* to any dispute. By its very terms it cannot be. For example, Article 2.1 of the TRIMs Agreement states that the TRIMs Agreement operates "[w]ithout prejudice to other rights and obligations under GATT 1994".

6.57 The Article continues, stating, "no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994". (This passage breathes new life into Article III of GATT 1994 which, complainants assert, Indonesia's *lex specialis* and conflict arguments would render moribund.) Thus the TRIMs Agreement itself states that it is naught but a general agreement that depends upon the General Agreement to have any meaning whatsoever.

6.58 Given this, other Annex 1A and 1C Agreements can apply and, more importantly, in the case of those agreements which are *lex specialis*, such as the SCM Agreement, control certain disputes, such as this one, to the complete exclusion of the TRIMs Agreement.

E. Arguments made in rebuttal to Indonesia's responses to the claims under the TRIMs Agreement

1. Rebuttal arguments made by Japan

6.59 **Japan** makes the following arguments in rebuttal to Indonesia's responses to the claims under the TRIMs Agreement:

(a) The February 1996 Programme violates TRIMs Article 2.1

6.60 As demonstrated (See Section VI.A), the February 1996 Programme violates GATT Article III, is a "trade-related investment measure," and thus violates TRIMs Article 2.1.

6.61 Indonesia argues that the TRIMs Agreement only interprets GATT Article III and GATT Article III is not applicable to the February 1996 Programme. As discussed (See Section VI.D), GATT Article III does apply and the Programme is inconsistent with it.[316]

6.62 Indonesia also attempts to evade its violation of the TRIMs Agreement by arguing that the Illustrative List of the TRIMs Agreement is "purely illustrative" and that the List cannot alter the "fact" that GATT Article III is inapplicable. Once again, however, the Government of Japan has amply demonstrated that Article III does in fact apply. It appears, moreover, that Indonesia misunderstands Japan's argument. The Government of Japan does not argue that the National Car Programme violates TRIMs Article 2 because it is on the Illustrative List, but that it violates TRIMs Article 2 because it is a TRIM and it is inconsistent with GATT Article III. Thus, Indonesia's argument about the nature of the List is irrelevant.

6.63 Therefore, the February 1996 Programme is inconsistent with the TRIMs Agreement and the Government of Indonesia's contrary argument lacks any merit.

(b) The SCM Agreement does not excuse indonesia's violations of the TRIMs Agreement

6.64 Indonesia seems to argue that there is a conflict between SCM Article 27.3 and TRIMs Article 2.1, such that SCM Article 27.3 excuses the violations of TRIMs Article 2.1. However, that argument also lacks any merit. These provisions do not conflict and Indonesia's assumption that the SCM Agreement would prevail in a hypothetical conflict is unfounded.

6.65 As discussed (See Section V.E.1), the Bananas III Panel found that a conflict between two WTO Agreements can only arise if the two establish "mutually exclusive" obligations or one "explicitly permits" what another prohibits. As already shown with respect to GATT Article III, however, the SCM Agreement neither creates obligations that are "mutually exclusive" with TRIMs Article 2.1 nor "explicitly permits" violations of TRIMs Article 2.1.

6.66 Rather, the TRIMs and SCM Agreements create “different or complementary obligations.” The TRIMs Agreement applies to TRIMs regardless of whether such TRIMs are also “subsidies” under the SCM Agreement and the SCM Agreement applies to “subsidies” regardless of whether such “subsidies” are also TRIMs. A WTO Member can, and therefore must, comply with the provisions of both Agreements with respect to a measure that is both a “subsidy” under the SCM Agreement and a TRIM under the TRIMs Agreement. Nothing in the text, context, object or purpose of the TRIMs Agreement supports the Indonesian contention that a TRIM is no longer a TRIM simply because the administering authority prefers to call it something else.

6.67 This conclusion is strengthened by a review of the TRIMs and SCM provisions that establish the transition periods for developing country Members. SCM Article 27.3 allows developing countries a period of time (five years for Indonesia) before they must comply with the prohibition on subsidies contingent on the use of domestic over imported products. TRIMs Article 5.1 likewise also allows developing country Members time before they must comply with the TRIMs Article 2 provisions on

[316]The Government of Indonesia misunderstands the nature of the TRIMs Agreement. Contrary to Indonesia’s assertion that the “TRIMs Agreement does not add any new obligations; it merely interprets Article III,” it in fact contains a variety of procedural and substantive obligations. The fact that TRIMs Article 2.1 references GATT Article III does not mean that the TRIMs Agreement “merely interprets” Article III, as Indonesia would have it. Instead, the principle of *pacta sunt servanda* requires that the TRIMs Agreement must apply in accordance with its terms to all measures within its scope (i.e., to all TRIMs). The language from Bananas III quoted by Indonesia fails to support its position. That language shows that the Bananas III Panel correctly noted that TRIMs Article 2.1 neither adds to nor detracts from GATT obligations. All that signifies, however, is that Article 2.1 does not modify the scope of the GATT provisions in cases where those provisions apply.

local content requirements which are inconsistent with GATT Article III, provided that the measure existed when the WTO Agreements entered into force (i.e., on 1 January 1995) and that the Member notified the measure within ninety days of such entry into force (i.e., by 1 April 1995).[317] For TRIMs that are also "subsidies" under the SCM Agreement, it is clearly possible for developing country Members to receive the benefits of the transitional arrangements under both Agreements by acting in accordance with the terms of each Agreement. Moreover, if such TRIMs should be subject only to the SCM Agreement, it would render the specifically crafted notification requirement under the TRIMs Agreement, for the substantial part of its coverage, meaningless.

6.68 Finally, if a conflict may some day arise between the TRIMs and SCM Agreements, there is no reason to assume - as Indonesia apparently does - that the SCM Agreement would prevail in such a conflict. Indonesia's faulty assumption seems to result from its mistaken equating of the GATT and the TRIMs Agreement, discussed above. The plain text of the General Interpretative Note refutes this assumption. That Note expressly provides that Annex 1A Agreements - including both the TRIMs Agreement and the SCM Agreement - prevail over the GATT to the extent of a conflict. The General Interpretative Note thus gives the TRIMs and SCM Agreements alike a hierarchical status above the GATT in the event of a conflict, but it does not establish any hierarchy between the two. Recent Appellate Body Reports also support the conclusion.[318] For example, in Canada - Certain Measures Concerning Periodicals, a WTO panel firmly rejected an argument by Canada that the scope of the GATS and the GATT were mutually exclusive, holding that:

> The ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicates that obligations under GATT 1994 and GATS can co-exist and that the one does not override the other. If the consequences suggested by Canada were intended, there would have been provisions similar to Article XVI:3 of the WTO Agreement or the General Interpretative Note to Annex 1A in order to establish hierarchical order between GATT 1994 and GATS. The absence of such provisions between the two instruments implies that GATT 1994 and GATS are standing on the same plain in the WTO Agreement, without any hierarchical order between the two."[319]

The WTO Appellate Body approved this aspect of the panel decision in the Periodicals case, quoting the above reasoning by the panel and noting that: "The entry into force of the GATS ... does not diminish the scope of application of GATT 1994".[320] Since GATS is not covered by the General Interpretative Note (which gives WTO agreements in Annex 1A other than GATT precedence over GATT in the event of a conflict), GATS is on equal footing with GATT. In the same way, the TRIMs Agreement is on equal footing with the SCM Agreement. Thus, the Panel should not, without any textual basis, elevate one Annex 1A Agreement over the others.

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[317]In this connection, India, a third party, stated at the first meeting that "[w]hile we agree that delay in notifying measures should ideally not occur, it must at the same time also be realized that small delegations often have constraints of resources which at times leads to an unintended delay in the notification of their measures." This point is irrelevant to our arguments and it is not necessary for this Panel to decide the procedural question raised by India. It is clear that the issue in this dispute is not merely procedural because the Government of Indonesia introduced the National Car Programme after the entry into force of the WTO, even after the deadline specified by Article 5.1 of the TRIMs Agreement, and it could never have notified the measure in accordance with Article 5.1, needless to say, regardless of how large a delegation it has in Geneva.

[318] Appellate Body Report on Canada - Periodicals, pp.18-19. Appellate Body Report on Bananas III, paras. 221-222.

[319]Report of the Panel on Canada - Periodicals, WT/DS31/R, para. 5.17.

[320]Report of the Appellate Body on Canada - Periodicals, page 19.

(c) Incentive measures are covered by the TRIMs Agreement

6.69 The Government of Indonesia also contends that "no consensus exist[ed] that subsidy measures also are subject to the disciplines of the TRIMs Agreement," that its incentives to encourage purchases of domestic goods over imports "are not TRIMs; they are subsidies", and thus "they are subject to the disciplines of the Subsidies Agreement". (See Section VI.D).

6.70 However, Indonesia's allegation contradicts the text of the TRIMs Agreement. The text of the Agreement requires only two elements for a measure to constitute a violation of TRIMs Article 2.1: first, the measure is an "investment measure related to trade in goods"; and second, the measure is "inconsistent with the provisions of [GATT] Article III or Article XI". As described in paragraph 3.14 above, it has been firmly established that GATT Article III:4 applies not only to mandatory measures but also to measures with which a company may comply voluntarily to obtain a benefit. Therefore, it is clear that TRIMs Article 2.1 also applies to such voluntary measures, or incentive measures, as long as they fall within the concept of "TRIMs".

6.71 The Illustrative List in the Annex of the TRIMs Agreement also demonstrates that the February 1996 Programme is a TRIM. That list explicitly provides that prohibited TRIMs include any local content requirement "compliance with which is necessary to obtain an advantage".

6.72 Because the text of the TRIMs Agreement clearly and unambiguously establishes that it applies not only to mandatory measures but also to measures "compliance with which is necessary to obtain an advantage", there is no need to resort to the drafting history to understand this point.[321] In fact, however, a review of the preparatory work of the TRIMs Agreement confirms - unsurprisingly, in view of the plain text - that the negotiators decided to include so-called "incentive measures" in the TRIMs Agreement.

6.73 Although the preparatory work shows active discussion about the definition of a "TRIM" throughout the negotiations and a wide variety of views were expressed[322], at the final stage a consensus was created, as discussed below.

6.74 Late in the TRIMs negotiations (i.e., October 1991 through 20 December 1991), the Chairman distributed texts for the purpose of discussion. The key phrase concerning incentive measures (i.e., "TRIMs .... compliance with which is necessary to obtain advantage") was included in the Chairman's first draft, removed in the revised text of 25 November 1991 at the behest of India and other developing countries, and revived in the Chairman's second draft after developed countries objected to the earlier deletion. Ultimately, this phrase was finally adopted, with the developing countries accepting it in exchange for the developed countries' acceptance of the five-year transition period. Indeed, the negotiating group rejected a proposal by one Member that would have expressly limited TRIMs to mandatory measures.

6.75 It is also relevant to note that the final TRIMs Agreement did not incorporate a position advanced by some developing countries that would have provided for only the disciplines of the SCM Agreement to apply, when a "subsidy" (as defined in the SCM Agreement) was granted contingent on meeting certain requirements, such as local content requirements. That position was rejected, because most Members recognized that it would create too large a loophole in the TRIMs Agreement. This

[321]Vienna Convention on the Law of Treaties, arts. 31-32.

[322]See Submission by Japan (MTN.GNG/NG12/W/12) dated 9 June 1988; Submission by Japan (MTN.GNG/NG12/W/20) dated 13 September 1989; Submission by India (MTN.GNG/NG12/W/18) dated 11 September 1989; Submission by the European Communities (MTN.GNG/NG12/W/22) dated 16 November 1989; Submission by the Nordic Countries (MTN.GNG/NG12/W/23) dated 22 November 1989; and Communication from the United States (MTN.GNG/NG12/W/24) dated 24 January 1990.

loophole was avoided by leaving both the SCM Agreement and the TRIMs Agreement silent about their relationship, thereby ensuring that the disciplines of both would apply to measures that were both TRIMs and "subsidies."

6.76 Thus, it is clear that the positions advanced in the quotations from the preparatory work cited in Indonesia's First Submission were not adopted in the final text of the TRIMs Agreement. Of course, it is the text of a treaty itself that governs and any views expressed during the negotiations that do not comport with the text carry no weight.[323]

6.77 Finally, subsequent practice under the WTO, which is relevant to its interpretation[324], confirms that TRIMs that fall within the SCM definition of "subsidy" have nevertheless been understood to also be subject to the TRIMs Agreement. This is demonstrated by the fact that even many developing country Members have included such measures in their notifications to the TRIMs Committee under Article 5.[325] In fact, the Government of Indonesia itself notified the TRIMs Committee of the incentive measures in its 1993 automobile programmes, although it did so late and later withdrew the notification, apparently in connection with these proceedings.[326]

(d) Indonesia's arguments would render parts of the TRIMs Agreement virtually meaningless

6.78 Finally, it should also be noted that Indonesia's argument that incentive measures should be governed only by the SCM Agreement, not by the TRIMs Agreement, would render parts of the TRIMs Agreement virtually meaningless.

6.79 As discussed (See Section VI.A), the text of the TRIMs Agreement clearly shows that an incentive measure, or a measure "compliance with which is necessary to obtain an advantage", is within the coverage of the Agreement. It appears that a TRIM that is an incentive measure would very often also be a "subsidy" under the SCM Agreement. Therefore, if an interpretation were taken that a measure, which constitutes both a "TRIM" under the TRIMs Agreement and a "subsidy" under the SCM Agreement, shall be governed only by the SCM Agreement, that would negate a substantial part of the TRIMs Agreement coverage.

6.80 Accordingly, a "TRIM" under the TRIMs Agreement should not be excluded from the coverage of the TRIMs Agreement, only because it constitutes a "subsidy" under the SCM Agreement.

2. Rebuttal arguments made by the European Communities

6.81 The following are the **European Communities'** rebuttal arguments to Indonesia's responses to the claims under the TRIMs Agreement:

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[323]See Vienna Convention on the Law of Treaties, arts. 31-32. See also Appellate Body Report on Japan - Alcoholic Beverages II, pp. 10-12.

[324]See Vienna Convention on the Law of Treaties, art. 31(3)(b).

[325]Incentive measures were notified, for example, by Venezuela, on 12 April 1995, G/TRIMS/N/1/VEN/1, by South Africa, on 8 May 1995, G/TRIMS/N/1/ZAF/1, and by the Dominican Republic, on 10 May 1995, G/TRIMS/N/1/DOM/1.

[326]Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia (G/TRIMS/N/1/IDN/1) (Japan Exhibit 17). Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia Addendum (G/TRIMS/N/1/IDN/1/Add.1) (Japan Exhibit 18).

(a) The measures at issue infringe GATT Article III and are therefore contrary to Article 2.1 of the TRIMs Agreement

6.82 Indonesia argues that the measures at issue do not infringe Article 2.1 of the TRIMs Agreement because they are not within the scope of, and therefore cannot be "inconsistent" with, Article III. The European Communities has shown (see Sections V.A.2 and V.C.2) that the measures at issue are inconsistent with GATT Articles III:2 and/or III:4. Therefore, they are contrary also to Article 2.1 of the TRIMs Agreement.

(b) Article 2.1 of the TRIMs Agreement lays down a legally distinct obligation

6.83 Indonesia claims that the TRIMs Agreement "interprets GATT Article III and does not add new obligations". Indonesia relies for this proposition on the following passage of the Panel Reports on EC regime concerning the Importation, Sale and Distribution of Bananas :

> with the exception of its transitional provisions, the TRIMs Agreement, essentially interprets and clarifies the provisions of Article III (and also Article XI) were trade-related investment measures concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment matters[327].

6.84 Properly interpreted, this passage means that, in substance, the TRIMs Agreement is limited to restate and clarify the obligations laid down GATT Article III. Formally, however, Article 2.1 of the TRIMs Agreement lays down an obligation which is distinct from the obligation contained in GATT III. This is confirmed by the prior finding in the same Panel Report that the provisions of GATT and the TRIMs Agreement were "equally applicable" to the European Communities's import licensing procedures.[328] Furthermore, if Article 2.1 of the TRIMs did not provide for an additional and distinct obligation, it would have been superfluous to stipulate in Article 3 of the TRIMs Agreement that all exceptions under GATT 1994 shall apply also to the provisions of the TRIMs Agreement. Likewise, it would have been unnecessary to sate in Article 4 of the TRIMs Agreement that developing Members shall be free to deviate from Article 2 "to the extent and in such manner" as Article XVIII of GATT and other related legal instruments permit those Members to deviate from GATT Articles III and XI.

(c) Even if it was found that there is a "conflict" between GATT Article III and the SCM Agreement, that conflict would not preclude a violation of Article 2 of the TRIMs Agreement

6.85 The General Interpretative Note to Annex 1A only applies to conflicts between GATT and the other Annex 1A Agreements. It does not apply to conflicts between the TRIMs Agreement and the SCM Agreement. Accordingly, even if it was found by the Panel that there is a "conflict" between GATT Article III and the SCM Agreement, such "conflict" would not preclude a violation of the legally distinct obligation contained in Article 2 of the TRIMs Agreement. In fact, the existence of a "conflict" between the SCM Agreement and GATT Article III would not make the measures concerned "consistent" with GATT Article III but merely exclude the application of that provision. Quite to the contrary, the existence of a "conflict" between the SCM Agreement and GATT Article III would presuppose necessarily that the measures are "inconsistent" with the latter.

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[327] See e.g. WT/DS27/R/USA, adopted 25 September 1997, at para 7.185.
[328] Id. at para 7.158.

(d) The TRIMs Agreement may apply to subsidies

6.86 The TRIMs Agreement applies to any trade related investment measure which is inconsistent with GATT Article III. Given that GATT Article III may apply to measures which are "subsidies" within the meaning of the SCM Agreement, it follows that the TRIMs Agreement may also apply to "subsidies". This is confirmed by the Illustrative List. In accordance with its ordinary meaning, the term "advantage" used in the Illustrative List may include also "subsidies" within the meaning of the SCM Agreement.[329]

3. Rebuttal Arguments made by the United States

6.+87 Noting that it agrees with the points made by Japan and the EC at the second meeting of the Panel, and, in particular, the arguments made by the European Communities (See Section VI.E.2(b)), the **United States** makes the following arguments in rebuttal to Indonesia's responses to the claims under the TRIMs Agreement:

(a) The tariff and tax incentives under the 1993 Programme and the National Car Programme are inconsistent with Article 2 of the TRIMs Agreement

6.88 With respect to Indonesia's violations of Article 2 of the TRIMs Agreement, Indonesia argues that the TRIMs Agreement imposes no new obligations, but is merely an interpretation of Article III of GATT 1994. Indonesia, of course, must advance this argument in light of its "conflict" argument (the flaws in which we have addressed (See Section V.E.III)), because the General interpretative headnote to Annex 1A addresses only alleged "conflicts" between the GATT 1994 and the provisions of another Annex 1A agreement, not alleged "conflicts" between two or more Annex 1A agreements other than GATT 1994.

6.89 In advancing its argument, Indonesia relies on a statement made by the panel in the Bananas III case at para. 7.185 of the report.[330] Indonesia argues that the panel ruled that the TRIMs Agreement does not add any new obligations. However, that is not what the Bananas III panel said. While the panel said that the TRIMs Agreement "essentially" interprets Article III and Article XI of GATT 1994, the panel also noted that the TRIMs Agreement clarified those obligations and granted transition provisions. Moreover, the panel's holding simply was that in the context of that particular case, the panel did not need to make a specific ruling under the TRIMs Agreement, because it already had found

[329]As recalled by Indonesia, one of the issues discussed during the negotiations of the TRIMs Agreement was whether the definition of TRIMs should cover subsidies. All the negotiating positions cited in Indonesia's submission correspond to this phase of the negotiations. Eventually, however, no agreement could be reached to prohibit (or otherwise limit the use) of any other TRIMs beyond those already prohibited by Articles III and XI of GATT 1947. In view of that, it was no longer considered necessary to define the notion of TRIMs, with the consequence that the question whether or not to include subsidies in that definition became moot.

It is worth noting that, despite the "lack of consensus" alleged by Indonesia, a majority of the Members which have made notifications under Article 5.1 of the TRIMs Agreement (15 out of a total of 24, according to the European Communities's own estimate) have included therein TRIMs linked to tax and tariff benefits which *prima facie* are subsidies within the meaning of Article 1 of the SCM Agreement. Namely, the list of such Members include Argentina, Chile, Colombia, Costa Rica, Dominican Republic, Egypt, Indonesia (withdrawn), Malaysia, Pakistan, Poland, Romania, Thailand, Uruguay, Venezuela and South Africa. Some of the notified schemes are remarkably similar to the ones at issue in this dispute. For instance, South Africa grants a rebate from an excise tax to motor vehicles which attain a minimum local content (G/TRIMS/N/1/ZAF/1), whereas Venezuela applies a lower import duty on imports of automotive parts and components by car assemblers which meet certain local content requirements (G/TRIMS/N/1/VEN/1).

[330]European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27//R, Report of the Panel, as modified by the Appellate Body, adopted 25 September 1997, para. 7.185.

the measures in question to be violative of Article III:4. That limited holding is far different from holding that the TRIMs Agreement does not, in itself, impose obligations.

6.90 Indeed, the Bananas III panel itself recognized that the TRIMs Agreement reflected a new balance of rights and obligations; namely, a trade-off between the clarification of obligations and the grant of transition periods. An additional trade-off that the panel did not mention was the addition of transparency requirements in the form of the notification provisions in Article 5. For purposes of our Autos dispute, the most important clarification was that "incentive-based" measures, such as Indonesia's local content incentives, are covered.

6.91 As the Appellate Body stated in the Wool Shirts case, page 16, where an agreement reflects a carefully drawn balance of rights and obligations of Members, "[t]hat balance must be respected".[331] Rather than respecting the balance reflected in the TRIMs Agreement, Indonesia would have this Panel ignore it.

6.92 Indonesia's other argument is that the drafting history of the TRIMs Agreement somehow demonstrates that the TRIMs Agreement was not intended to impose a new balance of rights and obligations. This argument, too, is easily disposed of.

6.93 Indonesia cites to a statement made by the United States during the TRIMs negotiations that allegedly demonstrates the subordinate nature of the TRIMs Illustrative List. However, the statement in question was made in the context of a United States proposal that was not adopted, and, thus, is of limited, if any, relevance.

6.94 Second, Indonesia refers to the fact that an issue in the negotiations was whether subsidies could be considered an "incentive" or a "condition for receipt of an advantage" and, thus, subject to the TRIMs Agreement. As discussed previously in connection with Indonesia's "conflicts" argument, the drafting history of the TRIMs Agreement demonstrates: (1) that local content subsidies are covered by the TRIMs Agreement; and (2) that Article 27.3 of the SCM Agreement was added at the last minute to ensure that subsidies permitted by the transitional provisions of the TRIMs Agreement would not be precluded by the SCM Agreement. Indeed, the very fact that Article 27.3 was added to the SCM Agreement demonstrates that the drafters intended that local content subsidies would be covered by the TRIMs Agreement.

6.95 Third, Indonesia refers to a document, "US Paper on WTO Agenda"[332], which states that "[o]ther issues that appear to require additional follow [sic] include: ... the relationship of the TRIMs Agreement with the Agreement on Subsidies and Countervailing Measures." The document was drafted for the so-called "Invisibles Committee" (senior Capital-Based Officials), which functions as an ad hoc and unofficial steering group of sorts. Other participants in the Committee had asked the United States to draft the paper as a means of "kick-starting" a collective assessment of the Singapore Ministerial and the ensuing and continuing work across the spectrum of WTO activities. Thus, the paper was a discussion paper, and was intended to provide a representative mix of Members' actual or perceived thoughts about where the WTO has been and where it ought to go. It definitely was not intended to convey US positions on particular issues.

6.96 With respect to the discussion of the TRIMs Agreement, the paper draws no conclusions about the legal relationships between the agreements cited, nor does it even suggest that there are conflicts among them. Instead, it merely expresses the commonsense and obvious point that in considering the future work of the TRIMs Committee, it might be appropriate to look at how the three agreements

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[331] United States - Measures Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/AB/R, Report of the Appellate Body adopted 23 May 1997, page 19.

[332] US Exhibit 40.

relate to one another given their obvious overlap. Given the views that Indonesia already had articulated in the TRIMs Committee and the SCM Committee, it is hardly surprising that this issue would be identified as one for further discussion. Also, by the time the paper was drafted, there already had been several "sleights of hand" by several Members that were making multiple notifications under the TRIMs and SCM Agreements and then later "withdrawing" some. Because a measure can be both a TRIM and a subsidy in substance, the italicized "Question for Discussion" in the paper appropriately suggests that Members should take a look at all of the notification provisions to see where gaps from one could fill in for another, or where improvements are needed in order to monitor phase-out obligations across agreements.

6.97 Thus, even if this Panel should find incorrectly that Article III:4 of GATT 1994 does not apply to the Indonesian tax and tariff incentives due to an alleged "conflict" with the SCM Agreement, those measures nonetheless violate Article 2 of the TRIMs Agreement.

(b) The Indonesian measures are "trade related investment measures"

6.98 Indonesia also argues that the measures in question do not violate Article 2.1 of the TRIMs Agreement because they are not "investment" measures. In the view of the United States, if a measure described in the Illustrative List of the TRIMs Agreement is being applied, nothing more need be shown to establish an Article 2 violation. If any Member, in whatever context, requires the purchase by an enterprise of a domestic product in order to obtain an advantage, that requirement by definition has investment consequences for such an enterprise, putting the measure within the coverage of the TRIMs Agreement. The United States is unaware of anything in the negotiating history of the TRIMs Agreement that would warrant a different conclusion.

6.99. Moreover, even if the identification of a relationship to an investment were necessary to prove an inconsistency with the TRIMs Agreement, the Indonesian measures in question fulfil such a condition, because they necessitate an investment in Indonesia (either as a producer of motor vehicles or motor vehicle parts) to qualify for the various tax and tariff incentives.

(c) The TRIMs Agreement imposed a new obligation on Indonesia

6.100 Indonesia's argument that because the TRIMs Agreement allegedly merely restates Article III, the TRIMs Agreement does not give rise to a separate obligation, reflects a fundamental misperception of the significance of the TRIMs Agreement. It is true that, to an extent, the TRIMs Agreement codifies the GATT 1947 panel jurisprudence concerning Article III:4 arising out of such cases as Italian Tractors, EC Parts and Components, and FIRA. However, because panel decisions were not, and are still not, stare decisis, Indonesia was not bound by this jurisprudence. Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, pages 14-16. By signing the WTO Agreement, Indonesia did become bound by this jurisprudence, as codified in the TRIMs Agreement. Thus, the TRIMs Agreement imposed a new obligation on Indonesia.

(d) The notion of *lex specialis* is irrelevant in this case with respect to the relationship between Article III and the TRIMs Agreement

6.101 Insofar as the issues in this dispute are concerned, because Indonesia did not notify the measures in question pursuant to Article 5.1 of the TRIMs Agreement, there are no conflicting obligations between Article III and the TRIMs Agreement. Thus, the notion of *lex specialis* is irrelevant.

6.102 Having said that, however, the United States should note that in the *Bananas III* case, the Panel found, at para. 7.158, that in the absence of a "conflict" between GATT 1994 and the TRIMs Agreement, both agreements applied equally. This finding would not have been necessary if the Panel had considered that the TRIMs Agreement was *lex specialis* in relationship to GATT 1994.

6.103. More generally, Article III:2, Article III:4, and the TRIMs Agreement each impose legally distinct obligations on Members, and a single measure may be found to be inconsistent with all three.

VII. ARTICLE I:1 CLAIMS

A. Claims raised by Japan

1. The National Car Programme of February 1996

7.1 **Japan** claims that the National Car Programme of February 1996 (See Section III.A) violates Article I:1 of GATT 1994. The following are **Japan's** arguments in support of this claim:

(a) Article I:1 of GATT 1994 requires immediate and unconditional MFN treatment for imported parts and components

7.2 The National Car Programme introduced in February 1996 accords a special advantage including exemption from customs duty to automotive parts and components imported or to be imported from Korea for use in assembling National Cars. This advantage constitutes a violation of Article I:1 of GATT 1994 which requires the "immediate and unconditional" extension of general most-favoured-nation treatment to imports from member countries relative to the treatment of imports of like products from any other country.

7.3 As the 12 December 1995 letter from the President Director of TPN to the State Minister for the Mobilization of Investment Coordinating Board shows clearly, TPN, which is currently the only National Car producer, has expressed its intention to rely on Kia Motors, Korea. In particular, the President Director of TPN stated plainly that the company applied to obtain approval to "(1) [m]anufacture four-wheeled motor vehicles with the 'TIMOR' brand name at *the KIA Motors Corp., South Korea* factory which are then to be delivered to Indonesia in SKD form with a local production of 65,000 units from 1996, 1997, and 1998; [and] (2) [m]anufacture four-wheeled motor vehicles with the 'TIMOR' brand name at third party's/parties' licensed assembly plant(s) in Indonesia with its primary material imported from overseas (*KIA Motors Corp.*) starting from full-CKD and gradually decreasing by the use of local components/parts with a total production from 1997, 1998, and 1999 of 125,000 units." (Italics added.) The correspondence between the President Director and the State Minister shows that both of them understood that most of the parts and components for assembling national cars in Indonesia would be imported from Korea at least in the initial stages and that they intended to effectuate this understanding. Accordingly, TPN is expected to import many of the parts and components for the purpose of assembling National Cars only from Kia. The preferential treatment for National Cars, including the duty-free treatment of imported parts and components in particular, is likely to lead to benefits for imports of parts and components from Korea, compared with those from other countries.

7.4 Article I:1 of the GATT provides as follows:

> "With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed in the international transfer of payments for imports or exports and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraph 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other parties."

7.5 In EC - Bananas III, a recent WTO panel articulated the following three-part test to determine whether an import measure violates Article I:1:

> [an import measure] is inconsistent with the European Communities' obligations under Article I:1 [if] it constitutes [1] an advantage [2] of the type covered by Article I that is accorded to [products from one country or group of countries] but [3] which is not accorded to like products from all Members ...[333] (emphasis added).

The National Car Programme must be evaluated under the same three-part test. It violates Article I:1 because the customs duty and luxury tax exemptions (1) confers an advantage, (2) of the type covered by Article I:1, (3) to imports of automotive parts and components from Korea but not to imports of like products from other WTO members.

7.6 In addition, Article I:1 requires that MFN treatment be accorded "immediately and unconditionally", but the National Car Programme also violates this requirement.

(b) The National Car Programme of February 1996 in practice grants benefits only to automotive parts and components imported or to be imported from Korea in violation of Article I:1 of the GATT 1994

7.7 The February 1996 Programme grants benefits only to automotive parts and components from Korea. As such, it impermissibly provides advantages to Korean parts and components that are not accorded to parts and components from other WTO Members, in violation of Article 1 (regardless of whether or not the Programme constitutes a subsidy). In addition, such advantages can be accorded to imported parts and components from other countries only if they are for use in National Cars, in violation of the Article I:1 requirement of "unconditional" most favoured nation treatment. The discrimination in practice in favour of parts and components from Korea is precisely the sort of discrimination that preceding panels have long held to be inconsistent with Article I:1.

(1) Indonesia grants benefits solely to imports from Korea

7.8 While National Cars are required to meet certain local content levels, the balance of the parts and components necessary to assemble National Cars is imported. Indonesia provides the sole National Car producer, PT Timor, with the benefits of duty free treatment of such parts and components.

7.9 While there is no reference to Korea or a Korean company in Indonesia's regulations which establish and regulate the National Car Programme, the intended beneficiary of the Programme, PT Timor, has intended, since even prior to the formal establishment of the Programme, to import parts and components for assembly of National Cars only from a Korean company. Even before the initiation of the Programme, the State Minister for the Mobilization of Investment Coordinating Board supported this intent and Indonesia effectuated it through Presidential Instruction No.2/1996.[334] Accordingly, only certain automobile parts and components from Korea are granted duty free treatment, while parts and components from any other country including Japan are not.

7.10 Indonesia also provides a luxury tax exemption for National Cars. On its face, this measure gives advantages to the sales of National Cars. In addition, the luxury tax exemption also indirectly benefits parts and components imported or to be imported from Korea for the purpose of assembling National Cars. The increase of the National Cars' market share, thanks to the luxury tax exemption, would naturally expand sales and profits of Kia. As parts and components for assembly of National

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[333] Report of the Panel on EC - Bananas III, para.7.194.

[334] Letter dated 27 December 1995 from Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board to Mr. Hutomo Mandala Putra, President Director of PT. Timor Putra Nasional (Japan Exhibit 35).

Cars are imported only from Kia, such indirect benefits are to be exclusively granted to Kia's parts and components. Accordingly, only certain parts and components from Korea are granted indirect benefits of the luxury tax exemption, while parts and components from any other country including Japan are not.

(2) The benefits for imports from Korea constitute an advantage that is covered by Article I:1

7.11 The duty free treatment is an "advantage" prohibited under Article I:1 because duty free treatment obviously is an advantage with respect to "customs duties and charges of any kind imposed on or in connection with importation. The luxury tax exemption is also an "advantage" prohibited under Article I:1 because the exemption relates to "internal taxes or other internal charges" that are "matters referred to in paragraph 2 ... of Article III." Accordingly, the first and second part of the EC - Bananas III three-part test are satisfied.

(3) The advantage is not accorded to "like products" from any country other than Korea

7.12 Article I:1 of GATT 1994 obliges the GOI to accord the advantage to "like products" from all WTO Members, not only from Korea.

7.13 With respect to the "likeness", the discussion in terms of Article III should apply with equal force. First, the Report of the Working Party on Boarder Tax Adjustments[335] suggests that the criteria, such as "the product's end users, consumers' tastes and habits, and the product's properties, nature and quality", should be used " for interpreting 'like or similar products' generally in the various provisions of GATT 1947".[336] Also in the Spain - Tariff Treatments of Unroasted Coffee the panel found whether the products in their end-use are "regarded as a well-defined and single product" to be relevant in determining whether they are "like products"[337], for the purpose of Article I:1.

7.14 Under the preceding criteria, parts and components imported from Japan, or any other country, and those imported from Korea for assembly of National Cars constitute "like products" for the purpose of Article I:1. Parts and components from Japan and those imported from Korea for assembly of National Cars are in their end-use regarded as a single product, that is, parts and components for use in the assembly of automobiles. Similarly, automotive parts and components imported from Korea and those imported from Japan and other countries share the same or similar properties, nature and quality. Thus, the third part of the EC - Bananas III three-part test is satisfied.

(4) The advantage is not accorded "unconditionally"

7.15 Article I:1 of GATT 1994 also obliges the GOI to accord all advantages "unconditionally".

7.16 Under Indonesia's Programme, in order to benefit from the duty free treatment and the indirect effect of the luxury tax exemption, parts and components must meet certain prerequisites; i.e., they must be for the assembly of National Cars. Accordingly, the Programme establishes "conditional most-favoured-nation" treatment and, therefore, violates Article I:1.[338]

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[335] Working Party Report on Border Tax Adjustment, para.18.

[336] Report of the Appellate Body on Japan-Alcoholic Beverages II, p.20.

[337] Spain - Tariff Treatment of Unroasted Coffee, L/5135, adopted 11 June 1981 (BISD 28S/102) para. 4.7.

[338] In the 1973 Working Party Report on the "Accession of Hungary," the GATT secretariat stated that "the prerequisite of having a co-operation contract [between the Hungarian government and importing companies] in order [for importing companies] to benefit from certain tariff treatment appeared to imply

(c) The fact that Indonesia's legislation does not explicitly discriminate in favour of Korean products cannot be a defence

7.17 Indonesia may contend that its regulations only establish requirements for preferential treatment, but without preference for any specific country, and, therefore, are consistent with Article I:1.[339] However, this defence cannot prevail for the following reasons.

7.18 First, in the precedent cases, including the Belgian Family Allowances[340], Spain Coffee, and EEC - Imports of Beef from Canada[341] cases, the panels have found that measures are inconsistent with Article I even if they do not explicitly mandate discrimination between countries, as long as they introduce discrimination between countries. In this case, Indonesia's measures obviously have introduced discrimination between Korean products and other countries' products. Moreover, Indonesia established the measures, well knowing that they would have such effects. Therefore, Indonesia's measures appear to intend to discriminate, and in practice do discriminate, between products from those countries.

7.19 In United StatesStandards for Reformulated and Conventional Gasoline, the Appellate Body emphasized the relevance of such "knowledge" in the context of Article III:4 violation:

> In our view, [the failure to mitigate regulatory impact on foreign suppliers] go[es] well beyond what was necessary for the Panel to determine that a violation of Article III:4 had occurred in the first place. The resulting discrimination must have been foreseen, and was not merely inadvertent or unavoidable.[342]

Since the text of Article I:1 is no less stringent than that of Article III:4, the prior recognition and the impact of discrimination should be *prima facie* evidence of an Article I:1 violation. Thus although Indonesia may argue that the pioneer company is free to import from anyone, anywhere, Indonesia obviously knew how the benefits of the programme would be distributed among their trading partners and assisted the execution of the plan. In sum, this is a case of active intervention, which violates the Article I:1 of GATT 1994.

7.20 Second, as discussed, Article I:1 prohibits "conditional" most-favoured-nation treatment. Therefore, even if the regulations set out no preference for any specific country, they are "conditional," and thus inconsistent with Article I:1.

(d) The fact that *only a certain portion of products* from Korea are granted preferential treatment cannot be a defence either

7.21 Indonesia may contend that only a certain portion, or not all, of parts and components from Korea are granted preferential treatment, and that, therefore, the measure is not inconsistent with Article I:1. However, this defence also fails, for the following reasons.

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conditional most-favoured-nation treatment and would, therefore, not appear to be compatible with the [GATT]." (BISD 20S/34) (1974), at 36 para.12 adopted 30 July 1973.

[339] In fact, Indonesia has presented this sort of argument in its replies to questions posed by Japan in the context of the updated subsidies notification. See SUBSIDIES/Replies to Questions posed by Japan concerning the Updating Notification of INDONESIA [G/SCM/Q2/IDN/9] (Japan Exhibit 20).

[340] Belgian Family Allowances, G132 (BISD 1S/59, 2S/18 and 7S/68), adopted 7 November 1952.

[341] EEC - Imports of Beef from Canada L/5099 (BISD 28S/92), adopted 10 March 1981.

[342] Report of the Appellate Body on United States - Standards for Reformulated and Conventional Gasoline (WT/DS2/AB/R) p.28.

7.22 First, the text of Article I:1 requires that any advantage to "any product" originating in any country shall be accorded to the like products from other Members of the WTO. The text does not prohibit advantages only when they are granted to "all products" or "most products" from a particular country. Thus, the GOI's possible contention must fail because it ignores the text of Article I. Indeed the recent WTO panel decision in the EC - Bananas III case confirmed that "Article I:1 obliges a Member to accord any advantage granted to any product originating in any country to the like product originating in the territories of all other Members, in respect [e.g.] of matters referred to in Article III:4."[343]

7.23 Further, the 1989 GATT panel report on US - Section 337 of the Tariff Act of 1930 stated as follows:

> The 'no less favourable' treatment requirement [is] an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given either to other foreign products, under the most favoured nation standard, or to domestic products, under the national treatment standard of Article III .... The 'no less favourable treatment' requirement of Article III:4 [and, by analogy, Article 1.1] has to be understood as applicable to each individual case of imported products.[344]

In the context of the Article III:2 violation, the WTO Appellate Body quoted this language from the Section 337 panel report to support its own conclusion that "dissimilar taxation of even some imported products as compared to directly competitive or substitutable domestic products is inconsistent with the provisions of the second sentence of Article III:2".[345] (Emphasis added.) The same reasoning was followed by other GATT/WTO panels (or Appellate Body) reports including the US Beverages panel which concluded that, with regard to Article III, the fact that only certain domestic products are treated preferentially does not cure an Article III inconsistency. There is no reason to apply a different rule with respect to Article I:1.

2. The Extended National Car Programme of June 1996

7.24 **Japan** claims that the extended National Car Programme of June 1996 (See Section III.A) violates Article I:1 of GATT 1994. The following are **Japan's** arguments in support of this claim:

(a) Indonesia granted benefits solely to imports of CBUs from Korea (i.e., National Cars assembled at the Kia factory in Korea) in violation of Article I:1 of GATT 1994

(1) Indonesia granted benefits solely to imports from Korea

7.25 Indonesia granted the duty free treatment and the luxury tax exemption solely to CBUs (i.e. National Cars assembled at the factory of Kia) imported from Korea.

7.26 Although it is not known whether the application for the authorization specified that the imports came from Korea, in fact all Timor cars imported under the June Programme have come from Kia in Korea, as Indonesia has confirmed. It is not at all adventitious, since Sedan/S515 -1500cc is a copy of Kia's Sephia model and, therefore, no foreign company, other than Kia, may produce the S515. Further, this fact was also easily predictable due to the statement in the 12 December 1995 letter of the president director of TPN to the State Minister for the Mobilization of Investment

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[343] Report of the Panel on EC - Bananas III, para. 7.194.

[344] United States - Section 337 of the Tariff Act of 1930, L/6439 (BISD 36S/345), paras. 5.11, 5.14, adopted 7 November 1989.

[345] Report of the Appellate Body on Canada - Periodicals, page 28.

Coordination Board. This letter stated that TPN wished to "manufacture four-wheeled motor vehicles with the 'TIMOR' brand name at *the KIA Motors Corp., South Korean* factory which is then to be delivered to Indonesia in SKD form ..." (italics added) in the initial three years and, therefore, substantial production or involvement of Kia at least at the initial stage was expected from the outset.

(2) Indonesia violates Article I:1 of the GATT 1994

7.27 As discussed with regard to the "February 1996" Programme (Section VII.A.1), the duty free treatment and luxury tax exemptions are advantages accorded only to imports (in this case, imported CBUs) from Korea but not to imports (of CBUs) from Japan or any other country. As Indonesia admitted, the status of a "pioneer" company is not granted automatically. Indeed after over one and a half years, PT Timor is still the only company which has been granted this privileged status. It is even conceivable that PT Timor will remain the exclusive beneficiary of the Programme, because it is hard to imagine that there will be many "National" cars, granting unconditionally most favoured treatment to all trading partners in the end. In light of the magnitude of the privilege, it is difficult to believe that the present status is merely accidental. In addition, the fact that the 25 per cent counter-purchase requirement is imposed, which inherently limits the number of qualified exporting companies or countries, is expected to bring benefits only to the Korean company or Korea. Thus, this discriminatory treatment clearly constitutes the violation of Article I:1 of the GATT 1994. The arguments made in the context of the February 1996 Programme (See Section VII.A.1) are equally applicable to the advantages given to the imports of CBUs from Korea.

(b) The fact that the previous authorization has expired cannot be a defence

7.28 Indonesia may contend that the authorization made in June 1996 expired on 30 June 1997 and, therefore, the Government of Japan has no legal interest in contesting this authorization.

7.29 However, Presidential Decree No.42/1996 remains in effect. (See Section X). Indonesia may designate other models to be imported as National Cars, under Presidential Decree No.42/1996. Further, at least one more vehicle model manufactured by Kia has been reported to be included in the National Car programme and to be eligible to receive authorization for importation as a National Car. On 5 November 1996, Kia announced in Seoul, Korea that "the company plans to manufacture 50,000 utility vans a year in Indonesia beginning in 1998. 'After discussions with our joint venture partner PT Timor Putra Nasional and the Indonesian Government, we have agreed to include production of utility vans in Indonesia's national-car project,' Kia's Executive Vice President Kim Seung-ahn said." A PT Timor spokesman confirmed that "Yes, we do have such a plan and I think it will be included (in the national car programme)."[346] In May 1997, Mr. Soemitro Soerachmad, chief executive of PT Timor's distribution subsidiary, said "'the company [PT Timor] had agreed with Kia Motors of South Korea to import the Sportage, a small sport utility vehicle, from early 1998.'... . The Sportage, a lightweight sports utility vehicle, called the J520i in Indonesia, will ..... qualify for the same tax and tariff breaks enjoyed by the Timor ... . However, Mr. Soemitro indicated early batches of the new model might have to be imported from Korea in completely built-up form pending completion of a new plant."[347] Therefore, the Government of Japan faces a tangible threat of further, renewed harm by reason of Indonesia's standing regulations.

7.30 Moreover, some preceding panels have examined measures and presented complete reports even though the relevant measures were terminated during the panel process, even prior to the

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[346] The Indonesian Observer, "PT Timor plans to manufacture utility vans", 6 November 1996, (Japan Exhibit 54).

[347] Financial Times, "Jakarta Plans New National Car", May 1997 (Japan Exhibit 55).

formation of the panel.[348] Therefore, the fact that the authorization made in June 1996 expired on 30 June 1997 is irrelevant to this proceeding.

B. Claims Raised by the European Communities

7.31 The **European Communities** claims that the following measures are inconsistent with Indonesia's obligations under Article I:1 of GATT:

(1) the exemption from customs duties on imports of National Cars;

(2) the exemption from the Sales Tax on Luxury Goods for imported National Cars;

(3) the exemption from the Sales Tax on Luxury Goods for National Cars assembled in Indonesia; and

(4) the exemption from customs duties on imports of parts and components for the assembly of National Cars in Indonesia.

7.32 The following are the **European Communities'** arguments in support of these claims:

7.33 Article I:1 of GATT is expressed as follows:

> With respect to customs duties and charges of any kind imposed on or in connection with importation ... and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating ... in any other country shall be accorded immediately and unconditionally to the like product originating in .... all other contracting parties.

1. Measures concerning the importation of National Cars

7.34 Exemptions (1) and (2) infringe Article I:1 because they provide an "advantage" which de facto benefits only imports of motor vehicles of the Kia brand originating in Korea, to the exclusion of imports of "like" motor vehicles originating in other Members.

(a) The measures provide "advantages" covered by Article I:1 of GATT

7.35 GATT Article I:1 applies, *inter alia*, to any advantage granted by a Member "with respect to customs duties ... imposed on or in connection with importation ....". Accordingly, the exemption from customs duties on imports of National Cars is a measure covered by Article I:1.

7.36 Article I:1 of GATT also applies to any advantage granted with respect to "all matters referred to in paragraph 2 ... of Article III". Article III:2 refers to "internal taxes or other internal charges". As shown above, the Sales Tax on Luxury Goods is an "internal tax" within the meaning of Article III:2. Therefore, the exemption from the Sales Tax on Luxury Goods is also an advantage covered by Article I:1.

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[348] EEC Measures on Animal Feed Proteins, L/4599, adopted 14 March 1978 (BISD 25S/49); See also, United States - Prohibition of Imports of Tuna and Tuna Products from Canada, L/5198, adopted on 22 February 1982 (BISD 29S/91).

(b) The cars covered by the measures are "like" other cars

7.37 As shown above, the definition of "National Cars" is not based on any factor which may affect *per se* the physical characteristics of those cars or their end uses. Consequently, in principle National Cars imported from Korea are "like" any motor vehicle imported from other Members.

(c) The measures benefit only and exclusively imports of Kia cars originating in Korea

7.38 Article I:1 of GATT does not prohibit only measures which discriminate formally and openly according to the country of origin of the imported goods. Measures worded in generally applicable, origin neutral terms have also been found to infringe Article I:1 in instances where de facto they benefited only or mainly imports from a certain Member. This has been recently confirmed by the Appellate Body in EC - Regime for the Importation, Sale and Distribution of Bananas, where it stated that:

> Articles I and II of the GATT have been applied, in past practice, to measures involving 'de facto' discrimination .[349]

7.39 As examples of that practice, the Appellate Body referred to the Panel reports on Spain - Tariff treatment of Unroasted Coffee[350]; EEC - Imports of Beef from Canada[351]; and Japan - Tariff on Imports of Spruce-Pine-Fir (SPF) Dimension Lumber[352].

7.40 Presidential Decree 42/96 has been carefully drafted so as to avoid any appearance of discrimination among Members. On paper, Presidential Decree 42/96 allows Pioneer Companies to

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[349] Appellate Body Report on EC - Regime for the Importation, Sale and Distribution of Bananas , adopted on 25 September, WT/DS 27/AB/R, para 232.

In the same report, the Appellate Body affirmed the Panel's findings that the "operator category rules", the "activity function rules" and the "hurricane licence rules" applied by the Community in order to allocate licences for importing bananas under a tariff quota violated the Most-Favoured-Nation obligation contained in Article II of GATS because in respect of each of those measures a majority of the service suppliers of ACP origin fell within the "more favoured" category of suppliers and/or a majority of the "like" suppliers of the Complainants' origin were found in the "less favoured" category. In reaching this conclusion, the Appellate Body rejected an argument by the Community to the effect that the measures pursued a "legitimate policy" and were not "inherently discriminatory". According to the Appellate Body, the "aims" of a measure are not "relevant" in order to establish whether it affords de facto Most-Favoured-Nation treatment (at paras. 240-248).

[350] In Spain - Tariff Treatment of Unroasted Coffee (adopted on 11 June 1981, BISD 28S/102, 111-112). the Panel concluded that by applying different tariff rates to different varieties of coffee which had been previously found to be "like", Spain had infringed its obligations under Article I:1 The Panel noted that the complainant, Brazil, exported to Spain mainly those varieties that were subject to higher import duties. Thus, even if the application by Spain of different tariff rates to different coffee varieties was formally origin neutral, imports from Brazil were discriminated de facto vis-à-vis imports from other countries that exported mainly the varieties subject to the lower duty rates.

[351] In EEC - Imports of Beef from Canada (adopted on 10 March 1981, BISD 28S/92, 113) the Panel examined a tariff concession for high quality beef granted by the Community during the Tokyo Round. The Panel did not consider necessary to judge whether the terms of the concession were in themselves discriminatory. The Panel limited itself to note that a regulation implementing the concession required a certificate of authenticity issued and endorsed by one of the authorities included in an annex to that regulation. The annex in question listed only a US agency, it being specified that this agency was empowered to certify only meat of US origin. In light of this, the Panel concluded that the measures at issue

"...in their present form had the effect of preventing access of like products from other origin than the United States, thus being inconsistent with the most favoured nation principle in Article I of the General Agreement" [emphasis supplied] (at para 4.10).

[352] Japan - Tariff on Imports of Spruce-Pine-Fir (SPF) Dimension Lumber, adopted on 19 July 1989 BISD 36S/167.

import duty free and tax free National Cars from any country in the world. De facto, however, all the cars which have so far benefited from Presidential Decree 42/96 were of Korean origin. This is not fortuitous. Presidential Decree 42/96 was conceived and applied from the outset by the Indonesian authorities with the deliberate and sole purpose of permitting the importation duty free and tax free by PT TPN of Kia cars made in Korea only, and no other cars.

7.41 The Indonesian authorities have acknowledged publicly that it is their policy to reserve the benefits of the National Car Programme exclusively for PT TPN. At a press conference held on 15 March 1996, Indonesia's Minister of Industry and Trade, Mr. Tunky Ariwibowo, announced the Indonesian Government's policy of reserving the benefits of the National Car Programme for PT TPN. Since then, this policy has been reiterated by Mr. Ariwibowo and other senior officials on many occasions.[353] That policy is confirmed by the fact that, as of date, PT TPN remains the only company which has been granted Pioneer status, even though other Indonesian car producers have also requested that status. Thus, in practice, Presidential Decree 42/96, even if drafted in generally applicable terms, had but a single addressee and beneficiary: PT TPN.

7.42 The decision of the Indonesian authorities to reserve the benefits of the National Car Programme for PT TPN entailed also a conscious, even if not explicit, decision by those authorities to grant the benefits provided by Presidential Decree 42/96 only with respect to imports of cars manufactured by Kia in Korea.

7.43 When adopting Presidential Decree 42/96, the Indonesian authorities could not have ignored that PT TPN would take advantage of that measure in order to import exclusively motor vehicles made by Kia in Korea. In particular, since they well were aware that:

- Mr Hutomo Mandala Putra, the owner of PT TPN, had set up a joint venture with Kia for the assembly of Kia cars in Indonesia already in 1993;

- the first National Car which PT TPN planned to assemble in Indonesia (the Timor S-515) is a version of an already existing Kia model, the Sephia;

- Kia's main operating facilities for the assembly of the Sephia are located in Korea.

7.44 Indeed, there is evidence in the record showing that Presidential Decree 42/96 was adopted in response to a precise request from PT TPN to be allowed to import specifically motor vehicles manufactured by Kia in Korea, and no other kind of motor vehicles. As discussed in the factual part, in a letter dated 12 December 1995, PT TPN asked the approval of the Indonesian authorities for *inter alia*:

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[353] "Indonesia backs its Trade Policy for Auto Makers", Asian Wall Street Journal, Jakarta, 18 March 1996 (EC Exhibit C-1); "Jakarta's tax breaks for car firm unfair: Japan", The Strait Times, Singapore, 24 March 1996 (EC Exhibit C-2); "The prospects for national cars", Business News, Jakarta, 18 April 1996 (EC Exhibit C-3). "Govt not to grant incentives for Bimantara cars", The Jakarta Post, Jakarta, 1 June 1996 (EC Exhibit C-4); "Another Suharto son launches Indonesia car", Reuters, Jakarta, 23 July 1996 (EC Exhibit C-7); "National car plan presses on in Indonesia", Financial Times, 9 July 1996 (EC Exhibit C-6); "Bimantara's request for car policy review refused", The Jakarta Post, Jakarta, 6 June 1996 (EC Exhibit C-5); "Only one car firm to get protection", The Jakarta Post, Jakarta, 15 November 1996 (EC Exhibit C-8); "Only one car firm to get protection", The Jakarta Post, Jakarta 15 November 1996 (EC Exhibit C-8); "Indonesia backs its Trade Policy for auto makers" Asian Wall Street Journal, 18 March 1996 (EC Exhibit C-1); "Only one car firm to get protection", The Jakarta Post, Jakarta, 15 November 1996 (EC Exhibit C-8).

1. Manufacture four wheeled motor vehicles with the “TIMOR” brand name at the Kia Motors corp., South Korean factory which is then to be delivered to Indonesia in SKD form [..].

3. Import vehicles in SKD resulting from production referred to in point 1 using domestic (Indonesian) components/parts exported to the Kia Motors Corp. plan with exemption of Import Duty, Additional Import Duty and Tax on Luxury Goods (Ppn BM) for such vehicles.

7.45 The subsequent implementation of Presidential Decree 42/96 provides further confirmation that this measure was devised with the exclusive purpose of permitting the importation duty free and tax free by PT TPN of cars manufactured by Kia in Korea.

7.46 On 7 June 1996, PT TPN was authorised on the basis of Presidential Decree 42/96 to import 45,000 cars. This authorization remains to date the only one issued pursuant to Presidential Decree 42/96. The authorization specifies the "kind/type" of the cars to be imported in the following terms: “sedan S/515 - 1500 cc”. The technical specifications of the S-515 are the same as those of Kia’s model “Sephia”. Thus, even if the authorization did not direct expressly PT TPN to purchase the cars from any particular source, it was implicit in its terms that it covered only cars made by Kia in Korea.

7.47 In light of the above considerations, it comes as no surprise that each and every one of the 39,727 cars imported by PT TPN under Presidential Decree 42/96 as of 30 June 1997, the date on which the aforesaid authorization expired, were manufactured by Kia and imported from Korea.

2. Measures concerning the assembly of National Cars in Indonesia

7.48 Exemptions (3) and (4) violate Article I:1 of GATT because they provide an “advantage” which de facto benefits mainly, if not exclusively, imports of parts and components originating in Korea, to the detriment of imports of “like” parts and components from other Members.

(a) The measures provide “ advantages” covered by Article I:1 of GATT

7.49 As discussed, GATT Article I:1 applies to any advantage granted by a Member with respect to the imposition of customs duties on or in connection with the importation of goods. Thus, the exemption from customs duties on imports of parts and components for the assembly of National Cars is an “advantage” covered by Article I:1.

7.50 Article I:1 also applies to any advantage granted with respect to “all matters referred to ... in paragraph 2 ... of Articles III”. The Sales Tax on Luxury Goods is an internal tax and, therefore, a “matter” referred to in Article III:2. The exemption from that tax of the sales of National Cars assembled in Indonesia represents an “advantage” not only for the National Cars as such but, indirectly, also for the parts and components assembled therein. That indirect “advantage” is also covered by Article I:1.

(b) Parts and components made in South Korea are “like” other parts and components

7.51 The mere fact of being manufactured in Korea does not confer to parts and components any specific physical characteristics or end uses which make them “unlike” parts and components manufactured elsewhere.

(c) The measures will benefit mainly, if not exclusively, imports of parts and components from South Korea

7.52 The first National Car to be assembled in Indonesia by PT TPN (the Timor S-515) is but a re-badged replica of Kia's model Sephia. Most of the parts and components assembled by Kia into its model Sephia are manufactured in Korea by Kia itself or its affiliates or by independent part makers linked to Kia by long standing supply relationships.

7.53 For PT TPN, it would make no commercial sense to try and import the parts and components for assembling the Timor S-515 from other suppliers established in third countries. This was already anticipated by PT TPN in its letter of 12 December 1995, in which it requested the approval of the Indonesian authorities for:

> 2. Manufacture four-wheeled vehicles with the "TIMOR" brand name at third party's/parties licensed assembly plant(s) in Indonesia with its primary material imported from overseas (Kia Motors Corp.) starting from full-CKD and gradually decreasing by the use of local components [...]

7.54 As a result, de facto the tariff and tax benefits for the assembly of National Cars in Indonesia will benefit predominantly, if not exclusively, imports of parts and components originating in Korea, thereby infringing Article I:1 of GATT.

C. Claims Raised by the United States

7.55 The **United States** claims that Indonesia's exemption of CBU Kia Sephia sedans imported from Korea from import duties and the luxury tax violates Article I:1 of GATT 1994. The following are the **United States'** arguments in support of this claim:

7.56 Under Presidential Decree No. 42/1996, "national motor vehicles" produced abroad were "granted the same treatment as that of national automobiles produced in Indonesia". This meant that CBU Kia Sephia sedans could be imported from Korea without being subject to (a) the 200 per cent tariff on imported CBU passenger cars; and (b) the 35 per cent luxury tax. This preferential treatment accorded to motor vehicles imported from Korea violates Article I:1 of GATT 1994.

7.57 Article I:1 provides, in pertinent part:

> With respect to customs duties and charges of any kind imposed on or in connection with importation ... and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation ..., and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in ... any other country shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties.

7.58 The exclusive exemption from the 200 per cent tariff and the 35 per cent luxury tax of Kia Sephia sedans imported from Korea clearly constitutes an "advantage, favour, privilege or immunity" within the meaning of Article I:1 that is not "accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties". Imports of CBU passenger cars that are "like" the Kia Sephia are ineligible for the same treatment. Instead, they are put at a competitive disadvantage by being subject to the 200 per cent tariff and the 35 per cent luxury tax. As such, this exemption violates Article I:1.

7.59 Indonesia has gone on record as asserting that this tariff and tax exemption does not violate Article I:1 "because it does not direct recipients of the subsidy to import automobiles from any particular country. Private parties designated as national car companies are free to import qualifying automobiles from any country".[354]

7.60 This attempted justification of such a blatantly WTO-inconsistent measure is disingenuous, at best. At the time Presidential Decree No. 42/1996 was issued, the Government of Indonesia already had approved the Kia Timor joint venture as the sole producer of a "national motor vehicle" and the sole beneficiary of benefits under the National Motor Vehicle programme. This project called for the production/assembly in Indonesia of Kia Sephia sedans, to be renamed the Timor S515 and S515i sedans. Indeed, Indonesia has claimed that it will not extend "national motor vehicle" benefits to any other vehicle to be produced by the Kia Timor joint venture.[355] Therefore, there was one car, and only one car, that could be imported as a "national motor vehicle", and that was a Korean car, the Kia Sephia sedan.

7.61 Moreover, the Government of Indonesia provided the one-year exemption from import duties and the luxury tax to facilitate the production/assembly in Indonesia of the Timor Kia Sephia sedan. As stated by the Minister of Industry and Trade: "This aims at accelerating the production process of Timor so that [the car] can quickly enter the market. The government gives PT Timor Putra Nasional a period of 12 months, from June 1996 through June 1997, to assemble the cars in Kia's factory in Korea."[356]

7.62 In light of this, it simply is incredible to claim, as does Indonesia, that private parties, either TPN or Kia Timor, were "free to import qualifying automobiles from any source". The objective of the one-year tariff and tax exemption on imported "national motor vehicles" was to facilitate the entry into the Indonesian market of the Timor Kia Sephia sedan - the only designated "national motor vehicle" at the time. This objective could not have been accomplished if Kia Timor or TPN were free to import any vehicle from any source they chose, such as an Opel Optima or a Ford Escort. Therefore, in reality, only Kia Sephia sedans from Korea were eligible for the preferential treatment accorded by Presidential Decree No. 42/1996.

7.63 Indeed, this case is analogous to the EEC Beef case, in which the panel found a violation of Article I in a situation where "exports of like products of other origin than that of the United States were in effect denied access to the European Communities market considering that the only certifying agency authorized to certify the meat ... was a United States agency mandated to certify only meat from the United States".[357] Just as only USDA-certified beef was eligible for access to the European Communities market in EEC Beef, in the instant case, the only motor vehicle "certified" for tariff- and tax-free treatment under Presidential Decree No. 42/1996 was the Kia Sephia sedan from Korea.

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[354] G/SCM/Q2/IDN/9 (23 May 1997), p. 3.

[355] In responding to a question under the Annex V procedure, Indonesia stated, "[T]he Government does not intend to grant National Car benefits to PT. Timor Putra Nasional ('TPN') for other models". (AV/14, p.4, Question #10(a)) and "In accordance with Manufacturing Licence for TPN, TPN also plans to produce or and assemble Timor commercial cars (Category I and IV). However, the Government of Indonesia maintains its position that the only national car produced in Indonesia is the S515i model sedan." (AV/16, p.3, Question #12/28(b)).

[356] "Indonesia's 'National Car' to Be Built in S. Korea", The Reuter Asia-Pacific Business Report, 5 June 1996 (US Exhibit 14, pp. 62-63).

[357] "EEC - Imports of Beef from Canada, L/5099, Report of the Panel adopted 10 March 1981, BISD 28S/92, para. 4.2(a).

D. Indonesia's response to the claims raised under Article I:1 of GATT 1994

7.64 The following are **Indonesia's** arguments in response to the claims raised under Article I:1 of GATT 1994:

1. The June 1996 Programme expired 30 June 1997, so there can be no present violation of Article I of GATT 1994

(a) The legal authority for the June 1996 Programme expired on 30 June 1997

7.65 By its terms, the June 1996 programme was a one-time, one-year programme. Article 2 of Decree of the President No. 42/1996 (4 June 1996) [358], which provided the underlying authority for the programme, declared expressly:

> The equal treatment contemplated in Article 1 is only granted once for a maximum period of one year and for amounts stipulated by the Minister of Industry and Trade. (Emphasis added.)

The limitation to a one-time, one-year grant is reaffirmed in Decree of the Minister of Industry and Trade No. 142/MPP/Kep/6/1996 (5 June 1996), which implemented the Presidential Decree.[359] Article 1 thereof states:

> Within the framework of preparations the production of national cars can be carried out overseas for a one-time maximum period of 1 (one) year on the condition that Indonesian made parts and components are used. (Emphasis added.)

7.66 These limitations are reflected in the authorization for TPN to import Timor S515 sedans under authority of the June 1996 programme. The "Recognition of Registered Importer/Sole Agent (IT/AT)," file number 1410/MPP/6/1996, signed by the Minister of Industry and Trade on 7 June 1996, notes in its title that it is valid through 30 June 1997.[360] It includes the following limitation in paragraph 1 of its terms and conditions: "Only to import a total of 45,000 units of sedan with importation period limited to 30 June 1997" (emphasis added).[361]

7.67 On 30 June 1997, the legal authority for the June 1996 programme expired as scheduled and the importation authority provided by "Recognition" number 1410/MPP/6/1997 ceased to be valid.[362] No comparable programme has been or will be authorized. Therefore, not only did the imports which Complainants claim violate Article I of the General Agreement cease over four-and-one-half months ago, there is no legal authority under which they could resume. The June 1996 programme has ended and, as demonstrated below, has no relevance to these proceedings.

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[358] Indonesia Exhibit 6.
[359] Indonesia Exhibit 7.
[360] Indonesia Exhibit 13.
[361] Indonesia Exhibit 13.
[362] Id.

(b) Because the programme and the authority under which it was granted have terminated, there is no basis for an affirmative determination by the Panel

7.68 Article 19.1 of the DSU provides that:

> [w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. (Footnote omitted.)

Article 3.7 of the DSU confirms that this forward-looking remedy - elimination of an inconsistent measure - is the only WTO-consistent remedy. (Compensation is expressly recognized as "a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement.")

7.69 The measure has been eliminated because the June 1996 programme and the legal authority under which it was granted expired on 30 June 1997. Therefore, even if the measure had been inconsistent with a provision of the WTO (which Indonesia does not accept), there is nothing further to remedy. Under such circumstances, it would be inappropriate for the Panel to do more than note the expiry of the programme and declare that no determination is warranted as to the claimed inconsistency of the expired programme.

(c) Prior Panel decisions support the refusal to rule on an expired measure

7.70 In Thailand-Restrictions on Importation of and Internal Taxes on Cigarettes (7 November 1990), BISD 37S/200, the complaint included allegations regarding an excise tax and a business and municipal tax. Prior to the panel's decision, Thailand issued regulations applying a single excise tax rate for all cigarettes (imported and domestic) and removing cigarettes from the products subject to the business and municipal tax. Even though the underlying authority to reimpose discriminatory taxes remained in effect, the panel concluded that the current regulations were consistent with Thailand's GATT obligations. The mere fact that by subsequent regulation Thailand conceivably could reintroduce taxes that discriminated against imports was insufficient to warrant a ruling of inconsistency. (See id. paras. 84-86 and 88 at pp. 227-28.)

7.71 In Thai Cigarettes the fact that the measures as they existed at the time of the panel's decision were not inconsistent with the General Agreement was sufficient to warrant a negative ruling by the panel. In the instant case, the June 1996 programme has ended and the very authority under which it was promulgated has expired.

7.72 The decision of the 1989 panel in Chile's complaint with respect to EEC - Restrictions on Imports of Dessert Apples (22 June 1987), BISD 36S/93, also is instructive. Chile urged the panel to rule that the European Communities should offer compensation to Chile because a ruling that the measures should be withdrawn would be meaningless because the measures had lapsed. The panel refused to make a finding of "retroactive prejudice" and to recommend compensation. (See id. para. 12.35 at p. 137.)[363]

7.73 In sum, prior panel decisions also support the conclusion that where, as here, a programme and its underlying legal authority have expired, the panel should declare that no decision on the merits of the alleged inconsistency with Article I of the General Agreement is appropriate.

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[363] The Government Procurement panel in Norway-Procurement of Toll Collection Equipment for the City of Trondheim (13 May 1992), GPR/DS2/R, reached the same conclusion. See id., paras. 4.17-4.26.

2. Indonesia has not violated Article I of GATT 1994 because it did not grant an advantage to automobiles or parts originating in one country that it did not accord to like products originating in other countries

(a) Indonesia did not grant an advantage to automobiles or parts originating in one country

7.74 Complainants concede that nothing in the regulations or decrees establishing either the February 1996 or the June 1996 programmes[364] mandates preferential treatment of automobiles, components or parts from any particular country.[365] Decree of the State Minister for the Mobilisation of Investment Funds No. 01/SK/1996 (27 February 1996)[366] expressly states that a national car producer has the freedom to determine the sources of technology and of components and parts. Further, the 7 June 1996 "Recognition of Registered Importer/Sole Agent (IT/AT)," file number 1410/MPP/6/1996, the document in which one would most expect to find such direction, contains no such limitation.[367] Indeed, there is nothing in the Recognition (or in any other official document) that even implies such an intention.

(b) That TPN made a commercial decision, without government involvement, to enter into a commercial relationship with a particular company does not constitute a de facto violation of Article I

7.75 Every automotive company around the world makes corporate decisions as to its suppliers, some of which are located in different countries. The mere fact that a company like TPN receives a subsidy does not constitute a de facto violation of Article I of the General Agreement. TPN is free to import automobiles, components and parts from whatever sources it chooses. In all of the panel reports cited by Complainants, the responding government had established a legal structure which in fact compelled or led to a particular result.

7.76 In Spain-Tariff Treatment of Unroasted Coffee (11 June 1981), BISD 28S/102, the government's differential tariff treatment of "mild" coffee and other varieties of coffee was found to be discriminatory. In European Economic Community-Imports of Beef from Canada (10 March 1981), BISD 28S/92, the only agency authorized by the European Communities regulation to certify beef as high-quality beef was a United States Government agency the mandate of which was limited to certification of United States beef. Also, Japan miscites the Reformulated Gasoline case[368] as standing for the proposition that measures violate Article I if they "introduce" discrimination. This characterization is incorrect. Rather, the decision declares that United States authorities must have foreseen that the two separate regulatory regimes that they had established were discriminatory.

7.77 In each of the three above-cited cases, despite the absence of explicit discrimination, a particular result was mandated by government action. In none of them was the choice of supplier made by the private-party recipient of the subsidy found to constitute government-mandated de facto discrimination.

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[364] As demonstrated in Section III, above, there can be no violation of Article I with respect to the June 1996 programme since it expired on 30 June 1997. However, even if the programme were still in effect (which it is not), it would not be inconsistent with Article I for the reasons set out in this section.

[365] See Sections VII.A and B. See also Indonesia's Statement to the Committee on Subsidies and Countervailing Measures in response to questions posed by Japan (G/SCM/Q2/IDN/9 (23 May 1997) at p. 3).

[366] Indonesia Exhibit 4.

[367] Indonesia Exhibit 13.

[368] Report of the Appellate Body, United States-Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R (29 April 1996).

7.78 Even if certain Government officials were aware of TPN's corporate intention to use Kia as a supplier, the legal structure of the national car programme did not compel or lead to this private-party decision or to imports from Korea. The essential fact remains that a private-sector choice, not government direction, was the reason why there were imports from Korea. Such a private choice is not within the scope of Article I of the General Agreement.

(c) The Timor S515 and components and parts imported for it are not "like" any passenger vehicles, components or parts imported from the territories of complainants

7.79 The "like product" concept is used in several GATT articles. As confirmed by drafting history, precedent and legal scholars, the meaning of the phrase depends on the context in which it appears. With regard to its use in Article I, the world's leading GATT scholar, Professor John Jackson, states:

> [T]here were scattered discussions in the preparatory meetings that yielded some illustrations of the meaning of like products, particularly as used in the MFN clause. At one point it was asked whether "all cereals would be considered 'like products' or only wheat?" and an answer given was that only wheat "would be considered as a 'like product.'" At a later conference, it was asked whether autos under 1,500 kilograms would be like products to those over 1,500 kilograms, in the case of a tariff classification that drew this distinction, and the inquirer was assured that this would not be the case.
>
> The term "like products," as used in Article I (MFN), can probably be considered in the light of the above preparatory concepts.[369]

7.80 The narrow scope of the "like product" concept in Article I is emphasized by The Australian Subsidy on Ammonium Sulphate and the EEC - Measures on Animal Feed Proteins panel reports, which note that, unlike Article III:2, in which effects on both "like products" and "directly competitive or substitutable products" are relevant, the MFN obligation of Article I is limited to "like products".[370]

7.81 Passenger vehicles are highly differentiated; numerous physical and nonphysical characteristics determine each model's properties, nature and quality and, thus, consumers' tastes, habits and preferences. These defining characteristics include quality, reputation, price, ride and comfort, standard features, safety features, available options, exterior size, interior space, engine size, technology, fuel type and fuel efficiency. Complainants have failed to establish that there is any "like product" to the Timor S515 in their unsuccessful efforts to establish serious prejudice, and they must also fail in the context of Article I. There simply is no car that matches the requisite physical and nonphysical characteristics of the Timor S515 to be considered a "like product" to it.

7.82 The same failing is true with regard to Complainants' arguments regarding automotive components and parts. Government experts have calculated that 93 per cent (by value) of the components and parts of the Timor are tailor-made to the specifications of that brand. The same is true (likely with slight variations in the percentage) with respect to all brands and types. (One does not and cannot, for example, use GM components in BMW sedans or Mercedes components in

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[369] John Jackson, World Trade and the Law of GATT (1969) § 11.4 (emphasis added)(footnotes omitted).

[370] Report of the Working Party on The Australian Subsidy on Ammonium Sulphate (3 April 1950), BISD II/188 (para. 8 at p. 191). Report of the Panel on EEC - Measures on Animal Feed Proteins (14 March 1978), BISD 25S/49 (para. 4.20 at p. 68).

Toyota sedans.) Tailor-made components and parts that cannot be used in other makes and models are not "like products". Indeed, they are not even "directly competitive or substitutable". Thus, for assembled Timors and Timor components and parts, there can be no violation of GATT Article I since there are no "like products" which are discriminated against.

3. The June 1996 Programme was a subsidy that expired and, therefore, there is no violation of Article I of GATT 1994

(a) The June 1996 Programme Has Expired and Will Not Be Renewed

7.83 As Indonesia has stated *ad nauseam*, the June 1996 Programme has expired and will not be renewed. One would think these statements would suffice. But Japan, ignoring Indonesia's numerous, direct pronouncements, insists that, during the consultations, Indonesia stated that the "June 1996 Presidential Decree 'is still in effect …'". Well, of course that is what Indonesia said. All of the consultations occurred well before 30 June 1997, the date the measure terminated. The June 1996 subsidy has ended and all of Complainants' argumentation regarding it is moot.

(b) As to Unsold Timors, the Fact That the Luxury Tax Is Not Forgone Until Sale Is a Subsidies Agreement Issue, Not an Article I Issue

7.84 In June 1996, pursuant to Presidential Decree No. 42/1996[371] ,TPN received a one-year subsidy for national cars made overseas. This treatment was necessary because TPN needed to import built-up Timors to establish the required marketing network and introduce a national car to the Indonesian buying public prior to the time that domestic production feasibly could begin.

The policy contained one quantity and two temporal limitations:

- the subsidy was granted only for the quantity of autos specified by the Minister of Industry and Trade (45,000 units);
- the subsidy was limited to one year; and
- the subsidy was granted only once.

7.85 Complainants accurately repeat Indonesia's report that not all of the Timors imported under the June 1996 subsidy have yet been sold.[372] They note that the Government does not forgo the luxury tax until each car is sold. This also is true.

7.86 The problem with complainants' arguments is that they fail to accept that the June 1996 measure is a subsidy. Thus, regardless of whether or not it still is in effect (it is not in effect), it is a subsidy and, as such, is subject to the Subsidies Agreement, not Article I.

7.87 **Indonesia**, in response to a question from the panel, subsequently further argued as follows regarding the process of importation and customs clearance[373]:

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[371] Indonesia Exhibit 6. See also Decree of the Minister of Industry and Trade No. 142/MPP/Kep/6/1996 (Indonesia Exhibit 7), dated 5 June 1996 and, per Article 5 thereof, effective on that date. This decree was published promptly in the State Gazette, as is true regarding all decrees of the Minister of Industry and Trade.

[372] The Government's most current data is that, as of 31 October 1997, only 17,507 Timors imported under the subsidy remained unsold.

7.88 Article 2 of Customs Law No. 10/1995[374] provides that a product is considered "imported" when it arrives in the customs territory of Indonesia (i.e. the territory of the Republic of Indonesia). A translation of the relevant sections of the Customs Law is attached.

7.89 The importer of the product is responsible for payment of the appropriate customs import duties, VAT, sales luxury tax, and advance payment of income tax at the moment of importation. In this case, the importer is TPN.

7.90 The importer is entitled to customs clearance upon presentation to the customs authorities of a customs declaration and proof of payment of the duties and taxes owing. Under Article 42 of the Customs Law, this obligation may be satisfied by payment of cash or deposit of security acceptable to Customs. In this case, under authority of Minister of Finance Decree No. 404 and Government Regulation No. 36, TPN was required to deposit a guarantee to cover the value of the customs import duties and luxury sales tax from which it would be exempt if it satisfied the requirements of the National Car Programme. TPN also was obligated to payment, in cash, of the VAT and income tax.

7.91 After importation and before completion of the customs clearance procedure, a product may be kept in "bonded storage". (See Article 44 of the Customs Law.) Bonded storage areas are operated by private entities, the importer or someone else with whom the importer has made a commercial arrangement, but they are under the control of Customs. The private party pays all costs associated with the facility and storage of the goods there. (In this case, then, TPN is incurring all costs associated with storage of the imported CBU's which have not received customs clearance.)

(c) Even if the Panel finds that Article I does apply, TPN, and Not Kia, was the beneficiary of the import duty exemption, the programme was not country-specific and complainants import no like product, so Article I was not violated

(1) TPN, and Not Kia, was the beneficiary of the June 1996 Programme

7.92 As Indonesia has demonstrated, TPN was the beneficiary of the June 1996 subsidy. TPN was the importer of record for all of the Timors. TPN is a 100 per cent Indonesian-owned entity. Kia received no benefit from the Programme, other than being paid by TPN as one of its suppliers. Thus, even if the Panel finds that Article I does apply, no country was “advantaged” or “favoured” within the meaning of Article I.

(2) The June 1996 Programme Was Not Country Specific

7.93 Complainants concede that nothing in the regulations or decrees establishing the February and June 1996 programmes mandates or even expressly provides for preferential treatment of imports from a particular country. They claim, though, that Indonesia’s anticipation that TPN would associate with Kia transforms the otherwise benign Programme into one that violates Article I because the Government, they assert, knew that the benefits would go to Kia, a Korean company.

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[373] **Indonesia** made the following additional arguments on this point: "Also with respect to claims under Article I of GATT 1994, the complainants argued that the June 1996 measures were still in effect because the luxury tax would not be foregone on the unsold cars until they were sold. This is not correct. The tax is due when the duties are due and then the consumer reimburses the company at the time of sale (TPN, of course, was exempt from this requirement). Secondly, TPN failed the Sucofindo audit (See Section X) and, thus, none of the remaining cars will receive the luxury tax exemption. So, even accepting complainants' position, the June 1996 measures have terminated. Thus, the Panel should reject complainants' Article I arguments."

[374] Indonesia Exhibit 50.

7.94 This argument is flawed for many reasons, as a glimpse through the prism of commercial reality makes clear. First, complainants' assertions reduce to the understandable plaint that they lost a contest. TPN could have and likely would have preferred to select any of complainants' producers for this venture, including companies such as Fiat, Renault or Mazda. TPN needs technology and stability in the National Car Programme, two attributes which Kia lacks. So, in addition to having a huge incentive to select one of complainants' makers, TPN had several disincentives to select Kia. Why, then, did it select Kia? It selected Kia for one reason and one reason only: unlike complainants' makers, which guard even their cast-off technologies, Kia was willing to transfer technology (including production technology and training) to TPN, and to do so for a commercially reasonable price.

7.95 The United States stoutly states that "the irony of this dispute is that the United States auto manufacturers sought to help Indonesia achieve its objective, but have been precluded from doing so" by the National Car Programme. This is utter nonsense. Had a single United States manufacturer come up with a reasonable offer, the Indonesian firms seeking pioneer status would have jumped at the chance to have an arrangement with such a prestigious partner.

7.96 The same is true of Japan and the European Communities. Each of the three complainants now complains about losing a contest it never even entered in earnest.

7.97 Second, of course Indonesia knew that TPN had a technical services arrangement with Kia. Well aware of the lack of technology and know-how in Indonesia, the Government of Indonesia would not have favourably entertained TPN's application if it were not advised of the technical and technological support for which TPN had contracted. Without the checks and balances complainants criticize, the Government could not ensure the legitimacy and strength of the proposed development. Indonesia needs a real national car industry making real cars that the majority of Indonesians can afford. The lack of project oversight complainants advocate is simply irresponsible.

7.98 As discussed above, TPN could have selected any company it wished to develop a national car; it made a commercial decision to select Kia. Complainants have not and cannot counter these facts.

(3) Complainants import no like product

7.99 Complainants concede that Article I is violated only if, among other things, complainants' like products are disadvantaged or disfavoured. Here, there can be no violation of Article I because, among other reasons, complainants import no like product, as discussed above.

E. Rebuttals to Indonesia's response

1. Rebuttal Arguments made by Japan

7.100 The following are **Japan's** rebuttal arguments to Indonesia's responses to the claims under Article I:1 of GATT 1994:

7.101 The February 1996 Programme and the June 1996 Programme provide benefits to certain Korean automotive parts and components and to certain Korean CBUs, respectively, that are not provided to like Japanese products, in violation of the most-favoured-nation obligation of GATT Article I:1.

(a) Indonesia's actions in structuring, adopting, and expanding the National Car Programme ensures that Korean products receive tax and tariff benefits denied to Japanese Products and, thus, constitute the violation of GATT Article I

(1) New evidence strengthens the Government of Japan's position that Indonesian Government measures deny MFN Treatment to Japanese products

7.102 Indonesia argues that the National Car Programme does not explicitly discriminate between Korean products and other imports, and that any advantage given to Korean products results from a private commercial arrangement and not from governmental action.

7.103 The Indonesian argument is wrong as a factual matter, because it is the Indonesian regulatory regime which created the discrimination against Japanese products. It is irrelevant for these purposes that the discrimination is not express on the face of Indonesian Government documents. The discrimination is plainly evident upon examination of the governmental measures and is an integral part of the National Car Programme. In receiving PT Timor's several applications, responding to them, and developing, implementing, and expanding the National Car Programme, Indonesia has not only known that the Programme would benefit Korean products and no other imports, but has also ensured that this would happen.

7.104 The Indonesian Government's central and essential role in the discriminatory measures has already been shown (See Section VII.A). The Japanese argument has been further strengthened by new evidence that has come to light.

7.105 The February 1996 Programme was designed and intended to accord benefits exclusively to PT Timor and Kia products. This was clear from PT Timor's application for Indonesian Government assistance in October 1995 and from subsequent correspondence between PT Timor and the State Minister for the Mobilization of Investment Coordinating Board.[375]

7.106 In particular, the "National Car Programme" began to be discussed at the latest in October 1995.[376] In particular, these proceedings have shown that Mr. Hutomo Mandala Putra, president director of PT Timor, sent a letter to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board on 12 December 1995 and requested import duty and luxury tax exemptions for PT Timor.[377] To this request, Minister Sanyoto Sastrowardoyo responded by letter of 27 December 1995 "we fully support your plan to immediately realize the project."[378] It is made even

[375] See Application Letter dated 19 October 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board. (English translation) (Japan Exhibit-33, Indonesia Exhibit 25); Letter dated 12 December 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Coordinating Board. (English translation) (Japan Exhibit 34); Letter dated 27 December 1995 from Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board to Mr. Hutomo Mandala Putra, President Director of PT. Timor Putra Nasional. (English translation) (Japan Exhibit 35).

[376] Application Letter dated 19 October 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board. (English translation) (Japan Exhibit 33).

[377] Letter dated 12 December 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board. (English translation) (Japan Exhibit 34).

[378] Letter dated 27 December 1995 from Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board to Mr. Hutomo Mandala Putra, President Director of PT. Timor Putra Nasional. (English translation) (Japan Exhibit 35).

more clear by the State Minister's "Domestic Investment Approval" of 9 November 1995 (No.607/I/PMDN/1995 (11/09/95)), which the Government of Indonesia provided to the Panel.[379] That document, and its attachments, reveal that the Government of Indonesia approved PT Timor's production of automobiles in Indonesia more than three months before the announcement of the February 1996 Programme and expressly stated that "Kia technology [was] to be developed into local technology".

7.107 Another result of the advance coordination between PT Timor and the Indonesian Government is that only PT Timor was in a position to apply in a timely manner for Pioneer status under the February 1996 Programme. PT Timor applied for Pioneer status on 28 February 1996[380], just one day after the Government of Indonesia enacted Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board No. 01/SK/1996[381], which formally established the February 1996 Programme. On the same day, the Government of Indonesia first disclosed the February 1996 Programme by way of press release to the public and other automobile companies.[382] At the first Panel meeting, the Government of Indonesia revealed for the first time the decree granting Pioneer status to PT Timor (Ministry of Industry and Trade decree No.002/SK/DJ-ILMK/II/1996), which, oddly, was dated 27 February 1996, one day before PT Timor's application. Although the Government of Indonesia submitted the cover letter of the PT Timor's application as Attachment No. 14 of its First Submission, it failed to include the attachments thereto, which, according to the cover letter, set forth the details of PT Timor's working proposals, which cover such matters as share ownership, design and engineering, source of technology, development of production facilities, use of components, etc.[383] The Panel should infer from Indonesia's failure to submit PT Timor's working proposals that they further confirm that, from the beginning, the Indonesian Government and PT Timor worked hand-in-hand to develop measures that would funnel benefits exclusively to PT Timor and imports from Korea.

7.108 The June 1996 Programme was also designed and intended to accord benefits exclusively to PT Timor and Kia. The Government of Indonesia essentially concedes this point in its First Submission, admitting that the June 1996 Programme "was necessary because [PT Timor] needed to import built-up Timors to establish the required marketing network and introduce a national car to the Indonesian buying public prior to the time that domestic production feasibly could begin". (See Section II.B.2). Even more to the point, Indonesia has submitted a letter dated May 28, 1996, from PT Timor to the Indonesian Minister of Industry and Trade, which clearly states that PT Timor applied for the production of "motor vehicles under Timor S515 trade mark at Kia Motors Co. South

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[379] Indonesia Exhibit 15.

[380] See Letter (No.071/PD/TPN/II/96) dated 28 February 1996 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to State Minister for the Mobilization of Investment Funds / Chairman of the Capital Investment Co-ordinating Board. (Indonesia Exhibit 14).

[381] Japan Exhibit 29.

[382] Indonesian Observer, "Govt unveils new national car programme" (29 February 1996) (Japan Exhibit 70); The Asian Wall Street Journal, "Suharto Project For National Car shocks Industry - version of a Kia Sedan to be Called Timor, Son's Firm Benefits" (29 February 1996) (Japan Exhibit 71); Jakarta Post, "PT Timor given tax exemptions" (29 February 1996) (Japan Exhibit 40); Indonesian Observer "Car Producers 'surprised' by new govt ruling (29 February 1996) (Japan Exhibit 41); and Bisnis Indonesia, "Tunky: PT. Timor has Adapted Impres 02/1996, (29 February 1996). All of these news articles indicated that the press release announcing this programme was made on 28 February 1996. On 27 February 1996, two days before, a newspaper article reported the production of Kia- Timor cars in Indonesia, but this article did not refer to the National Car Programme at all. (Jakarta Post, Kia of S. Korea to produce cars in Indonesia (27 February 1996) (Japan Exhibit 72).

[383] **Indonesia** submitted the working proposals on 12 January 1998, in response to a request from **Japan**. (Indonesia Exhibit 46).

Korea, to be shipped to Indonesia, totalling 65,000 units of motor vehicles for 1996-1997."[384] The Government of Indonesia, under Ministry of Industry and Trade's Recognition as Registered Importer/ Sole Agent (IT/AT) of Motor Vehicles (Number: 1410/MPP/6/1996) dated 7 June 1996, approved PT Timor's request, specifically designating the Timor S515, with detailed specifications in its attachment, as the car that could be imported and sold free of duties and luxury taxes.[385] In taking this action, the Indonesian Government fully knew that the designated model was and would be manufactured solely at the Kia facilities in Korea and established a legal regime that ensured that only Korean products would benefit from the June 1996 Programme.

(2) The National Car Programme denies unconditional MFN treatment to Japanese products and ensures that Korean products receive tax and tariff benefits denied to Japanese products

7.109 The Indonesian argument is also wrong as a matter of law. Certain Korean automobiles and automotive parts and components have been imported into, and sold in, Indonesia at favourable tariff and tax rates that are not available to other imports under Indonesian law. That is the very definition of a denial of MFN treatment.

7.110 The Indonesian argument that the discrimination results from decisions of PT Timor is clearly wrong, because it is the government, not a private company, that sets the discriminatory tariff and luxury tax rates. PT Timor operates in the discriminatory environment created by the Indonesian Government. Moreover, it is clearly the Government of Indonesia, not PT Timor, that established the Presidential Decree that accords advantages to imported automobiles on the conditions that the exporting enterprise purchase certain amounts of Indonesian parts and components and employ Indonesian workers. As discussed (See Section VII.A), GATT Article I:1 requires any advantage to be accorded unconditionally. As the precedent cases show[386], granting this kind of advantage conditioned upon certain requirements is clearly a "conditional" advantage within the meaning of GATT Article I:1. This means that, even if the advantage accorded to products from Korea were an advantage available to like products from all other WTO Members, subject to the same conditions, the National Car Programme would still violate GATT Article I:1.

(3) The Precedent GATT/WTO Cases Support Japan's Argument

7.111 Indonesia alleges that the precedent panel cases do not support Japan's argument that such governmental actions constitute a violation of GATT Article I:1. In reality, the GATT and WTO precedents also undercut the Government of Indonesia's position.

7.112 First, it should be noted that Indonesia itself concedes that previous panels have found violations of Article I:1 in circumstances where "despite the absence of explicit discrimination, a particular result was mandated by government action" or where a legal structure "in fact compelled or led to a particular result." As demonstrated (See SectionVII.A), the National Car Programme provides exactly such a legal structure that compels or leads to a particular result, namely, granting

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[384] Letter dated 28 May 1996 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Minister of Industry and Trade of the Republic of Indonesia (Indonesia Exhibit 18).

[385] The recognition of registered importer/sole agent (IT/AT) of motor vehicle (number: 1410/MPP/6/1997) and its attachment (Indonesia Exhibit 13).

[386] Panel Report on Belgian Family Allowances, G/32, adopted on 7 November 1952, BISD IS/94. Working Party Report on Accession of Hungary, adopted on 30 July 1973, BISD 20S/34.

advantages only to Korean products. Therefore, in its attempt to rebut Japan's arguments, Indonesia has instead conceded the point.[387]

7.113 It should be also recalled that the Appellate Body recently reconfirmed the importance of de facto as well as de jure non-discrimination. In Bananas III, the Appellate Body explicitly stated, "Article I and II of the GATT 1994 have been applied, in past practice, to measures involving de facto discrimination," referring to the panel report in European Economic Community - Imports of Beef from Canada.[388]

(b) Indonesia's bizarre assertion that no goods are like Timors or parts and components for Timors is simply wrong

7.114 Indonesia contends that the complainants, including Japan, have failed to establish for purposes of Article I that there are any like products to the Timor sedans and the automotive parts and components used to assemble them. Indonesia's discussion of both the factual similarities and the relevant legal precedent is misleading and incorrect.

(1) Japanese companies produce cars like imported National Cars from Korea

7.115 As discussed (See Section V.A.1), it is also virtually meaningless to discuss "likeness" in this case. The National Car Programme discriminates between certain Korean goods and all other imports based on whether or not they could be qualified as "National Cars," thus favouring only Korean products, and does not base its discrimination on any other characteristics of the products. Even if a product that is manufactured in Japan is identical to a product manufactured in Korea in connection with the National Car Programme, the Korean product would receive more favourable tariff and internal tax treatment than the Japanese product. Identical products are unquestionably like products, so there is no reason for further analysis of what characteristics make products like, when the measure at issue even discriminates between identical products.

7.116 Indonesia attempts to obfuscate the very clear discrimination embedded in its National Car Programme by arguing for a novel and extraordinarily narrow definition of "like product." Indonesia would have this Panel believe that the Timor S-515 sedan is so unique as to be "unlike" every other automobile in the world. If that position were adopted, Indonesia would be free to impose any discriminatory taxes or other discriminatory policies it saw fit against imported automobiles.

7.117 Indeed, the logic of the Indonesian position is that every car model is unique, so each and every WTO Member would be free to discriminate against any and all imported models. That position would effectively eliminate the core GATT disciplines of MFN treatment and national treatment from the automotive sector. Such a narrow view of "likeness" could also drastically limit the application of those GATT disciplines to all other manufactured products.

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[387] The Government of Indonesia also states that Japan "miscites" the US - Gasoline case, since "the decision declares that United States authorities must have foreseen that the two separate regulatory regimes that they had established were discriminatory." It further states, "[e]ven if certain Government officials were aware of TPN's corporate intention to use Kia as a supplier, the legal structure of the national car programme did not compel or lead to this private-party decision or to imports from Korea." However, again, it has already been fully demonstrated that the Indonesian authorities must have foreseen the discriminatory results and also that the legal structure of the National Cars Programme did compel and lead to the results. Therefore, the Government of Indonesia essentially admits its violation of GATT Article I.

[388] Appellate Body Report on Bananas III, para. 232.

(2) Japanese companies produce automotive parts and components like those imported from Korea for assembly of National Cars

7.118 Indonesia even goes so far as to claim that "there are no 'like products'" to "Timor components and parts." This claim is based on Indonesia's theory that no product can be like a customized component. The mere fact that a part or component is customized for assembly in a particular car model does not mean that it is ipso facto unlike other automotive parts and components. The reality is that a part or component may be customized only in a very minor respect and that a manufacturer can readily adapt a single standard part or component to customize it for a variety of car models.

7.119 Based on the Government of Japan's general understanding of the nature of automotive parts and components, it is true that automobile makers very often provide specifications for parts and components that are applied only for one model. Among automobiles of the same type or in the same class, however, power-related parts and components (such as engines, transmissions, and brakes), tires, batteries, wheels, lamps, seats, etc. are often interchangeable with only minor adjustments. Accordingly, when the specifications for the parts and components for particular models are determined, a single manufacturer may produce and supply parts and components adapted to the specific needs of a variety of models.

7.120 Under these circumstances, it is clear that, regardless of whether parts or components are "tailor-made" for a particular model, there often are many "like" products within a category of parts and components (such as engines, transmissions, brakes, etc.) that are produced by the same or other manufacturers for other models.

7.121 The Government of Indonesia may argue that the parts and components used for the assembly of Timors are different from this general characterization and are not interchangeable with minor adjustments from parts and components used in other models. Even if that were true, however, it would not mean that such products are necessarily "unlike" all other products within the meaning of GATT as alleged by Indonesia. Moreover, it would confirm Japan's argument that *de facto* the National Car Programme only benefits those parts and components imported from Kia Motors in Korea.

7.122 Thus, Japanese manufacturers may produce and ship the exact same parts and components with the necessary customization. However, the Indonesian measures would nevertheless provide less favourable treatment to the Japanese products, which cannot be used for assembling National Cars, than they accord to certain Korean products. In any event, the Government of Indonesia's theory regarding customized parts and components must fail to excuse all of the discrimination against imports, because by Indonesia's own admission the Timor S-515 does use some non-customized parts and components. (See Section VII.D.)

(3) Indonesia's Extremely Narrow View of "Like Products" Has No Support in the GATT/WTO Precedents

7.123 Indonesia offers no serious support for its extremely narrow conception of likeness. The only two GATT Panel decisions cited are wholly irrelevant. The Government of Indonesia cites Australian Subsidy on Ammonium Sulphate and EEC - Measures on Animal Feed Proteins[389] , for the proposition that the Article I concept of "like products" is narrower than the Article III concept of

[389] Panel Report on Australian Subsidy on Ammonium Sulphate, adopted on 3 April 1950, GATT/CP.4/39; and Panel Report on EEC - Measures on Animal Feed Proteins, L/4599, adopted on 14 March 1978, 25S/49.

"like" or "directly competitive or substitutable products," which is perfectly obvious and has nothing to do with the scope of the "like products" concept itself. Thus, those cases dealt with completely different situations from the instant case.

(4) The limited sales of foreign CBUs in the Indonesian Market Do Not Justify Indonesia's discriminatory measures

7.124 Indonesia indicates that sales of foreign CBUs are limited in the Indonesian market, and thus Japan has no grounds for claiming harm. (See Section VII.D.) However, in fact, all that the sole data indicates is how effective Indonesia's measures have been in impeding the entry of imported sedans to Indonesia. Indonesia banned all sedan imports until 1993. The current tariff rate on CBU's is still prohibitive at 200 per cent ad valorem.

7.125 Needless to say, Japanese car manufacturers do produce, and have the capacity to export, various types of sedans which are almost the same as, and certainly "like", the Timor in every relevant respect, including engine displacement, dimensions, maximum power and so on.

7.126 It is true that few of these products were exported to Indonesia as of 1997, which is quite rational considering Indonesia's protective trade policies, such as the 200 per cent tariff rate. If ever the Government of Indonesia should stop imposing prohibitively high import tariffs and luxury taxes on these imported sedans, as it actually does for certain Korean sedans under the June 1996 Programme, Japanese car manufacturers can and will certainly start exporting them to Indonesia.

7.127 This means that the small number of like imported products has been created by the Government of Indonesia itself. In other words, what the Government of Indonesia is attempting to do in its submission is to justify its discriminatory National Car Programme by virtue of the small volume of imports, when that circumstance has been caused by the Government of Indonesia's own long-standing protective trade policies. Under Indonesia's reasoning, a WTO Member that maintains an import ban would be allowed to maintain it forever, because there would be no imports and so no other Member would have legal standing to challenge the import ban.

7.128 As a matter of course, previous Panels under GATT or WTO have never permitted this kind of justification. GATT Panels have held that a "demonstration that a measure inconsistent with [GATT Articles] has no or insignificant effects would ... not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired"[390], which has been reaffirmed by the Appellate Body in the Bananas III case.[391] Moreover, in the Canada-Periodicals case where a tax policy was examined under GATT Article III:2, but imports of like products did not exist in the market because of the import prohibition, the Appellate Body, as well as the Panel, found that "hypothetical imports ... have to be considered."[392] The only alternative was to decline to examine the GATT Article III issue because of the non-existence of imports.

7.129 In the present case, it is quite apparent that a "hypothetical" viewpoint should also be taken for the sake of examining GATT Article I, instead of allowing trade-impeding measures to help GATT-inconsistent measures to evade WTO review.

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[390] See, in particular, Panel Report on United States - Taxes on Petroleum and Certain Imported Substances, L/6175, adopted on 17 June 1987, BISD 34S/136, para. 5.1.9.

[391] Appellate Body Report on Bananas III, paras. 252-253.

[392] Panel Report on Canada - Periodicals, para. 5.23. Appellate Body Report on *Canada - Periodicals*, p.19.

7.130 Finally, it should be also noted that Indonesia's argument is irrelevant with respect to automotive parts and components, as Japanese companies export substantial quantities of those products to Indonesia.[393]

(c) The June 1996 Programme is still valid and effective and can and should be reviewed by the Panel

7.131 **Japan** makes the following arguments, which are not limited to the context of Article I:1, but rebut Indonesia's arguments in general.

7.132 Indonesia seeks to remove the entire June 1996 Programme from the Panel's scrutiny by claiming that the Programme has expired. While Indonesia contends that the June 1996 Programme as a whole ended on 30 June 1997, the facts are clear that only the authorization to PT Timor to import National Cars duty free expired then. The Programme itself, including the luxury tax exemption for customers of PT Timor, remains in full force and effect, with the Government of Indonesia free at any time to make further authorizations. Moreover, even if the Programme actually expired at the end of June as alleged, this Panel has full authority to address the Government of Japan's challenges to the Programme. The Panel should exercise its authority, because not ruling here would encourage WTO Members to enact "one-time" measures, or declare that general measures have expired, to escape WTO review.

(1) The June 1996 Programme is still in full force and effect

7.133 Indonesia has conceded that Presidential Decree No.42 and Decree of Minister of Industry and Trade No.142/96 "have not been repealed by [any] positive action of the Indonesian Government". According to Indonesia's admission, these decrees "were drafted in general terms and applied to any national car company". A simple review of the decrees confirms that they have not expired by their terms, so they must remain in effect until "repealed by [a] positive action".

7.134 Even with respect to PT Timor, the measures still remain in effect. Because the luxury tax is collected at the time of sale, not at the time of importation, admitted by the Government of Indonesia, PT Timor will continue to benefit from the luxury tax exemption for its customers at least until such time as all 40,000 Imported National Cars have been sold. To the best knowledge of the Government of Japan, there are still thousands of Imported National Cars which remain unsold.

7.135 Further, the June 1996 Programme also should be regarded as remaining in effect from the viewpoint that the Government of Indonesia has not completed its compliance audit for the Programme, according to its admission at the first Panel meeting.[394]

7.136 In short, the June 1996 Programme is still operational and has not expired, contrary to the Government of Indonesia's recent allegation.

7.137 Indonesia alleges that its own previous statement that the "June 1996 Presidential Decree is still in effect ..." is irrelevant because it was made before 30 June 1997. That argument is wrong. Perhaps Indonesia has forgotten that it made this statement on 15 September 1997 - nearly three months after Indonesia now claims that the programme expired.

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[393] Japan Exhibit 76.

[394] As indicated in Section X.A, **Indonesia** has submitted evidence alleged to demonstrate that TPN failed the audit. (Indonesia Exhibit 47).

7.138 Even more striking, Indonesia has made an admission that completely undercuts its own argument. By conceding that over 17,000 Timors imported from Korea remain to be sold and that "the Government does not forego the luxury tax until each car is sold," Indonesia has admitted that the June 1996 Programme, at least in the context of the luxury tax exemption, is still in effect today.

(2) Even if the June 1996 Programme expired at the end of June 1997, the Panel can and should rule on it

7.139 It has been the usual practice of GATT/WTO panels to rule, at least, on measures that were effective at the time the panel's terms of reference were fixed, even if such measures later became ineffective before the panel rendered its ruling.[395]

7.140 This Panel was established on 12 June 1997, and the terms of reference were determined on the same date, in accordance with the requests of the Government of Japan and the European Communities. The Government of Japan's request for the establishment of a panel specifically referred to the June 1996 Programme and Indonesia has never expressed any objection to the terms of reference of this Panel. Although the terms of reference were slightly revised in July 1997, that revision was made only to accommodate the participation of the United States, and that revision does not affect the terms of reference of this Panel as far as the specific measures referred to by the Government of Japan are concerned.

7.141 Therefore, even if the June 1996 Programme expired on 30 June 1997, as Indonesia newly alleges, it is undisputed that the Programme was in effect when the Panel's terms of reference were fixed on 12 June 1997. Therefore, the Panel can and should rule on the Programme's inconsistency with Indonesia's WTO obligations.

(3) None of the precedent cases cited by Indonesia supports its argument

7.142 Indonesia cited three GATT Panel decisions in support of its contention that the Panel may not rule on "expired" measures. However, its citations are both misleading and inaccurate.

7.143 Indonesia cites EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile and Norway - Procurement of Toll Collection Equipment for the City of Trondheim[396] for its contention

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[395] Several panels have adjudicated claims involving measures that had expired or were no longer being applied, but that had been applied when the panel's terms of reference were fixed. See, Panel Report on United States - Measures Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/R, upheld by the Appellate Body, WT/DS33/AB/R, adopted on 23 May 1997 (ruling on a measure that was revoked after the Panel was established); Panel Report on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49 (ruling on discontinued measures that had terminated after the terms of reference of the Panel had already been agreed); Panel Report on United States - Prohibitions on Imports of Tuna and Tuna Products from Canada, adopted on 22 February 1982, BISD 29S/91, 106, para.4.3. (ruling on the GATT consistency of a measure withdrawn after establishment of the Panel but before agreement on the Panel's terms of reference); and Panel Report on EEC - Restrictions on Imports of Apples from Chile, adopted on 10 November 1980, BISD 27S/98 (ruling on a measure which had terminated before agreement on the Panel's terms of reference but was specifically included in the terms of reference). All these cases show that the Panel may rule on the consistency with WTO agreements of the measures that expired after the establishment of a Panel. The US - Gasoline Panel also supports this position by stating "it had not been the usual practice of a panel established under the General Agreement to rule on measures that, at the time the panel's terms of reference were fixed, were not and would not become effective," at para. 6.19. (Emphasis added).

[396] Panel Report on EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile (Dessert Apples"), L6491, adopted on 22 June 1989, 36S/93. Norway - Procurement of Toll Collection Equipment for the City of Trondheim ("Trondheim"), (GPR.DS2/R) adopted by the Committee on Government Procurement on 13 May 1992.

that Panels may not review the WTO consistency of expired measures. In fact, both Panel decisions flatly contradict the Government of Indonesia's position. Both Panels reviewed the expired measures and concluded that such measures violated obligations under GATT and the Agreement on Government Procurement, respectively. It should be especially noted that the Trondheim Panel stated:

> [T]he panel also believed that, in cases concerning a particular past action, a panel finding of non-compliance would be of significance for the successful party: where the interpretation of the Agreement was in dispute, panel findings once adopted by the Committee, would constitute guidance for future implementation of the Agreement by Parties.

It was only after reaching these conclusions that the Panels declined to recommend compensation for the expired measures. But compensation is not at issue here. Rather, what Japan is asking this Panel is, like the Dessert Apples and Trondheim Panels, to find that Indonesia's measures are inconsistent with its WTO obligations.

7.144 The other Panel Report cited by Indonesia, Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes,[397] also fails to support its position. The passage cited by Indonesia does not discuss the issue of whether a Panel may review such measures. Instead, in circumstances where a Member repealed its GATT-inconsistent mandatory legislation, while leaving discretionary legislation that may be applied in a GATT-inconsistent manner, the Panel declined to find the discretionary legislation to be inconsistent with GATT as long as it was not applied in a GATT-inconsistent manner. The Panel did not reach any decision with respect to the expired legislation. But that is completely different from Indonesia's assertion that panels cannot or should not review expired measures.

7.145 In sum, none of the GATT panel precedents cited by Indonesia support its position.

(4) Indonesia's attempt to circumvent this Panel's review should not be allowed

7.146 Finally, the Panel should reject Indonesia's attempt to escape its review by recasting the June 1996 Programme as a one-time-only measure that has expired. Otherwise, the disciplines established through the past fifty year effort to liberalize global trade would be severely weakened. If a panel could not rule on the WTO consistency of a measure that was in effect when the panel's terms of reference were established merely because a Member informed the panel that the measure had "expired", without so much as formally revoking it, the ability of WTO members to evade WTO review is all too obvious. If this sort of evasion is tolerated, the Uruguay Round's historic effort to create an effective system for resolving trade disputes will be crippled, the WTO disciplines themselves will be gravely weakened, and the goals of the WTO will be frustrated.

2. Rebuttal Arguments made by the European Communities

7.147 The following are the **European Communities'** rebuttal arguments to Indonesia's responses to the claims under Article I:1 of GATT 1994:

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[397] Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, DS10/R, adopted 7 November 1990, 37S/200.

(a) The fact that the authorisation granted to PT TPN expired in June 1997 does not prevent the Panel from ruling on the compatibility of that measure with Article I:1

7.148 According to Indonesia, the authorisation granted to PT TPN for importing duty free and tax free 45,000 passenger cars from Korea expired as of 30 June 1996. On that ground, Indonesia has requested the Panel to refrain from ruling on the compatibility of that measure with GATT Article I:1. The European Communities opposes that request and respectfully urges the Panel to rule on this claim, like on all the other claims contained in its terms of reference.

7.149 Although the above mentioned authorisation has expired, Presidential Decree 42/96, on the basis of which that authorisation was issued, still remains in force. Furthermore, both Presidential Decree 42/1996 and its implementing measure Decree 142/1996 are generally applicable regulations. Therefore, new authorisations may be granted in respect of other National Cars.[398]

7.150 Indonesia claims that "no comparable programme has been or will be authorised". Yet, the wording of Presidential Decree 42/96 and Decree 142/1996 suggests that the Indonesian Government has no discretion to deny this benefit once a car has been certified as a National Car.[399] Moreover,

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[398] Indonesia disclosed the existence of a letter from the Ministry of Industry and Trade "denying National Car benefits for a Sportage-type vehicle". (See Section VII.)

The basis for that decision is doubtful. It would appear that a Pioneer Company is not required to have each of its models recognised as a National Car by means of a specific decision. At the very least, Indonesia has not disclosed any such decision recognising the Timor S-515 as a National Car. The record only contains a decision of the Director General for Metal, Machinery and Chemical Industries No 002/SK/DJ-Ilmk/II/1996 (Indonesia Exhibit 41) appointing PT TPN as a Pioneer Company and a subsequent decision of the State Minister for Mobilisation of Investment Funds (Decree 02/SK/1996, EC Exhibit A-11) confirming that appointment.

Indonesia has admitted that no formal decision recognising the Timor S-515 as a National Car had been issued. Nevertheless, Indonesia made the extraordinary argument that the decision to limit the grant of National Car status to the Timor S-515 is "inherent" in the title of Decree 02/SK/1996 which, according to the translation of that decree provided by Indonesia, reads "The determination of PT Timor Putra Nasional to Establish and Produce A National Car". In this regard, it is worth noting that according to the translation of that Decree submitted by the European Communities (Exhibit EC A-11), which was made *in tempore non suspecto* by what Indonesia describes elsewhere as a "private entity", the title of Decree 02/SK/1996 is "Stipulation of PT Timor Putra Nasional to develop and produce National Cars". Identical formula is used in Article 1 of the same Decree. Note also that Indonesia's own description of the document in the Index of Attachments of its First Submission reads "Confirmation of PT Timor Putra Nasional as the Company to Develop and Produce National Automobiles."

Even if the Sportage was not granted National Car benefits, other models produced by PT TPN or by Bimantara (whose application for Pioneer status is still under consideration) can still be granted those benefits.

[399] Article 1 of Presidential Decree 42/96 reads as follows:

"National cars which are made overseas by Indonesian workers and fulfil the local content stipulated by the Minister of Industry and Trade will be treated equally to those made in Indonesia".

This wording only leaves discretion to the Minister of Industry and Trade for stipulating the level of local content. There is no indication that the Indonesian authorities may refuse the benefit to a car previously certified as a National Car (assuming that such certification is necessary. See the previous footnote)

Article 2 of Presidential Decree 42/1996 is also drafted in mandatory terms:

"The equal treatment contemplated in Article 1 is granted only once for a maximum period of one year and for amounts to be stipulated by the Minister of Industry and Trade"

Again, the Minister of Industry and Trade is left discretion to stipulate the "amounts", but there is no indication that the benefit can be refused. The term "once" is ambiguous. It could mean that the benefit is granted only once in respect of each National Car or only once to each Pioneer Company. The interpretation now made by Indonesia, according to which "once" means that the Government of Indonesia will grant no new authorisation to import National Cars duty and tax free is contrived and unconvincing. It suffices to note that the last day of the one-year period (30 June 1997) was not specified in Presidential Decree 42/1996

these assurances appear to be contradicted by the fact that neither Presidential Decree 42/96 nor Decree 142/1996 have been repealed.

7.151 Furthermore, it is important to note that, in accordance with Article 2 of Decree 42/96 any further authorisations will have, like the one granted in respect of the Timor S-515, a duration of only one year. Therefore, any such authorisation will have expired before a new Panel has time to rule on it.

7.152 The European Communities's request that the Panel rule on the expired measure is supported by prior Panel decisions. Under GATT 1947, several panels[400] considered measures that were no longer in force in cases where, as in the present case, the measures were still in force at the time the Panel was established[401] and the terms of reference set and/or where there was a threat of recurrence.

7.153 This practice has continued under the WTO Agreement. In US - Standards for Reformulated Gasoline[402] , the Panel decided not to rule on a discontinued measure, but only because the measure had been terminated before the terms of reference were established and was unlikely to be renewed. In US - Measures affecting imports of Woven Wool Shirts and Blouses from India, the Panel decided that:

> in the absence of an agreement between the parties to terminate the proceedings, we think that it is appropriate to issue our final report regarding the matter set out in the terms of reference of this Panel in order to comply with our mandate [....] notwithstanding the withdrawal of the United States restraint"[403] [404]

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or in any other generally applicable measure known to all potential beneficiaries of Presidential Decree 42/1996 but only in the import authorisation given to PT TPN in the "Recognition of Registered Importer/Sole Agent, file number 1410/MPP/6/1996".

[400] See for instance the Panel Report on EEC - Restrictions on Imports of Dessert Apples, Complaint by Chile , adopted on 22 June 1989, BISD 36S/93; the Panel Report on EEC - Restrictions on Imports of Apples, Complaint by the United States, adopted on 22 June 1989, BISD 36S/135; the Panel on United States - Prohibition of Imports of Tuna and Tuna Products from Canada, adopted on 22 February 1982, BISD 29S/91; the Panel Report on EEC - Restrictions on Imports of Apples from Chile, adopted on 10 November 1980, BISD 27S/98; and the Panel Report on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49.

Although the defendant claims that "prior Panel decisions support the refusal to rule on an expired Measure", it can point but to a single instance where a Panel decided not to rule on a measure withdrawn after the establishment of the Panel, namely the Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, adopted 7 November 1990, BISD 37S/200. That Panel report stands out as an aberration and subsequent decisions by WTO Panels dealing with the same issue do not refer to it.

[401] The Panel requested by the European Communities was established by the DSB at its meeting of 12 June 1997 (see WT/DS55/7, WT/DS64/5 and WT/DS54/7).

[402] Panel report on United States - Standards for Reformulated Gasoline , WT/DS2/R, adopted on 20 May 1996, para 6.19

[403] Panel report on United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, adopted on 23 May 1997, WT/DS33/R, para 6.2

[404] In Argentina - Certain measures affecting Imports of Footwear, Textiles, Apparel and Other Items (WT/DS56/R, at pp 83-86, unadopted) the Panel decided not to rule on a measure which was revoked after the circulation of the request for the establishment of a Panel but before the Panel was established. The Panel also noted that there was no evidence that the measure would be re-introduced.

(b) It is irrelevant that the Indonesian Government did not mandate expressly PT TPN to import automobiles or parts originating in Korea

7.154 There is ample and indisputable evidence that the Indonesian Government (and not merely "certain officials") (See Section VII:D) was perfectly aware that PT TPN would take advantage of the measures in dispute to import the Timor S-515 (and subsequently parts and components thereof) from Korea, and not any other passenger car from any other Member:

- the sole owner of PT TPN had set up a joint venture with KIA to assemble KIA cars in Indonesia already in 1993. That joint venture obtained an investment permit from the Indonesian Government.[405]

- the investment approval issued to PT TPN by the Indonesian Government on 9 November 1995 states expressly that the passenger cars to be assembled at Karawang Plant "will use KIA technology to be developed into local technology".[406]

- by letter addressed to the State Minister for the Mobilisation of Investment Funds on 12 December 1995, PT TPN requested approval of a programme "to realise the national automobile project". That programme envisaged *inter alia* the importation of motor vehicles manufactured by KIA in Korea as well as the importation, at a subsequent stage, of parts and components supplied by KIA for the assembly of cars in Indonesia.[407]

- by letter dated 28 May 1996, PT TPN requested authorisation to "produce motor vehicles under Timor S-515 trade mark at KIA Motor Co. South Korea, to be shipped to Indonesia ..." [408]

- the "Recognition of Registered Importer/Sole Agent"[409] issued to PT TPN on 7 June 1996 does not specify the source of the imports. Nevertheless, that recognition was issued in response to PT TPN's letter of 28 May 1997. Moreover, the specifications attached to the Recognition correspond to those of the KIA Sephia.

7.155 It is of course impossible for the European Communities to ascertain whether, in addition to being aware of PT TPN's choice and of its consequences, the Indonesian Government directed or influenced that choice. Given the importance attached by the Government of Indonesia to the National Car Programme, it is hard to believe that it had no saying in such a crucial issue as the choice of KIA. Furthermore, the facts of this case which have been disclosed until now by Indonesia evidence that throughout the process of conception and implementation of the National Car Programme, private and government action have been so timely and harmoniously concerted as to be almost indistinguishable. PT TPN requested approval for developing a National Car before such a programme existed.[410] When the National Car Programme was eventually approved, it provided benefits which corresponded precisely to those requested by PT TPN several months before. Even more extraordinary, PT TPN

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[405] The European Communities has never referred to PT TPN as a joint venture with KIA. The European Communities notes that Mr Hutomo Mandala, the sole owner of PT TPN, and KIA had established a joint venture in 1993 called PT Indauda Putra Nasional Motors. During the first meeting with Panel, the Government of Korea admitted the existence of some kind of joint venture arrangement between KIA and PT TPN. (See Section XII.B).

[406] Indonesia Exhibit 15.

[407] Indonesia Exhibit 24

[408] Indonesia Exhibit 18.

[409] Indonesia Exhibit 13

[410] Indonesia Exhibit 24

was granted Pioneer Status by the Ministry of Industry and Trade[411] just a few days after the adoption of the Programme[412] and before PT TPN had time to file its formal request.[413] A similar sequence of facts took place in May/June 1996. On 28 May 1996 PT TPN asked authorisation to "produce" National Cars in Korea.[414] On 6 June 1996, the Government approved Presidential Decree 42/96 creating that possibility. The next day, the Ministry of Trade and Industry granted PT TPN's request of 28 May 1996.[415]

7.156 In any event, whether or not PT TPN's choice was free or was influenced by the Indonesian Government is ultimately irrelevant. The measure attacked by the European Communities is not PT TPN's choice but the legal consequences knowingly and willingly attached by the Indonesian Government to that choice. The existence of a de facto violation of GATT Article I:1 is not dependent upon the content of PT TPN's choice. If instead of teaming-up with KIA, PT TPN had chosen a Japanese partner, the scheme put in place by the Indonesian Government would still have led necessarily to the same consequence that only imports from a Member would have benefited from the tariff and tax preferences.[416]

(c) The automobiles and parts covered by the measures are like any other automobiles and parts

7.157 Indonesia's allegation that the Timor S-515 is not like any of the cars imported from the European Communities is not only factually incorrect (See Section V.A.2) but also totally irrelevant. In order to establish a violation of GATT Article I:1 the European Communities is not required to show that the measure concerned has had any actual effects on its exports to Indonesia. Instead, it is sufficient for the European Communities to show that if a "like" product had been exported from the European Communities it would have not benefited from the same advantages as the Timors S-515 imported from Korea.

7.158 The tariffs and tax benefits granted by Indonesia to the Timors S-515 imported from Korea are based on three conditions:

- first, the cars must be National Cars manufactured by, or at least for, a Pioneer company;

- second, they must have been manufactured with the participation of Indonesian nationals;

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[411] Indonesia Exhibit 41. This decision was disclosed by Indonesia only during the First Meeting with the Panel. According to Indonesia, it was "overlooked including it in the list of translated documents". In fact, however, the existence of this decision had not been mentioned by Indonesia. Indonesia instead said that PT TPN was designated as a Pioneer Company on 5 March 1997 by means of Decree 02/SK/1996.

[412] In contrast, Bimantara's application is still awaiting a formal reply, more than one year after it was filed. PT Multimotor France's request was never answered.

[413] Indonesia Exhibit 14

[414] Indonesia Exhibit 18

[415] Indonesia Exhibit 13

[416] Indonesia's attempt to distinguish the present case from EC - Imports of Beef from Canada (adopted 10 March 1981, BISD 28S/92) and Spain - Tariff Treatment of Unroasted Coffee (adopted on 11 June 1981, BISD 28S/102) fails. It is obvious that "in none of them was the choice of the supplier made by the private party recipient of the subsidy found to constitute government-mandated de facto discrimination", since none of those two cases involved any subsidy! Instead, it is more relevant to note that the Spanish Government did not have more "direction" over the varieties of coffee grown by the favoured Colombian producers than the Indonesian Government had over PT TPN's allegedly private choice. In both cases, the Government relied on a fact which was not under its control but which was known to it in order to apply a measure that had the necessary result of benefiting only imports from a certain source.

- third, they must incorporate a certain percentage of counter-purchased parts and components imported from Indonesia.

7.159 It is obvious that none of the above three conditions affects *per se* the physical characteristics of the National Cars, nor therefore makes those cars unlike any other cars which are or may be exported from the European Communities. A passenger car manufactured in the European Communities which is identical in all respects (and therefore indisputably "like") to the Timors S-515 imported by PT TPN would still be refused the tariff and tax exemptions provided by presidential Decree 42/1996, simply because it is not a National Car manufactured by/for PT TPN.

7.160 Indonesia also alleges that 93 per cent of the parts for the Timor S-515 are tailor made for that model. Hence, according to Indonesia, they are not "like" parts for other cars, which are also customised. This argument cannot be accepted. It would lead to the absurd result that even if two cars were "like" when imported in assembled state, their individual parts and components could never be considered as "like" when imported separately. If upheld, Indonesia's argument would make possible for a Member to apply as many different import duty rates on a certain type of parts as models of cars are assembled within its territory. Carried to its logical conclusion, Indonesia's reasoning would have the effect of placing all the trade on customised parts and components beyond the reach of the numerous WTO rules, including some of the most basic ones, which rely upon the notion of "like product". For that reason, the EC considers that customised parts and components, including those for the assembly of cars, must be deemed "like" if they are sufficiently similar in terms of physical characteristics and end uses, even if they are not interchangeable. For these purposes, two customised parts should be considered as having sufficiently similar end-uses when they are intended for use in products which are themselves "like".

3. Rebuttal Arguments of the United States

7.161 As demonstrated (See Section VII.C) Indonesia violated Article I:1 of GATT 1994 when it authorized, for a period of one year, the importation and sale in Indonesia of completely built-up Kia Sephia sedans free of Indonesia's 200 per cent tariff and 35 per cent luxury tax.[417] In its first submission, Indonesia offered three arguments in response, none of which has merit.

(a) The One-Year Exemption Is Not a "Dead Measure"

7.162 Indonesia's first argument is that the one-year authorization has expired because TPN may not import any additional tax- and duty-free Sephias. Thus, according to Indonesia, the one-year authorization has expired (or, in trade law jargon, is a "dead measure") and the Article I:1 claim is moot.

7.163 As a factual matter, this argument is incorrect. Although it may be true that TPN is not authorized to import additional tax- and duty-free Sephias for the moment, this does not mean that the relevant measures are no longer in effect. With respect to the exemption of these Sephias from the luxury tax, there are a host of Sephias that were imported under the one-year authorization, but that remain unsold. In its Annex V response, Indonesia stated that these Sephias would be exempt from the luxury tax when they are sold.[418]

7.164 Likewise, the tariff incentives are still in effect. It has been widely reported that as a condition for receiving the one-year authorization, TPN was required to satisfy the first-year 20 per

[417] The United States noted that with respect to Indonesia's violation of Article I:1, the United States, at the second meeting of the Panel, agreed with the points made by Japan and the European Communities.

[418] AV/15, United States follow-up question #12/27, and Indonesia's response thereto in AV/16.

cent local content requirement of the National Car Programme.[419] In addition, TPN was required to post a bank guarantee to the Directorat General of Customs to guarantee repayment of the foregone duties if the Kia Timor venture failed to meet the 20 per cent requirement. These reports are consistent with Decree 82/1996 and Decree 36/1997, both of which refer to possible repayment by the national car company if local content levels are not met and to a requirement to submit a bank guarantee to Indonesia authorities to ensure such repayment.[420]

7.165 A statement in Indonesia's initial Annex V response refers to the bank guarantee, and states that "the subsidy will be granted after the auditing of local content [is] achieved."[421] In addition, at the first meeting of the Panel, the Indonesian representatives confirmed that the audit had not been completed. What this means is that as of December 4, 1997, well after this Panel was established, the one-year tariff incentives conferred on TPN remained conditional, and could be recouped by the Government if TPN and Kia Timor failed the audit.

7.166 In short, the measures authorizing the one-year tax- and tariff-incentives are still operational and have not expired.

7.167 Moreover, Indonesia's assertion that it will not grant such exemptions in the future is carefully worded. In its responses to questions 3(1) and 3(2) from Japan (Indonesia Exhibit 43), Indonesia says that it will not grant any future tariff and tax exemptions under Presidential Decree No. 42/96. These responses do not rule out the authorization of future tariff and tax exemptions new decrees. Given the apparent ease with which such decrees can be issued, the Panel should rule on the complainants' Article I claims to ensure that Indonesia is put on notice that the authorization of similar exemptions in the future constitutes a violation of Article I.

7.168 Moreover, as a legal matter, previous panels have reviewed the consistency of measures that ceased to be effective after the date on which a panel and its terms of reference were established.[422] In this case, the measures in question continue to be effective well after the date on which this Panel and its terms of reference were established.

(b) Indonesia conferred an advantage to a country

7.169 Indonesia also argues that it did not violate Article I:1 because it allegedly did not grant an advantage to automobiles originating in Korea. Instead, according to Indonesia, TPN was free to import duty- and tax-free cars from whatever source it chose.

7.170 This assertion simply is contradicted by the facts. The document authorizing these importations, Decree No. 1410/MPP/6/1996, did not permit TPN to import any passenger car it chose, but instead expressly authorized only the importation of the "TIMOR Sedan/S515 - 1500cc.". Moreover, as Indonesia admits:

> This treatment was necessary because TPN needed to import built-up Timors to establish the required marketing network and introduce a national car to the Indonesian buying public prior to the time that domestic production could begin.[423]

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[419] US Exhibit 23.
[420] Indonesia Exhibits 21 and 9.
[421] AV/14, Attachment U-16/1.
[422] United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/R, Report of the Panel adopted on 23 May 1997, para. 8.1; and EEC - Measures on Animal Feed Proteins, Report of the Panel adopted on 14 March 1978, BISD 25S/49.
[423] See section VII.D.3(b).

This objective could be accomplished only by the importation of Kia Sephias from TPN's joint venture partner, Kia Motors of Korea. It could not have been accomplished by importing and selling, for example, GM Opels, Ford Escorts, or Chrysler Neons. To paraphrase Indonesia's own statement regarding the Reformulated Gasoline case, the Indonesian authorities must have foreseen that the regime they were establishing was discriminatory.

7.171 In this regard, the Appellate Body recently reaffirmed the importance of the principle of de facto, as well as *de jure*, non-discrimination. In Bananas III, the Appellate Body stated the following in connection with the MFN obligation under Article II of GATS: "Moreover, if Article II was not applicable to de facto discrimination, it would not be difficult ... to devise discriminatory measures aimed at circumventing the basic purpose of that Article.".[424] Here, Indonesia has attempted to circumvent the basic non-discrimination principle of Article I of GATT 1994.

7.172 One issue that Japan and the European Communities did not address is Indonesia's argument that TPN, not Kia, was the beneficiary of Decree No. 42/96, and that Kia received no benefit other than being paid by TPN as one of its suppliers. First, the United States would note that Article I applies to products, not business entities. Nevertheless, in the view of the United States, being paid for products one supplies constitutes an advantage, favour, or privilege within the meaning of Article I:1, particularly when the ability to be paid is attributable to a special exemption from tariffs and taxes that is not extended to suppliers from other countries. Accepting Indonesia's arguments would open up a tremendous loophole in Article I, because one always could argue that those advantaged by non-MFN behaviour are importers rather than suppliers.

(c) The passenger cars in question are like products to the Kia Sepia Sedan

7.173 Finally, Indonesia asserts that the complainants have failed to establish for purposes of Article I that there is any "like product" to the Timor Kia Sephia sedan. Arguing that passenger vehicles are highly differentiated, Indonesia asserts that: "There simply is no car that matches the requisite physical and nonphysical characteristics of the Timor S515 to be considered a 'like product' to it." (See section VII.D.2(c).)

7.174 To the contrary, the United States provided more than enough evidence in its first submission to establish that GM Opels, Ford Escorts, and Chrysler Neons are "like products" to the Timor Kia Sephia. Indonesia has not provided any evidence to the contrary, but simply has asserted that there is no passenger car "identical" to the Sephia. However, product identity is not required for purposes of a "like product" analysis under Article I, especially in the case of consumer products, such as passenger cars, that by their very nature will be differentiated from one another for reasons of product competition. If product identity were required, Article I would be a dead letter in the case of consumer products.[425]

VIII. CLAIMS UNDER THE SCM AGREEMENT

8.1 The **European Communities** and, in its request for the establishment of a panel, the **United States**, both claim that the measures under the 1993 programme and the National Car

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[424] European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997, para. 233.

[425] In this regard, in Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, p. 24, the Appellate Body affirmed the panel's finding that shochu and vodka are "like products" for purposes of Article III:2, first sentence, a provision that the Appellate Body stated should be narrowly construed. Anyone who has tasted shochu and vodka knows that those two beverages are not "identical."

programme cause serious prejudice to their interests in the sense of Article 6 of the SCM Agreement. However, in its first submission, the United States clarified that it was limiting its claim of serious prejudice to subsidies provided under the National Car programme. In addition, the **United States** claims that, in modifying the 1993 programme, and adopting the National Car programme, Indonesia has violated Article 28.2 of the SCM Agreement.

8.2 In this dispute, all parties making arguments concerning serious prejudice (i.e., the **European Communities** and the **United States** in their claims, and **Indonesia** in its responses) agree that the tariff and tax measures under the 1993 programme and the National Car programme are specific subsidies. The **United States** and **Indonesia** disagree as to whether the $690 million loan is a specific subsidy. The following are the parties arguments in this regard:

A. Existence of specific subsidies

1. The measures at issue are subsidies

(a) Arguments of the European Communities

8.3 The following are the **European Communities'** arguments that the measures at issues are "subsidies" within the meaning of Article 1 of the SCM Agreement:

8.4 Article 1.1 of the SCM Agreement states in the relevant part that:

> For the purposes of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a Government or any public body within the territory or any body within the territory of a Member .... i.e. where:
>
> (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
>
> and
>
> (b) a benefit is thereby conferred

8.5 The measures at issue provide for the granting of three types of incentives:

- customs duty relief for parts and components intended for assembly into National cars;
- exemption from the Sales Tax on Luxury Goods for National Cars; and
- customs duty relief for National Cars imported from Korea.

8.6 Both the customs import duties and the Sales Tax on Luxury Goods are imposed, collected, and appropriated by the Indonesian Government. Accordingly, they constitute “Government revenue”.

8.7 The importation into Indonesia of motor vehicles and of parts and components thereof is legally subject to the payment of customs duties. Likewise, sales of passenger cars are legally subject to the payment of the Sales Tax on Luxury Goods. Thus, by granting the incentives under consideration, the Government of Indonesia is “foregoing revenue” that would otherwise be “due” .

8.8 The measures provide a direct "benefit" to those persons and entities that, in the absence of the incentives, would be responsible for the payment of the duties/taxes, i.e. to PT TPN. For the above reasons, it must be concluded that the incentives provided under the National Car Programme constitute "subsidies" in the sense of Article 1 of the SCM Agreement.

(b) Arguments of the United States

8.9 The **United States** argues that the tariff and tax incentives and the government-directed $690 million loan under the National Motor Vehicle programme constitute subsidies within the meaning of Article 1.1 of the SCM Agreement. The following are the **United States'** arguments in this regard:

8.10 The tariff and tax incentives and the government-directed $690 million loan to TPN under the National Motor Vehicle programme constitute subsidies within the meaning of Article 1.1 of the SCM Agreement, because they each entail (1) a financial contribution; and (2) the conferral of a benefit.

8.11 With respect to the tariff and tax incentives, the Government of Indonesia admits that these incentives constitute subsidies. (See e.g., Section VII.C.) However, independent of this admission, these tariff and tax incentives meet the definition of a subsidy under Article 1.1. The exemption from import duties on parts used to produce the "national motor vehicle" (the Timor Kia Sephia sedan), the one-year exemption from duties of CBU Kia Sephia sedans imported from Korea, and the effective exemption from the luxury tax on sales of Timor Kia Sephia sedans (whether imported in CBU form from Korea or assembled in Indonesia) clearly constitute "government revenue that ... is foregone" within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. As such, they constitute a "financial contribution." Moreover, they confer a benefit by lowering the recipient's costs and allowing the product in question, the Timor Kia Sephia sedan, to be sold at a lower price than would be the case absent the tariff and tax exemptions.

8.12 With respect to the government-directed $690 million loan, the loan falls under Article 1.1(a)(1)(iv), which defines a "financial contribution" as existing where:

> a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments ... . (emphasis added).

As described above, the evidence is overwhelming that the Government of Indonesia directed the consortium of government-owned and private banks to provide the $690 million loan to TPN. In so doing, the Government was directing a private body to carry out the function illustrated in Article 1.1(a)(i); i.e., to provide a concessional loan. Such concessional financing normally is provided by government lending institutions or other public bodies.

8.13 Finally, the government-directed loan conferred a benefit on TPN. By ordering the banks to lend to TPN, the Government conferred two types of benefits on TPN: (a) TPN received financing that it otherwise would not have been able to obtain; and (b) even assuming that TPN could have received financing of a comparable size, the terms of the financing were more favourable than the terms that TPN would have received absent the Government's involvement. (See Section V.C.3).[426]

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[426] Indonesia disputes the fact that the $690 million government-directed loan to TPN is a subsidy, but has not provided any evidence that the loan is not a subsidy. Instead, Indonesia makes the bare assertion that the GOI had no role in the granting of the loan, but that the GOI since has done an independent investigation and

(c) Arguments of Indonesia

8.14 **Indonesia** also argues that the measures at issue are subsidies in the sense of Article 1 of the SCM Agreement. These arguments are set forth in part in Section V.D. See also Indonesia's further arguments in this regard in Section VIII.A.3, below.

2. The measures at issue are specific

(a) Arguments of the European Communities

8.15 The **European Communities** argues that the subsidies are contingent upon compliance with local content requirements and, accordingly, are "specific" in the sense of Article 2 of the SCM Agreement. The following are the **European Communities'** arguments in this regard:

8.16 Article 1.2 of the SCM Agreement stipulates that:

> A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

8.17 According to Article 2.3 of the SCM Agreement,

> Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

8.18 Article 3.1 of the SCM Agreement then states that:

> 3.1 .... the following subsidies within the meaning of Article 1, shall be prohibited:
>
> > (b) subsidies contingent, whether solely or as one of several other conditions upon the use of domestic over imported goods

8.19 The grant of duty relief on imports of parts and components is contingent upon the finished vehicle or the parts and components into which the imported goods are assembled reaching a minimum local content percentage. Similarly, the grant of the exemptions from the Sales Tax on Luxury Goods is conditional upon the motor vehicles concerned meeting certain local content requirements. Finally, the grant of duty relief for imports of National Cars is conditional upon the overseas manufacturer of the cars purchasing a certain amount of Indonesian parts and components

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determined that the loan was granted on commercial terms. However, Indonesia does not offer any evidence to support its assertions or to rebut the evidence provided by the United States in its first submission.

In this regard, while the Panel has ruled that the US claims concerning the loan are inadmissible, the loan remains relevant to this case. Cf., Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, WT/DS56/R, Report of the Panel issued 25 November 1997, para. 6.15. Indonesia asserted at the first meeting of the Panel that after TPN's start up phase, the "market will determine the winners and the losers, as it should". Indonesia Statement to the Panel, page 2. This statement is simply contradicted by the fact that the GOI ordered a consortium of banks to provide a $690 million loan to TPN on preferential terms. The loan is a subsidy, and, with a 10-year term, has a 10-year allocation period. In other words, TPN will be deemed to be receiving subsidies from the loan for the next ten years. The existence of the loan belies Indonesia's claim that, as of 1999, the "market" will determine the winners and losers. Moreover, Indonesia's claim that the GOI played no role in the provision of the loan is so at odds with the reported facts that it calls into question the credibility of other factual assertions made by the GOI in this case.

and incorporating them into the products exported to Indonesia.[427] Thus, three types of incentives at issue are "contingent upon the use of domestic over imported goods" within the meaning of Article 3.1 (b) and, accordingly, must be deemed "specific" in the sense of Articles 1.2 and 2 of the SCM Agreement.

8.20 Even if the subsidies at issue were not contingent upon the use of domestic over imported goods, they would still be "specific" pursuant to Article 2.1 of the SCM Agreement, since eligibility is limited to certain enterprises belonging to a certain industry and which meet certain non objective criteria. Furthermore, the decision whether to grant the subsidies is a discretionary one and, in practice, the benefits have been granted to only one enterprise: PT TPN.

8.21 Indonesia does not dispute that the measures are "specific subsidies" subject to the provisions of the SCM Agreement. Indeed, the measures were notified by Indonesia pursuant to Article XVI:1 of the GATT and Article 25 of the SCM Agreement on 28 October 1996, simultaneously with Indonesia's withdrawal of its previous notification of some of the measures under the TRIMs Agreement.[428] Furthermore, in connection with this dispute, Indonesia admits that the measures at issue constitute subsidies contingent upon local content.

8.22 The **European Communities** also argues that Indonesia admitted during consultations that the June 1996 programme as well as the February 1996 programme are specific subsidies.[429]

(b) Arguments of the United States

8.23 The **United States** argues that the tariff and tax benefits and the government-directed $690 million loan under the National Motor Vehicle programme are specific within the meaning of Article 2 of the SCM Agreement. The following are the **United States**' arguments in this regard:

8.24 Under Article 1.2 of the SCM Agreement, in order for a subsidy to be actionable under Part III of the SCM Agreement, the subsidy must be "specific in accordance with the provisions of Article 2". The tariff and tax subsidies and the government-directed $690 million loan under the National Motor Vehicle programme meet the specificity requirements of Article 2.

8.25 First, each of these subsidies is specific under Article 2.3, which provides: "Any subsidy falling under the provisions of Article 3 shall be deemed to be specific". Because the tariff and tax subsidies under the National Motor Vehicle programme are contingent on satisfying the local content requirements for a "national motor vehicle", these subsidies fall under Article 3.1(b) of the SCM

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[427] This incentive could also be characterised as a subsidy contingent upon export performance of the type prohibited by Article 3.1 (a) of the SCM Agreement.

[428] G/SCM/N/16/IDN. See also G/SCM/Q2/IDN/9 dated 23 May 1997

[429] Thus, for instance, in reply to a written question from the Community, Indonesia stated that:

> Under both the February 1996 and the June 1996 decrees, instructions and regulations, companies that satisfy the designated criteria are exempted from the luxury tax and customs import duties. All of the requisite elements of a subsidy are involved: a financial contribution by the government by virtue of revenue foregone; a benefit to the recipients by virtue of exemption from the luxury tax and customs import duties, and specificity, by virtue of limitation of the subsidy to those companies that meet the criteria of the February 1996 and the June 1996 decrees, instructions and regulations. Among the criteria for receipt of subsidies under the February 1996 and the June 1996 decrees, instructions and regulations is the obligation to achieve designated rates of local content. This constitutes 'subsidies contingent .... upon the use of domestic over imported goods' within the meaning of Article 3.1 (b) of the SCM Agreement. See also Indonesia's replies to questions from the Community, dated 25 November 1995, at points 2.a, 5.h, 5.I, and 6.l. (EC Exhibit B-4)

Agreement, which refers to "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods". Likewise, the government-directed $690 million loan also falls under Article 3.1(b), because the evidence overwhelmingly demonstrates that the Government ordered the provision of the loan due to TPN's status as a participant in the production of a "national motor vehicle." This status, in turn, was contingent on the satisfaction of the local content criteria of the National Motor Vehicle programme.

8.26 Second, these subsidies also are specific under Article 2.1 of the SCM Agreement, which sets forth criteria for determining specificity with respect to subsidies other than prohibited subsidies and regional subsidies.[430] Article 2.1 provides as follows:

> In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:
>
> (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.
>
> (b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.
>
> (c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation. (footnotes omitted).

8.27 With respect to the tariff and tax subsidies, these are specific under paragraph (a), because Presidential Instruction No. 2/1996 and the various implementing decrees and regulations limit access to these subsidies to producers of motor vehicles. In other words, the subsidies are limited to a single industry, the automotive industry.

8.28 Finally, the tariff and tax subsidies are specific under paragraph (c). These subsidies are used only by Kia Timor and TPN, which clearly constitute "a limited number of certain enterprises" within the meaning of paragraph (c), second sentence. Moreover, the decision to limit these subsidies to Kia Timor and TPN constitutes the exercise of discretion within the meaning of paragraph (c), second

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[430] Regional subsidies are dealt with in Article 2.2.

sentence. The only explanation given for limiting these subsidies to Kia Timor and TPN is that it is the Government of Indonesia's policy to do so. If true, this type of exercise of a government's policy prerogatives is the paradigm of a discretionary decision.

8.29 With respect to the government-directed $690 million loan, the evidence demonstrates that this loan was "special credit" provided to a single firm, TPN. [431] At a time when the Government of Indonesia was clamping down on credit and cancelling other large projects[432], TPN was able to obtain a massive loan package on very favourable terms that would not have been available to similarly situated firms. Clearly, the provision of this loan is specific within the meaning of Article 2.1(c).

8.30 Moreover, putting aside the evidence the United States has provided, it should be emphasized that, in the Annex V process, Indonesia refused to provide information that would have permitted a more thorough analysis of the specificity of the loan under Article 2.1(c). In Question 29(b) of AV/15, the United States sought information relating to the specificity of the government-directed $690 million loan. In particular, the United States asked the following: "Please describe other recent projects financed by state bank-led consortia, including the amount of financing provided and the terms of the financing." Indonesia refused to respond, stating that it "question[ed] the relevance of this request to the Annex V process."[433]

8.31 Clearly, information relating to the specificity of a subsidy is relevant to the Annex V process, which, pursuant to paragraph 2 of Annex V, is aimed at obtaining "such information from the government of the subsidizing Member as necessary to establish the existence and amount of subsidization . . . " In light of Indonesia's non-cooperation with respect to information concerning the loan, the Panel should draw an adverse inference pursuant to paragraph 7 of Annex V and find the government-directed $690 million loan to be specific.

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[431] "Analysts Warn About Loans for Timor Car", Jakarta Post, 13 August 1997 (US Exhibit 14, pp. 163-165).

[432] The decision to grant the $690 million loan package came at a time when the Government of Indonesia, due to the depreciation of the rupiah and overly aggressive lending by banks, was clamping down on credit and canceling large projects, thereby making the loan to TPN all the more extraordinary. As one commentator noted of the decision to grant the $690 million loan, "The move appears to contradict government policy to clamp down on credit growth." ("Jakarta Plans New 'National' Car," Financial Times (London), 7 May 1997, p. 4 (US Exhibit 14, pp. 110-111).) Indeed, the President of Indonesia, in his state of the nation address, announced "that all projects that were not a national priority would be shelved given the 'new realities' facing the country." ("Timor Car Project Not to Be Rescheduled in Face of Currency Crunch," Agence France Presse, 20 Aug. 1997 (US Exhibit 14, pp. 170-171)). It was further reported that:

> President Soeharto, in his National Day Address last Saturday, called on the business community to select projects for implementation carefully in view of the currency upheaval currently confronting the economy. Soeharto said the government and business should review their investment projects to ascertain which should be given top priority and which should be postponed.

("Timor Car Project Won't Be Rescheduled," Jakarta Post, 21 August 1997 (US Exhibit 14, pp. 172-173); See also, "Indonesia: Jakarta Pledges to Cut Big Projects," Financial Times (USA) (17 September 1997) <http://www.usa.ft.com/hippocampus/v4514e.htm> (US Exhibit 15, pp. 3-4).) As a result, according to the Coordinating Minister for Economy and Finance, the Government "took stock of projects according to their scale of priority. Obviously, high priority programs will not be axed." However, when asked by reporters whether the Timor car project would be rescheduled, the Coordinating Minister responded that "the term 'national' classifies it as a high priority project." ("Ministers Review Projects Rescheduling," Business Daily, 8 Sept. 1997 (US Exhibit 14, pp. 174-175).) This followed an earlier statement by the Coordinating Minister that "Everyone must support the [national car] program." ("13 Banks Ordered to Finance Timor Car Project," The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114)).

[433] AV/16, p. 3.

(c) Arguments of Indonesia

8.32 **Indonesia** also argues that the Government's grant of exemptions and reductions in import duties and the luxury tax to certain manufacturers and assemblers of automobiles and automotive parts are specific in the sense of Article 2 of the SCM Agreement. These arguments are set forth in part in Section V.D. See also Indonesia's further arguments in this regard in the following section.

(3) Indonesia's arguments that the measures are specific subsidies

8.33 The following are **Indonesia**'s further arguments (in addition to those in Section V.D) that the measures at issue are specific subsidies:

8.34 Articles 1 and 2 of the Subsidies Agreement define a specific subsidy. They provide in the relevant part that "a subsidy shall be deemed to exist if ... there is a financial contribution by a government" where:

> "government revenue that is otherwise due is foregone or not collected" (Article 1.1(a)(l)(ii)); and
>
> a benefit is thereby conferred that is "specific to an enterprise or industry or group of enterprises or industries" (Article 2.1).

8.35 Under the 1993 incentive programme, the Government foregoes or does not collect revenue that is otherwise due by granting an exemption from or reduction in the rate of import duties on automotive parts and components. Thus, there is the requisite financial contribution by the Government.

8.36 The February 1996 national car programme exempts companies designated by the Government as producers of a national car from the payment of either import duties on automotive parts and components or the luxury tax. The Government, therefore, foregoes or does not collect revenue otherwise due from specific enterprises. (See also section V.D.2(a).)

8.37 In addition, the subsidy under the 1993 incentive programme falls under the provisions of Article 3 of the Subsidies Agreement. Thus, by virtue of Article 2.3 of that Agreement, there is the requisite specificity. The same is true of the February 1996 programme.

8.38 **Indonesia** also indicates at several points in its arguments that the June 1996 programme is (or was) a specific subsidy. (See, e.g., Section VII.D.3 and Section X.A). See also the arguments of the **European Communities**, above, quoting an Indonesian response to a written question in consultations.

B. Serious Prejudice Claims

1. Summary of claims

8.39 The **European Communities** and the **United States** note that the National Car Programme provides three types of benefits for National Cars in Indonesia: exemption from import duties on parts and components used for the assembly of National Cars; exemption from import duties on National Cars imported from Korea; and exemption from the Sales Tax on Luxury Goods on National Cars,

whether imported from Korea or assembled in Indonesia. These incentives constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement.[434]

8.40 The **European Communities** and the **United States** observe that the subsidies are contingent upon the use of domestic over imported parts and components. As such, they would be prohibited by Article 3.1(b) of the SCM Agreement, were it not because, as a developing country Member, Indonesia benefits from the temporary exception to that prohibition provided in Article 27.3 of the SCM Agreement.

8.41 The **European Communities** and the **United States** claim that, nonetheless, the subsidies cause "adverse effects" to their respective interests in the form of "serious prejudice" within the meaning of Articles 6 and 27 of the SCM Agreement. Specifically, the subsidization of the National Cars has caused serious prejudice by (i) displacing or impeding imports of motor vehicles of European Communities and United States manufacturers into the Indonesian market; and (ii) resulting in significant price undercutting of motor vehicles of European Communities and United States manufacturers in the Indonesian market. Therefore, Indonesia is required, in accordance with Article 7.8 of the SCM Agreement, to withdraw them or to take appropriate steps to remove their adverse affects.

2. Basis for serious prejudice as a cause of action against Indonesia as a developing country

8.42 The **European Communities** and the **United States** argue, and **Indonesia** acknowledges that serious prejudice can be a cause of action against Indonesia in this dispute. The **European Communities** and the **United States** argue that such claims can be raised only if one of the situations described in Article 6.1(a) of the SCM Agreement exists. Indonesia indicates that 6.1(a) situations can be a basis for serious prejudice claims against developing countries, but that serious prejudice as a cause of action against developing countries also can be reached directly where the subsidies in question fall under the provisions of Article 3 of the Agreement. The following are the arguments of the **European Communities**, the **United States**, and **Indonesia** in this regard.

(a) Arguments of the European Communities

(1) The subsidies are actionable under Part III of the SCM Agreement.

The subsidies would be "prohibited" by Article 3.1 (b) of the SCM Agreement but for the temporary exception for developing countries provided in Article 27.3 of the SCM Agreement.

8.43 Article 3.1 (b) of the SCM Agreement prohibits subsidies that are:

> "... contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods".

8.44 This prohibition is subject to the temporary exception provided in Article 27.3 of the SCM agreement, which states that:

> The prohibition of paragraph 1(b) of Article 3 shall not apply to developing country members for a period of five years, and shall not apply to least developed country

[434] The Community considers that the benefits granted for the assembly of other motor vehicles and parts and components thereof under the 1993 Deregulation Package and under the National Car Programme are also "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement. Nevertheless, the Community has decided no to take action against those subsidies under Part III of the SCM Agreement within the framework of the current dispute. The Community reserves its right to do so in the future, if necessary.

> Members for a period of eight years from the date of entry into force of the WTO Agreement.

8.45 As shown above, the subsidies at issue are contingent upon compliance with local content requirements and, accordingly, fall within the prohibition laid down in Article 3.1 (b).

8.46 Nevertheless, given Indonesia's status as a "developing country Member", the prohibition of Article 3.1(b) will not apply to the measures in dispute for a period of five years from the entry into force of the WTO Agreement, i.e. until 1 January 2000.

(2) Article 27.3 does not preclude the "actionability" of the subsidies under Part III of the SCM Agreement

8.47 By its own words, Article 27.3 of the SCM Agreement excludes the application of the prohibition contained in Article 3.1(b) only, and of no other provision of the SCM Agreement. Therefore, Article 27.3 does not confer immunity against actions based on other provisions of the SCM Agreement and, in particular, against action under Part III of the SCM Agreement.

8.48 This is further confirmed by the express wording of Article 5 of the SCM Agreement, which provides that:

> No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members... [emphasis added]

8.49 Thus, Article 5 applies with respect to all specific subsidies within the meaning of paragraphs 1 and 2 of Article 1 of the SCM Agreement, including those which are prohibited by Article 3. As demonstrated above, the measures at issue are specific subsidies. Consequently, Indonesia is subject in respect of those measures to the disciplines laid down in Article 5 of the SCM Agreement.

(3) The subsidies cause "adverse effects" to the interests of the Community in the form of "serious prejudice"

8.50 Article 5 of the SCM Agreement lists three different types of "adverse effects":

> serious injury to the domestic industry of another Member;
>
> nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994, in particular the benefits of concessions bound under Article II of GATT 1994;
>
> prejudice to the interest of another Member.

8.51 Footnote 13 to subparagraph (c) of Article 5 of the SCM Agreement specifies that:

> "The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994 and includes threat of serious prejudice".

8.52 The Community claims and will demonstrate below that the subsidies at issue cause "adverse effects" to its interests in the form of "serious prejudice".

(4) The European Communities is not precluded by Article 27.9 of the SCM Agreement from invoking "serious prejudice"

8.53 Article 27.9 of the SCM Agreement provides that, where a subsidy is granted by a developing country Member, "serious prejudice" can only be invoked if the subsidy in question falls within one of the categories "referred to" in Article 6.1 of the SCM Agreement.

8.54 Article 6.1 "refers", inter alia, to subsidies where the total *ad valorem* subsidization of the product concerned exceeds 5 per cent on the value of sales (or 15 per cent on the value of the total invested funds in the case where the recipient is in a start-up situation). As shown below, in the present case the amount of subsidisation is well above that percentage by any possible measurement. Accordingly, Article 27.9 of the SCM Agreement does not prevent the Community from invoking "serious prejudice" with respect to the subsidies in dispute.

(5) The subsidies would be presumed to cause "serious prejudice" to the Community's interests but for Indonesia's status as a developing country Member

8.55 Article 6.1 provides that serious prejudice in the sense of Article 5 © shall be deemed to exist where the total ad valorem subsidisation of the products concerned exceeds 5 per cent on the relevant sales value (or 15 per cent on the value of invested funds where applicable). As demonstrated below, in the present case the amount of subsidization exceeds by far that threshold. Thus, in accordance with Article 6.1, the subsidies at issue would have to be deemed to cause "serious prejudice" to the European Communities.

8.56 Nevertheless, Article 27.8 of the SCM Agreement stipulates that the presumption of Article 6.1 shall not apply where, as in the present case, the subsidy is granted by a developing country Member. Article 27.8 further states that, in that case, serious prejudice must be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6 of the SCM Agreement.

(6) The subsidization is massive

8.57 The European Communities have calculated the amount of total *ad valorem* subsidization on the basis of data supplied by Indonesia and in accordance with the provisions contained in Annex IV of the SCM Agreement. The results of that calculation are summarized in the table below:

Product	Subsidization rate	Period
Timor S-515 all cars (based on estimated invested funds)	219-225%	Start-up period Nov 1995-April 1999
Timor S-515 imported from Korea (based on value of sales)	156-460%	Oct. 1996-June 1997
Timor S-515 assembled in Indonesia (based on estimated value of sales)	49-61%	May 1998-Dec. 1998
	40-50%	1999

8.58 A detailed explanation of the calculation of the amount of subsidization is provided below:

(a) Methodology

8.59 In accordance with Paragraph 1 of Annex IV of the SCM Agreement, the amount of the subsidies must be calculated "in terms of cost to the granting government".

8.60 In the present case, the "cost to the granting government" is the amount of the import duties and of the Sales Tax on Luxury Goods not collected by the Indonesian Government pursuant to the National Car Programme.[435]

8.61 In principle, the rate of ad valorem subsidization must be calculated by expressing the subsidy amount as a percentage of the sales value of the products benefiting from the subsidy. Nevertheless, by way of exception, Paragraph 4 of Annex IV provides that where the recipient firm is in a start-up situation the following rule shall apply instead:

> Where the recipient firms is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidisation exceeds 15 per cent of the total funds invested. For purposes of this paragraph, a start-up period is deemed not to extend beyond the first year of production.

8.62 According to Footnote 65, start-up situations include

> "instances where financial commitments for product development or construction of facilities to manufacture products benefiting from the subsidy have been made, even though production has not begun".

8.63 The incentives provided in respect of the finished cars imported from Korea and in respect of the cars assembled at Tambun Plant are transitional measures until PT TPN starts its own production at Karawang Plant. In view of this, it may be considered that PT TPN is still in a "start-up situation" in the sense of Paragraph 4, which situation began with the incorporation of PT TPN in November 1995 and will run until one year after production starts at Karawang Plant (i.e. until the end of April 1999). On that assumption, the rate of *ad valorem* subsidisation received by PT TPN would have to be calculated by expressing the total amount of the subsidies to be received by PT TPN during the said start-up period as a percentage of PT TPN's estimated total invested funds.

8.64 If it was considered that PT TPN is not in a "start-up situation" within the meaning of Paragraph 4, the *ad valorem* subsidisation rate would have to be calculated by expressing the amount of each subsidy as a percentage of the relevant sales value in accordance with the rules contained in Paragraphs 2 and 3 of Annex IV.

8.65 In the case of the exemption from the Sales tax on Luxury Goods, this calculation seems unnecessary. Since the Sales Tax on Luxury Goods takes the form of an *ad valorem* tax on the net sales value of the cars, the *ad valorem* rate of subsidisation may be considered to equal the rate at which that tax is generally applied to the category of products concerned, i.e. 35 per cent.

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[435] In the Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing measures (G/SCM/W/415) it is recommended that:

> the cost to the government of tax exemptions, deductions, holidays and any similar measures be calculated as the amount of revenue that the government otherwise would have collected" (recommendation 12, at para A. 1)

8.66 As regards the subsidy in the form of import duty relief, Paragraph 3 of Annex IV provides that where a subsidy is tied to the production or sale of a given product, the relevant sales denominator for the calculation of the rate of *ad valorem* subsidisation shall be:

> "the total value of the recipient firm sale's of that product in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted".

8.67 In the present case, however, PT TPN did not sell any motor vehicles in the period preceding the granting of the subsidies. This makes it impossible to establish the sales denominator in accordance with the rule contained in Paragraph 2. In view of this, it is considered appropriate to use instead the sales data made available by Indonesia for the period October 1996-June 1997.

8.68 The generally applicable import duty rate on CBU passenger cars is higher than the applicable import duty rate on imports of parts and components, including CKD kits. Furthermore, it can be expected that the customs value of the CBU Timors S-515 imported from Korea will be higher than the customs value of the parts and components imported from Korea for assembly in Indonesia. As a result, the *ad valorem* subsidisation of the cars imported from Korea by PT TPN and sold during the period October 1996-June 1997 is likely to be higher than the rate of subsidization of the cars assembled at Tambun Plant as from June 1997 and at Karawang Plant as from May 1998.

8.69 For the above reasons, it seems appropriate to calculate separately the subsidization rate of the cars imported from Korea and the subsidisation rate of the cars assembled in Indonesia. Since production at Karawang Plant has not started yet and Indonesia has not made available the necessary data with respect to the production at Tambun Plant, the calculation of the subsidization rate of the cars assembled in Indonesia must necessarily be based on the estimates for the amount of subsidization and for the sales value of the cars to be assembled at Karawang Plant provided by Indonesia in the framework of the Annex V Procedure.

(b) Calculation based on invested funds during the "start-up" period

8.70 According to PT TPN's investment permit, the estimated total investment by PT TPN is Rp. 975,800 million.

8.71 The total amount of subsidization received by PT TPN during the start-up period may be estimated as follows:

Subsidies on cars imported from South Korea	Rp. 1,914,252 million*
Subsidies on cars assembled at Tambun Plant	n.a
Subsidies on cars to be assembled at Karawang Plant during 1998	Rp. 104,304-131,904 million**
Subsidies on cars to be assembled at Karawang Plant during Jan-Apr 1999	Rp. 118,888-148,688 million**.
Total	Rp. 2,137,444-2,194,844 million

*Total amount of uncollected duties as calculated in 3.1+35 per cent of total sales value mentioned under point 3.1

**Based on Attachment A-28

8.72 Thus, on this basis, the *ad valorem* amount of subsidization would be:

2,137,444 million-2,194,688 million/975,800 million x 100 = 219 %-225%

(c) Calculation based on value of sales

(i) Subsidies on imported passenger cars

8.73 The amount of subsidization of the cars imported by PT TPN from Korea equals the amount of customs duties not collected upon importation into Indonesia plus the amount of uncollected luxury taxes.

8.74 The applicable customs duty on imports of CBU passenger cars is 200 per cent.[436] Thus, the amount of uncollected customs duties will be the amount that results from applying that percentage to the total import value of the cars.

8.75 According to Indonesia's Response to the European Communities Questionnaire in the Annex V Procedure[437] , the import value of the cars was the following:

June-December 1996	US$131,242,800
January-June 1997	US$237,210,266
Total	US$368,453,066

8.76 The amount of uncollected import duties may thus be estimated as follows:

JuneDecember 1996	US$262,485,600 (= Rp. 629,965,440,0004[438])
JanuaryJune 1997	US$474,420,532 (= Rp. 1,138,609,277,800)
Total	US$736,906,132 (= Rp. 1,768,574,716,800)

8.77 In turn, according to Indonesia's Response[439] , the sales value of the imported cars was the following:

October-December 1996	Rp. 153,002,850,000
January-June 1997	Rp. 263,218,585,000
October 1996-June 1997	Rp. 416,221,435,000

[436] AV/3, at point 23.
[437] Id. at point 21.

[438] All amounts in US$ have been converted into Rp at the rateUS$1 = Rp. 2,400.

[439] AV/3 at point 22.

8.78 The *ad valorem* subsidisation rate corresponding to the non collection of import duties is thus the following:

October-December 1996	412%
January-June 1997	433%
October 1996-June 1997	425%

8.79 The total *ad valorem* subsidization rates which result from adding the above percentages to the rate of subsidization corresponding to the exemption from the Sales Tax on Luxury Goods (35 per cent) are:

October-December 1996	447%
January-June 1997	468%
Total	460%

8.80 The above calculation does not make any adjustment for the fact that as of 30 June 1997, 28,391 cars had not been sold yet out of 39,727 cars imported. In view of that, it is perhaps more appropriate to calculate the amount of *ad valorem* subsidization on the basis of the average unit import value for the period June 1996/June 1997 and the average unit sales value for the period October 1996/June 1997.

8.81 On the basis of the data provided in Indonesia's Response, the unit import value for the period June 1996/June 1997 was US$9,275.

8.82 Accordingly, the uncollected amount of import duties per unit was US$9,275 x 200% = US$18,550 (= Rp.44,520,000).

8.83 In turn, the unit sales value for the period October 1996/June 1997 was Rp. 36,716,781.

8.84 On this basis, the *ad valorem* rate of subsidization resulting from the non collection of import duties would be:

(44,518,560 /36,761,782) x 100 = 121 %

8.85 This percentage, added to the subsidization rate corresponding to the exemption from the Sales Tax of Luxury Good, results in a total *ad valorem* subsidization rate of:

121% + 35% = 156%

(ii) Subsidies on Passenger cars assembled at Karawang Plant

8.86 In the Attachment A-28 to its Response in the Annex V Procedure (AV/3), Indonesia has estimated the amount of the subsidies to be granted in respect of the assembly of passenger cars at Karawang Plant as follows:

	1998	1999
Import duty	US$15.99-23.12 million	US$51.80 - 74.89 million
Luxury Tax	US$27.47-31.84 million	US$96.81-110.97 million
Total	US$43.46-54.96 million	US$148.61-185.86 million

8.87 In the same Attachment, Indonesia gives the following estimate of the sales value of those cars:

1998	US$89.56 million
1999	US$373.18 million

8.88 On the basis of the above estimates, the total rate of *ad valorem* subsidisation would be the following :

1998	48.5-61.4%
1999	39.8-49.8%

8.89 In response to a question from the United States, Indonesia has stated that "Items 3 to 8 of Attachment A-28 are also applicable to the Tambun Plant".[440] Accordingly, the above calculation may be considered to constitute also an accurate estimate of the total subsidisation rate of the cars assembled at Tambun Plant.

(b) Arguments of the United States

(1) Because the subsidies provided under the National Motor Vehicle programme exceed 5 per cent ad valorem, the subsidies fall under Article 6.1(a) of the SCM Agreement and are actionable under Articles 27.8 and 27.9

8.90 For purposes of this dispute, the United States assumes that Indonesia is a developing country. Therefore, under Articles 27.8 and 27.9 of the SCM Agreement, a serious prejudice case may be brought against Indonesia only if the Indonesian subsidies are of a type described in Article 6.1. Article 6.1(a) refers to subsidies where "the total ad valorem subsidization of a product exceed[s] 5 per cent". (Footnote omitted). With respect to the subsidies provided under the National Motor Vehicle programme, the subsidies vastly exceed 5 percent. Therefore, a serious prejudice case may be brought against Indonesia.

(2) The one-year authorization to import Korean-made Kia Sephia sedans free of Indonesia's 200 per cent tariff on CBU passenger cars, alone, results in a subsidy in excess of 5 per cent

8.91 As shown below, the subsidies provided as a result of Presidential Decree No. 42/1996, alone, are well above the 5 per cent threshold. The authorization to import CBU Kia Sephia sedans free of Indonesia's 200 per cent tariff on CBU passenger cars resulted in a subsidy of 122 percent, assuming that the entire amount of the subsidy is attributed solely to the one-year period in 1996-97 for which the authorization was in effect.[441]

8.92 However, it would not be appropriate to allocate this subsidy solely to this one-year period, because of the tremendous size of the subsidy and the fact that the one-year authorization is a "non-recurring" subsidy. Therefore, this subsidy must be allocated over several years. The United States submits that in the absence of specific guidance in the SCM Agreement regarding the mechanics of subsidy allocation over time, the recommendations made by the Informal Group of Experts

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[440] AV/16 at point 12.28.c

[441] See Table 13.

established under the auspices of the SCM Committee offer a reasonable basis for dealing with this issue.[442]

8.93 By way of background, footnote 14 to Article 6.1(a) provides that "[t]he total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV". Annex IV to the SCM Agreement is entitled "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)". Although Annex IV contains some general principles regarding subsidy calculation, footnote 62 to Annex IV provides: "An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for purposes of paragraph 1(a) of Article 6." To that end, on 13 June 1995, the SCM Committee established an Informal Group of Experts ("IGE") to make recommendations concerning calculation rules for purposes of Annex IV and Article 6.1(a).[443] On 25 July 1997, the IGE submitted to the SCM Committee its recommendations.[444]

8.94 Recommendation 1 of the IGE Report deals with the question of "expensing" (allocating subsidies to the year of receipt) versus "allocating" (allocating subsidies over two or more years). Paragraph 2 of Recommendation 1 states that "non-recurring subsidies should be presumptively allocated ...". The IGE provided the following explanation for this recommendation:[445]

> The frequency and size of a subsidy were deemed relevant to the question of expensing versus allocating. Just as it is recommended that recurring and/or small subsidies be expensed, so is it recommended that non-recurring and/or large subsidies generally be allocated. One consideration in this context is that it might be illogical to expense very large subsidies due to the likely substantial impact that such subsidies would have on the recipient companies beyond the year in which they were received. For example, it is likely that non-recurring large subsidies would be used to purchase fixed assets, or even if not so used, would free up a comparable amount of company funds for this purpose.

8.95 The SCM Committee has not yet adopted the recommendations of the IGE, and those recommendations, of course, are not binding on this Panel. However, in light of Annex IV, paragraph 7, as well as the Tokyo Round Committee Guidelines, the IGE's recommendations regarding the allocation of non-recurring subsidies make sense, and should be followed in this case. The one-year tariff exemption provided to TPN on imports of Korean-made Kia Sephia sedans was a huge subsidy, the Government of Indonesia has asserted that this subsidy will not recur, and this tremendous gift of money frees up a comparable amount of TPN's funds to purchase assets for its Indonesian production/assembly facility.

8.96 The next question is how to allocate the one-year tariff exemption over time. In this regard, Recommendation 2, paragraph 1, of the IGE Report states: "As a general principle, the average useful life of assets should be used as the allocation period for subsidies subject to allocation." Paragraph 2 of Recommendation 2 then sets out a hierarchy of bases from which to determine the average useful life of assets, ranging from "Information for the individual firm or firms receiving the subsidy" to

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[442] Although Annex IV does not provide detailed calculation rules on this particular point, it clearly contemplates the allocation of subsidies over time, because paragraph 7 refers to "[s]ubsidies . . . the benefits of which are allocated to future production ... ." In addition, the Tokyo Round Subsidies Code Committee adopted "Guidelines on Amortization and Depreciation" that also called for the allocation of certain subsidies over time. BISD 32S/154.

[443] G/SCM/5 (22 June 1995).

[444] Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415 ("IGE Report").

[445] IGE Report, p. 5, para. 11.

"Information for other firms producing the product outside the country in question." Paragraph 3 of Recommendation 2 sets forth a formula for calculating the average useful life of assets.

8.97 The United States does not have information for the firms in question, and has not been able to develop information based on the formula set forth in paragraph 3 of Recommendation 2. Therefore, as a reasonable surrogate, the United States has used a 12-year allocation period based on the class life of assets for manufacturers of motor vehicles as set forth in the regulations of the US Internal Revenue Service.[446] Using a 12-year, straight line allocation method, this results in a subsidy of 10.18 per cent for the one-year period during which the duty-free authorization was in effect. (See below.) Although this method underestimates the size of the subsidy[447], the amount is still well in excess of the 5 per cent threshold.

(3) The inclusion of the other subsidies provided under the National Motor Vehicle programme simply increases the amount by which the total ad valorem subsidization exceeds 5 per cent

8.98 As demonstrated, a consideration of merely one component of the National Motor Vehicle programme establishes that the level of subsidization is in excess of 5 percent and that a serious prejudice case may be brought against Indonesia. However, for the sake of completeness, the United States notes, as shown below, that the exemption of the Timor Kia Sephia from the luxury tax results in a subsidy of 44 per cent for 1997[448] and an estimated subsidy of 35 percent for 1998 and 1999.[449] The exemption under the National Motor Vehicle programme from import duties on parts results in an estimated subsidy of 14 per cent for 1998 and 9 per cent for 1999.[450] Finally, the government-directed $690 million loan results in a conservatively calculated estimated subsidy of 7.1 per cent in 1998, 28.95 per cent in 1999, and 5.3 per cent in 2000.[451]

(4) Calculation of subsidization from the one-year tariff exemption on CBU imports of the Kia Sephia from Korea

8.99 If the subsidy attributable to the one-year tariff exemption on CBU imports of the Kia Sephia from Korea is “expensed” (allocated to the year of receipt), the resulting subsidy is 122.18 per cent ad valorem. This figure is derived as follows:

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[446] See Table 14 and accompanying note.

[447] This method underestimates the subsidy attributable to the one-year tariff exemption, because Recommendation 3, paragraph 1, of the IGE Report provides the following: “It is recommended, where subsidies are allocated over time, that subsidy amounts be adjusted fully for inflation and include a portion of the ‘real’ interest rate.” If this adjustment were made, the amount of the subsidy would increase.

[448] See Table 15.

[449] See Table 16.

[450] See Table 17.

[451] See Table 21.

Table 13

One-Year Tariff Exemption (Expensed)

Step 1	Determine the US$ value of importations during the one-year period (1996-97). Based on Attachment U-12 to AV/14, this figure is US$368,453,066.
Step 2	Multiply the value of importations by 200% to arrive at the total subsidy amount in US$. ($368,453,066 x 200% =$736,906,132).
Step 3	Determine the total sales value during the same period. Based on Attachment U-12, this figure is Rp. 418,221,435,000.
Step 4	Divide the total sales value by the total number of units sold to arrive at an average sales value in Rp. of cars sold. (418,221,435,000/ 11,336 = Rp. 36,893,210.57).
Step 5	Multiply the average sales value by the number of units imported to arrive at the total sales value in Rp. of the cars imported. (36,893,210.57 x 39,727 = 1,465,656,576,238.97).
Step 6	Convert the Rp. sales value into dollars by dividing by 2430 (the conversion rate provided by Indonesia in Attachment A-28 to AV/14. (1,465,656,576,238.97/ 2430 = $603,150,854.42).
Step 7	Divide the total subsidy amount by the total sales value to arrive at the subsidy percentage. **($736,906,132.00/ $603,150,854.42 = 122.18%)**.

8.100 If the subsidy attributable to the one-year tariff exemption on CBU imports of the Kia Sephia from Korea is "allocated over time", as it should be, the resulting subsidy is 10.18 per cent ad valorem. This figure is derived as follows:[452]

[452] Note that this calculation does not adjust for the "time value of money". If such an adjustment were made, as the United States believes it should be, the subsidy would increase.

Table 14

One-Year Tariff Exemption (Allocated)

Step 1	The total subsidy amount calculated in Step 2, Table 13 ($736,906,132) is divided by 12, the number of years over which the subsidy should be allocated.[453] This results in an allocated subsidy amount for 1996-97. ($736,906,132/ 12 = $61,408,844.33).
Step 2	Divide the allocated subsidy amount for 1996-1997 by the total sales figure to arrive at the subsidy percentage **($61,408,844.33/ $603,150,854.42 = 10.18%).**

(5) Calculation of subsidization from the exemption from the 35 per cent luxury sales tax

8.101 For the period 1996-97, the subsidy attributable to the exemption of the Timor Kia Sephia from the 35 per cent luxury tax is 44.43 per cent.[454] This figure is derived as follows:

[453] The period of 12 years is based on the class life (in years) for manufacture of motor vehicles set forth in the Class Lives tables of the Modified Accelerated Cost Recovery System of the U.S. Internal Revenue Service. 1997 US Master Tax Guide [CCH], ¶190. Because the United States was unable to develop information concerning the actual life of assets for Kia Timor or for the automotive industry as a whole (either in Indonesia or worldwide), it has used the Class Lives tables as the best information otherwise available to it.

[454] This figure relates to sales of imported CBU Kia Sephias from Korea during the one-year period authorized under Presidential Decree No. 42/1996. Although, after June, 1997, Kia Timor began to assemble Timor Kia Sephias in Indonesia, the data provided by Indonesia in its Annex V responses does not permit the calculation of the precise amount of subsidization attributable to the exemption from the luxury tax of cars assembled in Indonesia during the second half of 1997. However, given the nature of the subsidy, one can assume that the amount was around 35 per cent *ad valorem*.

Table 15

Luxury Tax Exemption (1996-97)

Step 1	Attachment U-12 to AV/14 states that the luxury sales tax is calculated on the basis of cost of goods sold. However, Indonesia did not provide a value for cost of goods sold, nor did it provide sales information for the 28,391 imported Kia Sephias that, according to Indonesia, had not yet been sold. However, AV/16, p. 3, indicates that all of the imported Kia Sephias will be exempt from the luxury tax when sold. Therefore, the calculation must be based on the estimated sales value of cars that were imported during 1996-97.
Step 2	Determine the US$ value of importations during the period (1996 97). Based on Attachment U-12 to AV/14, this figure is $368,453,066.
Step 3	Using Attachment A-30/1 to AV/14 as a guide, it is assumed that the value of importations equals the CIF price referred to in that attachment.
Step 4	Attachment A-30/1 shows that the amount of luxury sales tax is equal to 146.6259 per cent of the CIF price. However, this figure is based on the assumption that imported CBU cars are subject to the 200 per cent tariff, an assumption which does not hold for the Kia Sephias imported under Presidential Decree No. 42/1996. Therefore, by eliminating the effect of the 200 per cent tariff, the factor for the luxury tax is reduced to 72.6 per cent.
Step 5	Multiply the total CIF value by 72.6 per cent to arrive at the US$ value of the luxury tax exempted. ($368,453,066 x .726 = $267,496,925.90).
Step 6	Determine the total sales value for the same period. Based on Attachment U-12, this figure is Rp. 418,221,435,00.00.
Step 7	Divide the total sales value by the total number of units sold to arrive at an average sales value in Rp. of cars sold. (Rp. 418,221,435,000/ 11,336 = Rp. 36,893,210.57).
Step 8	Multiply the average sales value by the number of units imported to arrive at the total sales value in Rp. of importations. (Rp. 36,893,210.57 x 39,727 = Rp. 1,465,656,576,238.97).
Step 9	Convert the Rp. sales value into dollars by dividing by 2430 (the conversion rate provided in Attachment A-28) (Rp. 1,465,656,576,238.97/ 2430 = $603,150,854.42).
Step 10	Divide the total amount of the tax exempted by the total sales value to arrive at the subsidy percentage. **($267,496,925.90/ $603,150,854.42 = 44.43%.**

8.102 For 1998 and 1999, the estimated ad valorem subsidy rate attributable to the luxury tax exemption is 35.20 per cent. This figure is derived as follows:

Table 16

Luxury Tax Exemption (1998-99)

Step 1	According to Attachment U-12, AV/14, the luxury tax is calculated based on the cost of goods sold. Again, Indonesia did not provide this value in its Annex V responses.
Step 2	Using Attachment A-30/2, AV/14, as a guide, we know that the luxury sales tax amount is 96.8793% of the CIF value. The CIF value can be obtained through information provided in Attachment A-28, AV/14.
Step 3	Indonesia did not indicate how the values in Attachment A-28 relate to the values in Attachment A-30/2. Therefore, certain assumptions have to be made. Logically, it seems that the "dealer price" in A-28 is the same as the "sole agent sales price" in A-30/2. Attachment A-30/2 shows that the "sole agent sales price" is 426.3768 per cent of the CIF price. Given this assumption, calculate the average dealer's price (without subsidy - since we are trying to determine what part of that price is attributable to the luxury sales tax). [($22,170+$24,085)/2 = $23,127.50]
Step 4	Calculate the average CIF price by dividing the average dealer's price by 426.3768 per cent. [$23,127.50 / 426.3768% = $5,424.19]
Step 5	Next, determine the estimated number of units to be sold. [Attachment A-28]. In 1999, there are sales estimated in both the domestic and export markets. Assuming that the luxury sales tax would not be paid on exported cars, use only the number of units sold domestically in the calculation. [1998 - 6,000] [1999 - 25,000]
Step 6	Multiply the number of units sold by the average CIF price to determine the total CIF value of sales. [1998 - 6,000 x $5,424.19 = $32,545,157.24] [1999 - 25,000 x $5,424.19 = $135,604,821.84]
Step 7	Multiply the total CIF value by 96.8793 per cent to arrive at the total amount of luxury tax exempted. [1998 - $32,545,157.24 x 96.8793% = $31,529,520.52] [1999 - $135,604,821.84 x 96.8793% = $131,373,002.16]
Step 8	Determine the total value of sales for the period. [Attachment A-28] [1998 - $89,560,000.00] [1999 - $373,180,000.00 (domestic only)]
Step 9	Divide the total amount of tax exempted by the total sales to arrive at the % of subsidization. **[1998 - $31,529,520.52 / $89,560,000.00 = 35.20%]** **[1999 - $131,373,002.16 / $373,180,000.00 = 35.20%]**

(6) Calculation of subsidization from the exemption from import duties on imported automotive parts

8.103 According to Indonesia, TPN's one-year authorization to import CBU Kia Sephias from Korea duty-free has expired, and Kia Timor is now assembling Timor Kia Sephias in Indonesia. Under the National Motor Vehicle programme, as the producer of a "national motor vehicle", Kia Timor benefits from the tariff exemption on imported automotive parts. For 1998 and 1999, the estimated ad valorem subsidy rate attributable to the exemption from import duties on automotive parts is 14.17 per cent and 9.45 per cent, respectively.[455] This figure is derived as follows:

Table 17

Tariff Exemption on Parts (1998-99)

Step 1	To determine the import duty exemption, we must know the total value of importations. This value was not provided in Indonesia's Annex V responses. Therefore, we must extrapolate the value from what Indonesia did provide.
Step 2	Determine the amount of local content in the cars sold. [Attachment A-28, AV/14] [1998 – 40%] [1999 - 60%]
Step 3	From this, assume that the amount of imported content is: [1998 - 60%] [1999 – 40%]
Step 4	To determine the CIF value of the completed car, follow the steps described above in connection with the luxury tax subsidy for 1998-99, Table 16, to arrive at the average CIF value of $5,424.19.
Step 5	Multiply the average CIF value by the percentage of imported parts to obtain the average CIF value of importations. Then multiply that amount by the number of cars sold to arrive at the total CIF value of importations. [1998 - $5,424.19 x 60% x 6000 = $19,527,094.34] [1999 - $5,424.19 x 40% x 25000 = $54,241,928.74] (Note - For the number of units sold, the number sold solely in the Indonesian market was used because import duty exemption on parts incorporated into an exported product arguably would not be considered an actionable subsidy.)
Step 6	Multiply the value of importations by 65 per cent to arrive at the amount of import duty exemption. [1998 - $19,527,094.34 x 65% = $12,692,611.32] [1999 - $54,241,928.74 x 65% = $35,527,253.68]
Step 7	Divide the total value of import duty exemptions by the total sales value to arrive at the % of subsidization. **[1998 - $12,692,611.32 / $89,560,000.00 = 14.17%]** **[1999 - $35,527,253.68 / $373,180,000.00 = 9.45%]**

[455] Again, the data provided by Indonesia in its Annex V response do not permit the calculation of a subsidy rate for those Timor Kia Sephias assembled in Indonesia during the latter part of 1997.

(7) Calculation of subsidization from the government-directed $690 million loan

8.104 With respect to the government-directed $690 million loan to TPN, the United States estimates the amount of the subsidy to be 7.1 per cent in 1998, 28.95 per cent in 1998, and 5.3 per cent in 2000. The United States calculated these percentages in the following manner.

8.105 As noted above, newspaper reports indicated that the terms of the loan were 3 per cent over the 3-6 month deposit rate, a maturity of 10 years, and a grace period of 3 years. Thus, the first task is to determine the interest rate to be paid by TPN, which is based on the 3-6 month deposit rate. Because Indonesia did not provide this rate in its Annex V responses, the United States was forced to rely on other sources. The most recent information available to the United States is from The Economist Intelligence Unit Limited (April 1997) (EIU)[456] ,which indicates that as of the end of February 1997, the average rate on Bank Indonesia certificates was 8.75 per cent.[457] Adding 3 per cent to this figure results in an interest rate on the $690 million loan of 11.75 per cent.

8.106 The next task is to determine the "benchmark" interest rate against which TPN's interest rate should be judged. Because the Government of Indonesia did not provide the loan to TPN directly, but instead directed banks to provide the loan, it would be inappropriate to use the Government's cost as the benchmark. Instead, one must use the cost of the actual lender; in this case, the banks. The cost to a bank is reflected in the interest rate that it would charge a comparable commercial borrower. Again, because the Government of Indonesia refused to provide relevant information in its Annex V responses, the United States has been forced to estimate the benchmark interest rate based on the best information otherwise available to it.

8.107 The United States began with the rate on a 10-year "Yankee Bond" that the Indonesian Government began to issue in July 1996.[458] According to EIU, the rate on this US$ denominated bond was set at 7.825 per cent, 1 percentage point above the 10-year Treasury bond rate.[459] The use of a US$ denominated benchmark is appropriate, because in AV/16, p. 4, Answer 13, Indonesia referred to a US$ denominated rate.

8.108 The United States added a spread of seven percent to the Yankee Bond rate of 7.825 per cent. According to EIU, p. 28 (Exhibit 16), Indonesian bank spreads range from three to seven percentage points, depending on the reputation of the client. As discussed above, TPN was not a reasonable credit risk for a loan of the magnitude of $690 million.[460] Therefore, a bank would have charged the maximum spread to a commercial borrower comparable to TPN. Adding 7 per cent to the Yankee Bond rate results in an interest rate of 14.825 per cent.

8.109 Finally, the United States added on a "risk premium" to more accurately reflect the fact that TPN was an unsound credit risk. In other words, a bank lending to a borrower comparable to TPN would have charged more than 14.825 per cent in order to cover its (the bank's) costs. In the absence of any other information, the United States relied on the methodology used by the US Department of Commerce to calculate a risk premium under the US countervailing duty law. Under this

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[456] US Exhibit 16.

[457] According to EIU, these certificates are the primary tools used by Bank Indonesia to control interest rates and money supply.

[458] See EIU, p. 3 (US Exhibit 16).

[459] Because it is highly unlikely that anyone but the US Government is in the business of issuing US$ denominated Treasury bonds, the United States assumed that the reference in EIU to the 10-year Treasury bond rate is to the 10-year US Treasury bond rate.

[460] In this regard, the United States emphasizes that in the Annex V process, Indonesia refused to answer questions regarding TPN's financial situation. See AV/15, Question 12/29(d) and AV/16, Question 12/29(d).

methodology, in the case of a company considered to be "uncreditworthy," the Department of Commerce adds to the "benchmark" interest rate an amount equal to 12 per cent of the prime rate in the country in question. Here, the United States used 10.825 per cent as the prime rate. This was based on the Yankee bond rate (7.825) plus 3 per cent, 3 per cent being the low spread for bank lending.[461] 12 per cent of 10.825 equals 1.29 per cent. Adding 1.29 per cent to the benchmark rate of 14.825 results in a final benchmark rate of 16.124.

8.110 Having determined the interest rate paid by TPN (11.75 per cent) and the cost to the banks (16.124 per cent), we next must calculate a "grant equivalent" of the benefit received by TPN from the loan. The first step in this process is to calculate the net present value of payments under the loan to TPN and the benchmark loan. The difference in payments between the two loans constitutes the subsidy.

8.111 Assuming that there will be interest-only payments during the 3-year grace period, and assuming an 11.75 per cent interest rate, the payment schedule for the loan to TPN is as follows:

Table 18

Payment Schedule for Loan to TPN

Year	Beginning Balance	Add: Interest	Less: Payment	Ending Balance
0	0	0	(690,000,000)	690,000,000
1	690,000,000	81,075,000	81,075,000	690,000,000
2	690,000,000	81,075,000	81,075,000	690,000,000
3	690,000,000	81,075,000	81,075,000	690,000,000
4	690,000,000	81,075,000	149,994,645	621,080,355
5	621,080,355	72,976,942	149,984,645	544,062,652
6	544,062,652	63,927,362	149,994,645	457,995,368
7	457,995,368	53,814,456	149,994,645	361,815,179
8	361,815,179	42,513,284	149,994,645	254,333,817
9	254,333,817	29,884,224	149,994,645	134,223,396
10	134,223,396	15,771,249	149,994,645	(0)

8.112 Using 16.124 per cent as the interest rate, the payment schedule for the benchmark loan is as follows:

[461] EIU, p. 28 (US Exhibit 16).

Table 19A

Payment Schedule for Benchmark Loan

Year	Beginning Balance	Add: Interest	Less: Payment	Ending Balance
0	0	0	(690,000,000)	690,000,000
1	690,000,000	111,255,600	111,255,600	690,000,000
2	690,000,000	111,255,600	111,255,600	690,000,000
3	690,000,000	111,255,600	111,255,600	690,000,000
4	690,000,000	111,255,600	171,477,239	629,778,361
5	629,778,361	101,545,463	171,477,239	559,846,584
6	559,846,584	90,269,663	171,477,239	478,639,008
7	478,639,008	77,175,754	171,477,239	384,337,523
8	384,337,523	61,970,582	171,477,239	274,830,866
9	274,830,666	44,313,729	171,477,239	147,667,355
10	147,667,355	23,809,884	171,447,239	0

8.113 Having calculated payment schedules for both the loan to TPN and the benchmark loan, we now must calculate the net present value of the payment differentials. This results in the following schedule, using a standard net present value calculation and a discount rate of 16.124 per cent:

Table 19B

Payment Differential

Year	TPN Loan Payment	Benchmark Loan Payment	Payment Differential	NPV of Pmt. Diff.
0	0	0	0	0
1	81,075,000	111,255,600	30,180,600	25,989,976
2	81,075,000	111,255,600	30,180,600	22,381,227
3	81,075,000	111,255,600	30,180,600	19,273,559
4	149,994,645	171,477,239	21,482,594	11,614,049
5	149,994,645	171,477,239	21,482,594	10,173,650
6	149,994,645	171,477,239	21,482,594	8,761,023
7	149,994,645	171,477,239	21,482,594	7,544,541
8	149,994,645	171,477,239	21,482,594	6,496,970
9	149,994,645	171,477,239	21,482,594	5,594,855
10	149,994,645	171,477,239	21,482,594	4,818,001
Total			240,919,960	122,847,850

8.114 Having calculated a "grant equivalent" of the loan payment differential of US$122,847,850, the next step is to translate this lump sum into annual benefits. For this purpose, the United States has prorated the amount of the “grant equivalent” over a 10-year period based on the life of the loan to TPN. An amount is added to each annual allocation to account for the time value of money of the remaining unallocated portion, using a discount rate of 16.124 per cent. Using a "declining balance" formula, these two amounts are added together and divided by one plus the discount rate to obtain the amount of the "grant equivalent" allocable to any one year. This results in the following schedule of annual benefits:

Table 20

Annual Benefit from Loan

Year	Benefit to Year
0	0
1	27,636,640
2	25,930,879
3	24,225,117
4	22,519,355
5	20,813,594
6	19,107,832
7	17,402,070
8	15,696,308
9	13,990,547
10	12,284,785

8.115 The final calculation step is to translate the annual subsidy amount into an ad valorem percentage:

Table 21

Annual Subsidy Rate for Loan (1998-2000)

	1998	1999	2000
Benefits in US$	27,636,640	25,930,879	24,225,117
Sales in US$	387,569,0434[462]	89,560,000	453,180,000
Subsidy	7.1%	28.95%	5.3%

[462] The United States has assumed that payment on the TPN loan will not begin until 1998, thus rendering 1998 “Year 1" of the loan. In addition, pursuant to paragraphs 2 and 3 of Annex IV of the SCM Agreement, the denominator in the ad valorem subsidy calculation is based on sales in the preceding year. Accordingly, the denominator for the 1998 subsidy is based on 1997 sales, the subsidy for the 1999 subsidy on 1998 sales, and the subsidy for the 2000 subsidy on 1999 sales.

The figures for 1998 and 1999 sales (Column 1999 and Column 2000) were taken from Attachment A-28, AV/14. The figure for 1997 sales (Column 1998) was estimated based on data in Attachment U-12, AV/14. The United States calculated the total sales value of cars imported during a particular year by calculating an average sales price.

(c) Arguments of Indonesia regarding serious prejudice as a cause of action in this dispute

8.116 The subsidies at issue technically fall within the scope of Article 3.1(b) as "subsidies contingent (whether solely or as one of several other conditions) upon the use of domestic over imported goods". As Indonesia is a developing country, it is within the ambit of Article 27.3 of the SCM Agreement, which provides that "[t]he prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years...from the date of entry into force of the WTO Agreement (i.e., until 1 January 2000)". Instead, the provisions of Articles 5 to 7 regarding "actionable" subsidies apply.

8.117 Subsidies which are not "prohibited" may be either "actionable" or "non-actionable." The subsidies involved in this dispute do not meet the criteria of Article 8 of the Agreement, and so must fall into the residual category of "actionable" subsidies. This rationale for application of Articles 5 to 7 must be used because the language of Article 27.7 is ambiguous. It states that:

> The [remedial] provisions of Article 4 shall not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. The relevant [remedial] provisions in such a case shall be those of Article 7. (Emphasis added.)

8.118 "Export" subsidies and "domestic content" subsidies are not synonymous. The former are covered by Article 3.1(a) and Annex I of the Agreement, while the latter are covered by Article 3.1(b). Given the context of Article 27.7 (including its citation to Article 27.3), the drafters of the Agreement clearly meant Article 27.7 to cover domestic content subsidies, as well as export subsidies. This is confirmed by the analysis above. Under Article 32 of the Vienna Convention on the Law of Treaties, recourse to supplemental means of interpretation is permissible in this instance due to the ambiguity of the text of Article 27.7.

8.119 The European Communities and the United States assert that the actual and alleged subsidies of the National Car programme bestowed by the June 1996 programme, the February 1996 programme and the $US690 million loan exceed the 5/15 per cent ad valorem thresholds established by Article 6.1(a) of the Subsidies Agreement. They properly recognize, however, that Article 27.8 stipulates that serious prejudice in terms of Article 6.1(a) shall not be presumed where, as here, the subsidy is granted by a developing country Member. Rather, in such a case, a complainant must demonstrate serious prejudice by positive evidence in accordance with the provisions of paragraphs 3 through 8 of Article 6.

8.120 Thus, whether proceeding on the basis of Article 6.1(a) or independently on the bases of Article 6.3, complainants must demonstrate serious prejudice by positive evidence in accordance with the provisions of paragraphs 4 through 8 of Article 6 before the remedial powers of Article 7.8 may be applied.

8.121 In response to a question from the Panel, **Indonesia** indicated that the approximate *ad valorem* amount of subsidization conferred on the Timor by the exemption from the luxury tax was as follows:

CBUs imported from Korea	29.54%
Timors assembled at Tambun	26.20%
Timors produced at Karawang	18.68%

3. Like product

(a) Scope of "like" models

(1) Arguments of the European Communities

8.122 The **European Communities** asserts for purposes of its serious prejudice claims that all passenger cars must be considered as "like" products. The following are the **European Communities'** arguments in this regard:

8.123 In order to assess the effects of the subsidies under consideration it is necessary to define first the scope of the relevant category of "like products".

8.124 For that purpose, footnote 46 to Article 15.1 of the SCM Agreement provides the following guidance:

> Throughout this agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects has characteristic closely resembling those of the product under consideration

8.125 All motor vehicles falling within the category of "passenger cars", as defined in Indonesia's regulations, constitute a single category of "like products" for the purposes of the SCM Agreement given that they all share the same basic physical characteristics and serve an identical end-use. Thus, the passenger cars exported from the European Communities are like the Timor S-515.

8.126 Indonesia takes an unduly restrictive view of what constitutes a "like product". To paraphrase the Appellate Body, Indonesia has squeezed the "accordion of likeness" to a point where it can no longer sound any note.

8.127 Presently, there are more than 60 different models of passenger cars being sold in the Indonesian market. Yet, Indonesia would have the Panel to believe that the Timor S-515 is so unique that none of them is "like" the Timor S-515. By the same token, it could be claimed that each of the other models of passenger cars sold in Indonesia constitutes also a category of like products on its own. If upheld by the Panel, Indonesia's approach would render the provisions of Part III and Part V of the SCM Agreement inapplicable except in those cases where subsidies are granted with respect to commodities or similarly homogeneous products.

8.128 The starting point for determining whether the cars exported from the European Communities are "like" the Timor S-515 must be the definition of the term "like product" contained in footnote No 46 of the SCM Agreement. That definition makes it perfectly clear that in order to be "like", two products need not be identical. In the absence of identical products, two products having "closely resembling characteristics" must be considered as "like" products. It is evident that the Timor S-515 and the passenger cars exported from the European Communities are not identical. Yet, they have sufficiently resembling characteristics to be considered as "like".

8.129 The European Communities agrees with the proposition that the term "like products" must be construed narrowly in the context of the SCM Agreement. Nevertheless, the European Communities consider that the definition of "like product" contained in footnote No 46 of that SCM Agreement

already embodies such a narrow interpretation. An even narrower interpretation of the definition itself is unwarranted.[463]

8.130 It is true that, within the category of passenger cars, there are virtually limitless variations in respect of factors such as size, weight, engine type, cylinder capacity, engine power, transmission system, equipment, body design, colour, etc.[464] Nevertheless, those variations do not affect the essential similarity of all passenger cars nor prevent them from being "like" products.

8.131 Any attempt to define two or more sub-categories of "like products" within the category of passenger cars on the basis of any of those criteria would unavoidably yield arbitrary results. First of all, it would require to make a necessarily arbitrary choice among all possible criteria, the only alternative being to combine several criteria simultaneously at the risk of multiplying ad infinitum the categories of "like" products. Furthermore, in respect of many of those criteria (e.g. size or cylinder capacity), there is a full continuum of products. Drawing a line within that continuum would be arbitrary, regardless of where the line is drawn. Thus, for instance, a distinction between "large" and "small" passenger cars would be arbitrary because there would always be more "likeness" between the smallest large car and the largest small car than between products at either end of each of the two categories.

8.132 If, despite the above, the Panel took the view that not all passengers cars are "like products", the European Communities submit that, at the very least, the Opel Optima and the Peugeot 306 must be considered as being "like" the Timor S-515. The table below contains an exhaustive comparison of their physical characteristics. That comparison confirms beyond doubt that the Timor S-515 and the European Communities models concerned, albeit not alike in all respects, have closely resembling characteristics. The European Communities also has submitted sales brochures of the Timor S-515, the Peugeot 306 and the Opel Optima.

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[463] Indonesia's claim that the notion of "like product" should be construed even more narrowly in the context of an exception granted in favour of developing Members is simply non-sensical. The notion of "like product" is an objective one and cannot have different meanings depending on the GDP level of the subsidising country Member.

[464] Some of the criteria enumerated by Indonesia as being relevant for a like product determination are too subjective (e.g. "reputation") or vague (e.g. "quality" or "ride and contort") for being measurable. Price is not relevant for a like product determination, especially when as in the present case one of the products concerned benefits from a huge subsidy, and the imported products are subject to the payment of very high import duties. As noted by the Panel Report on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, adopted on 10 November 1987, BISD 34/119:

"...like products do not become "unlike"... merely because of .... differences in their prices, which were often influenced by external measures (e.g. customs duties) and market conditions (e.g. supply and demand, sales margins)"

Table 22

Comparison of Certain Models

Marque Make Modele Basic model	Peugeot 306 1.8 St	Peugeot 306 1.8 St LM	Opel Optima 1.8 GLS	Opel Optima 1.8 New CDX	Timor S515 1.5	Timor S515i 1.5
I/Mechanical Features						
Length (mm)	4,240	4,240	4,329	4,329	4,360	4,360
Height (mm)	1,367	1,367	1,410	1,410	1,390	1,390
Width (mm)	1,692	1,692	1,688	1,688	1,692	1,692
Wheel Base (mm)	2,580	2,580	2,517	2,517	2,500	2,500
Petrol or Diesel Engine	XU7JP	XU7JP	MPFI	MPFI	85C	EFI
Cubic Capacity (cm3)	1,761	1,761	1,796	1,796	1,498	1,498
Number of Cylinders	4	4	4	4	4	4
Number of Valves/Cylinder	8V	8V	8V	8V	8V	16V
Maximum Power (DIN/ch)	103	103	118	118	-	-
Nbr RPM	6,000	6,000	5,400	5,400	-	-
Maximum Power (JIS/ch)					82	105
Nbr RPM					5,500	5,500
Maxi torque (DIN)	16.0	16.0	16.3	16.3	-	-
Maxi torque (JIS)					12.2	15.0
Nbr RPM	3,000	3,000	3,200	3,200	2,500	4,000
Carburetor/Injection	I	I	I	I	C	I
Manual Gear Box (NB. of Speeds)	5	5	5	5	5	5
Automatic Gear Box (NB. of Speeds)	-	-	-	-	-	-

Marque Make Modele Basic model	Peugeot 306 1.8 St	Peugeot 306 1.8 St LM	Opel Optima 1.8 GLS	Opel Optima 1.8 New CDX	Timor S515 1.5	Timor S515i 1.5
Brakes (Disc/drums/Ventil.)	VD/DR	VD/DR	D/DR	D/DR	VD/DR	VD/DR
Anti-lock Brake system	-	-	-	X	-	-
Power Steering	X	X	X	X	X	X
II/Outside Features						
Number of Doors	4	4	4	4	4	4
Additional Headlamps	-	-	X	X	-	-
Bodyside Mouldings	X	X	X	X	X	X
Rear Spoiler	-	-	-	-	X	X
Light Alloy Wheels	-	X	X	X	-	-
Tyre Size	185/65/R14	185/65/R14	195/60/R14	195/60/R14	175/70/R13	175/70/R13
Metallic Paint	X	X	X	X	-	O
Tinted Glass	X	X	X	X	X	X
III/Inside Equipment						
Air Bag (1/2)	-	-	-	1	-	-
Side Impacts Beams	X	X	X	X	X	X
Central Door Locking	X	X	X	X	X	X
Adjustable Steering Column	X	X	X	X	-	X
Electric Windows Front/Rear	F/R	F/R	F/R	F/R	X	X
Electric Windows (Front/1 Touch)	FR/one T	FR/one T	FR/one T	FR/one T	-	X
Driver Side Mirror Manu./Electr.	E	E	E	E	M	E
Passenger Side Mirror Manu./Elec.	E	E	E	E	M	E

Marque Make Modele Basic model	Peugeot 306 1.8 St	Peugeot 306 1.8 St LM	Opel Optima 1.8 GLS	Opel Optima 1.8 New CDX	Timor S515 1.5	Timor S515i 1.5
Alarm System	-	-	X	X	-	-
Air Conditioning	X	X	X	X	X	X
Radio Equipment	X	X	X	X	-	X
Height Adjust. Frt Seats Manu./Elec	M	M	M	M	M	M
Rear Seat Folding	1/3-2/3	1/3-2/3	1/3-2/3	1/3-2/3	-	-
Rear Head Restraints	X	X	X	X	X	X
TRIM	VELOURS	LEATHER	VELOURS	VELOURS	CLOTH	CLOTH
Number of Rear Seat Belts	3	3	3	3	3	3
3rd Braking Light	X	X	X	X	X	X

8.133 Should the Panel take the view that it is necessary to distinguish two or more "segments" within the category of passenger cars, the European Communities would refer the Panel to the classification made in the DRI Reports. According to the DRI Reports, the models of passenger cars sold in Indonesia between 1994 and 1997 may be classified into four segments, as follows:

Segment B ("Supermini Class"): Daihatsu Charade, Suzuki Baleno, Suzuki Esteem, Toyota Starlet;

Segment C ("Lower Medium Class"): Daewoo Cielo, Ford Laser, Honda City, Honda Civic, Hyundai Accent/Bimantara Cakra, Peugeot 306, Opel Optima, Mitsubishi Lancer, Mazda 323, Mazda MR 90, Toyota Corolla, Toyota Corona, Kia Sephia/Timor S-515;

Segment D ("Upper Medium Class"): Audi A4, Daewoo Cielo, Ford Telstar, Honda Accord, Hyundai Elantra/Bimantara Nenggala, Mazda 626, Mitsubishi Galant, Opel Vectra, Peugeot 405/406;

Segment E ("Executive Class"): Audi A6, BMW 3 Series, BMW 5 series, BMW 7 series, Mercedes Benz C class, Mercedes Benz E class, Mercedes Benz S class, Nissan Cedric, Nissan Zafiro, Toyota Crown, Volvo U.

According to the DRI Reports, no model was sold within Segment A ("Utility Class").

8.134 Indonesia cannot reasonably deny that the Timor and the EC cars, and in particular the Opel Optima and the Peugeot 306, have closely resembling physical characteristics. For that reason, Indonesia is forced to emphasize the importance of what it terms "non-physical characteristics". (See Section VIII.B.3). These include a long list of vague and essentially subjective criteria, such as "brand reputation", "status", "quality", "reliability", etc. which cannot be properly measured and compared. If the Panel upheld Indonesia's view that two vehicles which have closely resembling physical characteristics may nevertheless not be "like" because of differences in factors such as "quality" or "brand reputation", it would be opening the door to all kinds of arbitrary and abusive distinctions. An examination of prior Panel reports shows that alleged differences regarding

non-physical characteristics have never been regarded as determinant for a like product determination. For instance, in the 1987 case on Japan - Taxes on Alcoholic Beverages[465], Japan claimed that high quality Scotch whisky was not "like" domestic Japanese whisky of inferior quality. The Panel rightly ignored those arguments and concluded that all whisky was "like". In relative terms, there is no more difference between a Mercedes and a Timor than between a premium brand of malt Scotch whisky and a Japanese brand of second grade whisky made by adding water to a concentrate.

8.135 To be precise, the European Communities' position is that cars which have closely resembling physical characteristics do not become "unlike" simply because of alleged differences in so-called "non-physical characteristics."

8.136 "Riding comfort" is determined by the physical characteristics of a car. The same is true of "quality". "Reputation for quality" is one of the factors which make up the "brand image of a product." It is obvious that "brand image" may influence consumers' choices. In the European Communities' view, however, mere differences in brand image do not suffice to make two products "unlike". Moreover, this criterion is largely subjective, cannot be accurately measured, and may change over time. For instance, by definition new entrants lack an established "brand image". Thus, on Indonesia's construction, a subsidizing Member could always claim that subsidies for the establishment of a new domestic industry cannot cause "serious prejudice" to imports.

(2) Arguments of the United States

8.137 The **United States** argues that the passenger cars which, but for the National Motor Vehicle programme, United States motor vehicle manufacturers would have sold in Indonesia, are “like” the Timor Kia Sephia sedan. The following are the **United States'** arguments in this regard:

8.138 Footnote 46 of the SCM Agreement defines “like product” in the following manner:

> Throughout this Agreement the term “like product” (“produit similaire”) shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

8.139 Obviously, this definition provides only general guidance, and a case-by-case analysis is necessary to determine whether a particular product is “like” another. In this regard, the guidance provided by the Appellate Body in connection with the application of the “like product” concept for purposes of the WTO agreements is particularly apt:[466]

> No one approach to exercising judgement will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as

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[465] Panel report on Japan - Customs Duties. Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages adopted 10 November 1987, BISD 34S/83, 118.

[466] “Japan - Taxes on Alcoholic Beverages,” WT/DS8/R, Report of the Appellate Body, adopted 1 November 1996, p. 22.

> well as by the context and the circumstances that prevail in any given case to which that provision may apply.

Factors which should be considered in applying a case-by-case analysis include "a product's end-uses in a given market, consumers' tastes and habits, which change from country to country, and the product's properties, nature and quality."[467]

(a) The passenger cars that the United States would have sold in Indonesia are comparable to the Timor.

8.140 With this analytical framework in mind, let us now turn to an analysis of specific passenger cars of US motor vehicle manufacturers. Because of the National Motor Vehicle programme, there currently are virtually no passenger cars of US manufacturers that are imported and sold in Indonesia.[468] However, the passenger cars that were imported and sold in Indonesia prior to the introduction of the National Motor Vehicle programme were "like" the Timor Kia Sephia sedan. In addition, the passenger cars that, but for the National Motor Vehicle programme, would have been imported and sold in Indonesia are "like" the Timor Kia Sephia sedan.

8.141 Prior to the introduction of the National Motor Vehicle programme, General Motors sold two passenger cars under its "Opel" brand that easily can be considered as "like" the Timor Kia Sephia sedan. These are the Opel Optima and the Opel Vectra.

8.142 The Opel Optima and the Timor Kia Sephia both fall within "Segment C" of the motor vehicle market (lower medium class passenger cars).[469] Moreover, as set out in Table 23, below, the specifications for the Optima and the Timor Kia Sephia are quite comparable. The size and weight of the two cars are virtually identical, while the Optima has a slightly bigger engine.

8.143 With respect to the Opel Vectra, while it is positioned slightly higher in the market than the Optima or the Timor Kia Sephia[470], in terms of specifications, as set out in Table 23, it is not all that dissimilar to the Timor Kia Sephia. The Vectra is slightly larger than the Timor Kia Sephia (e.g., the Vectra is about 100mm longer than the Timor Kia Sephia), and has a more powerful engine. However, both cars share the same end-uses; i.e., to transport passengers.

8.144 Turning to Ford, Ford had well-advanced plans to import and sell Ford Escorts in Indonesia, plans that Ford had to abandon in light of the National Motor Vehicle programme and the introduction of the heavily subsidized Timor Kia Sephia sedan. Like the Timor Kia Sephia, the Escort falls in Segment C of the passenger car market.[471] A comparison of specifications, as set forth in Table 23, confirms the similarities between the Escort and the Timor Kia Sephia and the fact that the Escort is "like" the Timor Kia Sephia. The Timor Kia Sephia is a little bit longer (65mm) and a little bit higher (44mm) than the Escort, while the Escort is a little bit wider (183mm) and has a slightly larger engine (1597cc versus 1498cc for the Timor Kia Sephia).

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[467] Id., p. 21, citing to Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para. 18.

[468] See AV/13, p. 3 (Question 6) and Attachment 8 (Question 6).

[469] See McGraw-Hill World Car Industry Forecast Report, February 1997, pp. 284-85, included as Annex 1 to AV/2. Cars falling within a particular market segment will roughly be of the same size, be in the same price range, and share the same target customers.

[470] The Vectra falls within "Segment D" (upper medium class) of the passenger car market. Id.

[471] See McGraw-Hill World Car Industry Forecast Report, February 1997, pp. 284-85, included as Annex 1 to AV/2.

8.145 The following table demonstrates that the Timor Kia Sephia, the Opel Optima, and the Ford Escort are quite comparable in terms of specifications:[472]

Table 23

Timor, Escort, and Opel Specifications

Items	Timor S515	Ford Escort4dr "Ghia" Notchback Manual Transmission	Opel Optima	Opel Vectra
Dimensions				
1. Overall length (mm)	4,360	4,295	4,329	4,477
2. Overall width (mm)	1,692	1,875	1,688	1,707
3. Overall height (mm)	1,390	1,346	1,410	1,425
4. Wheel base (mm)	2,500	2,523	2,517	2,637
5. Turning circle (m)	5.1	10	4.9	
6. Curb weight (kg)	1,055	1,145	980	
Engine				
1. Type	4 cyl, inline, SOHC, carburetor	4 cyl., Zetec inline	4 cyl., 8 valves, Multi-Port Fuel injection (MPFI)	4 cyl., 8 valves Multi-Port Fuel injection (MPFI)
2. Displacement (cc)	1,498	1,597	1,796	1,998
3. Max. Power	85PS/5,500rpm	l75@ 5500	118 PS/5,400 rpm	136 hp
Transmission				
Gear Ratio:				
-1st	3.417	3.10	3.58	--
-2nd	1.895	1.19	2.14	--
-3rd	1.296	1.28	1.48	--
-4th	0.906	0.95	1.12	--
-5th	0.738	0.76	0.89	--
-Reverse	3.736	3.615	3.333	--

8.146 Finally, with respect to Chrysler, Chrysler had plans to import and sell its Neon passenger car in Indonesia. The table below presents a comparison of the specifications of the Neon and the Timor Kia Sephia. The data show that the Chrysler Neon closely resembles the Timor Kia Sephia, and, thus, can be considered a "like product" to the Sephia. The Neon is only 4 mm longer, 16 mm wider, and

[472] Source: US companies.

5 mm taller than the Sephia, and is only 54 kilogrammes heavier. Also, although the Neon has a larger engine, both the Neon and the Timor Kia Sephia fall within the C segment, and, thus, in the view of the industry, compete for the same customers.[473] As such, the Neon can safely be considered as "like" the Timor Kia Sephia.

8.147 The specifications for the Chrysler Neon that would have been sold in Indonesia but for the National Car Programme are as follows:

Table 24

Timor and Neon Specifications

Items	Timor S515	Chrysler Neon
Dimensions		
1. Overall length (mm)	4,360	4,364
2. Overall width (mm)	1,692	1,708
3. Overall height (mm)	1,390	1,395
4. Wheel base (mm)	2,500	2,642
5. Turning circle (m)	5.1	10.8
6. Curb weight (kg)	1,055	1,109
Engine		
1. Type	4 cyl, inline, SOHC, carburetor	4 cyl. inline MPI SOHC
2. Displacement (cc)	1,498	1,996
3. Max. Power	85 PS/5,000rpm	98@ 5,850 rpm

8.148 To summarize, the passenger cars that US manufacturers did import and sell in Indonesia, as well as the passenger cars that they would have imported and sold in Indonesia, can be considered as "like products" to the Timor Kia Sephia. While none of these US passenger cars is "identical" to the Timor Kia Sephia, identity between motor vehicles is not required under the SCM Agreement. If identify of products were required, it is difficult to fathom how there ever could be a serious prejudice dispute (or a countervailing duty proceeding, for that matter) involving motor vehicles or any other type of consumer good, where slight variations in models or products are made for the very purpose of distinguishing products in competition with one another. Instead, under the SCM Agreement, it is enough that one product has "characteristics closely resembling" those of the subsidized product. The Opel Optima and Vectra, the Ford Escort, and the Chrysler Neon each satisfy this standard.

[473] Id.

(b) The GM Opel Blazer is comparable to the Kia Sportage

8.149 As noted above, Kia Timor's plans call for the assembly and sale in Indonesia of the Kia Sportage, to be known as the Timor J520i. When introduced, the Timor Kia Sportage will compete directly with GM's Opel Blazer, which GM continues to import and assemble in Indonesia.

8.150 A comparison of specifications demonstrates that the Blazer and the Timor Kia Sportage are comparable products:[474]

Table 25

Sportage and Blazer Specifications

Engine	Sportage	Blazer DOHC
Type	2.0L DOHC, 4cyl, 16v	2.2L DOHC, 4cyl.
Horsepower	130hp 5500 rpm	138hp 5600 rpm
Torque	127 lb-ft 4000rpm	195 Nm 3800 rpm
Transmission	5 spd man	5 spd man
Brake	Front disc/Rear drum with rear ABS	Front disc/Rear drum with ABS
Dimension		
Wheel base	2650mm	2718mm
Length	4245mm	4602mm
Width	1730mm	1690mm
Height	1650mm	1508mm
Fuel capacity	60L	76L
Head room	1005.8mm	1005mm
Leg room	1130.3mm	1078mm

(c) Indonesia's arguments concerning "like product" are incorrect as a matter of law

8.151 Finally, let us consider the heart of Indonesia's defense; namely, that none of the passenger cars that would have been sold by US manufacturers can be considered a "like product" to the Timor Kia Sephia sedan for purposes of footnote 46 of the SCM Agreement. Putting aside the fact that Indonesia did not make this argument in connection with the United States claim of serious prejudice, Indonesia nevertheless is, once again, wrong on the facts and the law.

[474] Source: US companies. The United States also believes that Jeep Cherokees and Wranglers are comparable to the Sportage, but lacks detailed specifications.

8.152 Indonesia begins its like product legal analysis with an accurate quotation of footnote 46, noting that in the absence of an identical product, a like product can consist of a product which "has characteristics closely resembling those of the product under consideration." (Emphasis added). Because this language obviously undermines Indonesia's entire case, Indonesia dismisses the quoted phrase as "amorphous and skeletal" and never refers to it again.

8.153 However, as the Appellate Body has so often noted, a treaty interpreter must start with the language of the treaty.[475] The SCM Agreement does not require identity of products, but only a close resemblance. All of Indonesia's subsequent legal argumentation is designed to do nothing more than divert the Panel's attention from what the SCM Agreement actually says.

8.154 Next, Indonesia makes the extraordinary argument that the ability to bring a serious prejudice case against a developing country Member constitutes a so-called "exception" to the "right" conferred on Indonesia by the SCM Agreement to subsidize. As such, Indonesia argues, this exception, including the definition of "like product," must be narrowly construed. This is utter nonsense.

8.155 As a general matter, the United States does not agree with the principle that simply because a particular provision or agreement can be labelled as an "exception" to something else, that provision or agreement must be mechanically and narrowly construed. In the Wool Shirts case, India made a similar argument, and the Appellate Body rejected it.[476] Moreover, it is ludicrous to suggest that like product analyses differ depending upon whether the complainant is challenging the subsidies of a developed or a developing Member.

8.156 However, even assuming that this mechanical rule of treaty interpretation applies, Indonesia's application of it is 180 degrees backward. If there is an "exception" in Article 27 of the SCM Agreement, it is that developing country Members are excepted from the general prohibition against the use of local content subsidies and the remedies available to combat such subsidies that require no showing of adverse trade effects. Thus, if the principle suggested by Indonesia is to be correctly applied, this Panel must interpret all relevant provisions in such a way as to limit the exceptional treatment afforded by Article 27.3. In the context of this case, this means, among other things, interpreting the term "like product" broadly, not narrowly.[477]

(d) Indonesia's arguments concerning "like product" are incorrect as a matter of fact

8.157 Having disposed of Indonesia's legal arguments concerning like product, let us turn to Indonesia's factual arguments. As discussed above, Table 23 compares the specifications for the Timor Kia Sephia, the Ford Escort, and two types of Opels, the Optima and the Vectra. This comparison establishes the close physical resemblance between these products. However, notwithstanding the fact that physical characteristics are a standard criterion in identifying like products, Indonesia simply dismisses this comparison as "unduly restrictive".

8.158 With respect to end-use, another standard like product criterion, the United States noted that these cars all have the same end-use; namely, the transport of persons. Here, too, Indonesia dismisses this criterion as irrelevant.

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[475] India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R, Report of the Appellate Body issued 19 December 1997, para. 45.

[476] United States - Measure Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/AB/R, Report of the Appellate Body adopted 23 May 1997, page 19.

[477] Carried to its logical conclusion, a correct and consistent application of Indonesia's argument would result in Indonesia bearing the burden of proving that serious prejudice has not occurred. Of course, this is the type of burden shifting that India proposed in Wool Shirts, and that the Appellate Body rejected.

8.159 Instead, Indonesia recycles the same argument it made in connection with Article I of GATT 1994, which is that consumers consider numerous physical and non-physical characteristics in making their purchasing decisions. While this is true in a general sense, it proves nothing, and Indonesia offers no evidence as to how this factor justifies the conclusion that Escorts, Neons, and Opel Optimas and Vectras are not "like" the Sephia. Of course, consumer products, including passenger cars, are different from each other, because product differentiation is one of the means by which products compete. However, the fact that consumer products inevitably will not be identical to one another does not mean that they cannot be considered as "closely resembling" one another for purposes of identifying a "like product" under the SCM Agreement. If products had to be "identical" (or virtually identical) in order to be considered "like," it would be impossible to bring a serious prejudice case (or a countervailing duty case, for that matter) against a subsidized consumer product.

8.160 There are a few "facts" that Indonesia throws out in order to confuse the issue. First, it notes that the DRI/McGraw-Hill market segmentation categories were developed in the context of the European market. Even if true, Indonesia does not explain how this renders these categories inappropriate for purposes of this case or the Indonesian auto market. Indeed, DRI/McGraw-Hill uses these categories for purposes of its authoritative Asia Automotive Industry Forecast Report.[478]

8.161 Second, Indonesia notes that cars with the same nameplate often differ significantly from market to market. Even if true, Indonesia offers no evidence that the passenger cars in question do differ significantly.

8.162 Third, Indonesia cites the fact that for HTS purposes, passenger cars are distinguished on the basis of total cylinder capacity, with breakpoints at 1000cc, 1500cc, and 3000cc. However, these breakpoints are arbitrary, and provide no basis for concluding that the US passenger cars are not like products to the Sephia simply because the Sephia, at 1,498cc, falls two "cc's" below the breakpoint. Moreover, Indonesia does not explain why, if 1500cc is such a significant breakpoint, it chose 1600cc as the breakpoint for conferring tax incentives under Government Regulation No. 36/1996.

8.163 Finally, notwithstanding all of the money and resources that Indonesia reportedly has devoted to this case, Indonesia apparently has been able to find only one document, (Indonesia Attachment 12), that groups the Sephia in a different category from the Escort and Neon. However, neither the document itself nor Indonesia explains how these categories were drawn.

8.164 The United States has provided more than sufficient evidence to establish that the US passenger cars in question "closely resemble" the Timor Kia Sephia and, thus, are "like" the Sephia. In response, Indonesia has presented only flawed legal arguments and virtually no evidence.

(e) Market segment

8.165 It is important to put the issue of "market segments" in a proper and legally relevant context. Article 6.4 of the SCM Agreement indicates that displacement or impedance includes a situation where there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product. In analysing changes in relative market shares, the United States generally

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[478] US Exhibit 29 presents two pages of DRI promotional materials that attest to the authoritative nature of the DRI Global Automotive Group. Note in particular that the selected list of clients includes familiar names in this case, such as Chrysler, Ford, GM, Honda, Hyundai, Kia, Mitsubishi, Nissan, and Toyota. The United States does not take the position that the DRI market segmentation is dispositive with respect to the like product issues in this case. Rather, DRI's market segmentation confirms what a traditional like product analysis demonstrates; namely, that the Timor Kia Sephia is "like" the products that US manufacturers would have sold in Indonesia but for the National Car programme.

agrees with the statement by Indonesia that, to be meaningful, market share data must be calculated for the market segment into which the like products fall.

8.166 Having said that, however, it also is important to note that, based on Indonesia's own data, by the end of May, 1997, the Timor Kia Sephia had achieved a market share of 26.53 per cent. *See* AV/14, Attachment U-21/6. Although it is not readily apparent from Attachment U-21/6 itself, when one examines Attachments U-21/4-B and U-21/5-B to AV/14, it is clear that the 26.53 percent figure represents the Timor Kia Sephia's share of the market that includes all passenger cars sold in Indonesia.[479]

8.167 In the view of the United States, the attainment of a 26.53 per cent market share in less than one year more than satisfies the requirements of Article 6.4. Eliminating certain passenger cars from the market segment used by Indonesia in its calculations (i.e., all passenger cars) simply increases the market share attained by the Timor Kia Sephia, thereby making the serious prejudice case against Indonesia all the more damning. Thus, unless the Panel were of the view that the attainment of a 26.53 per cent market share did not demonstrate serious prejudice, attempting to place all of the passenger cars sold in Indonesia into their appropriate market segments would appear to be an exercise that is somewhat tangential to the issues raised in this case.

8.168 Nevertheless, in order to be responsive to the Panel's questions, the United States suggests that instead of "reinventing the wheel", the Panel might want to rely on the market segmentation categories actually used by the automobile industry. Such an approach seems particularly appropriate in light of the fact that "[t]he GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets." Japan - Taxes on Alcoholic Beverages, supra, page 26.

8.169 Applying this approach, the Timor Kia Sephia falls into the "C" segment, which includes "lower medium class" cars. (See above for a discussion of automobile market segment categories.) Other C segment passenger cars that are sold (or that, but for the National Car Programme, would have been sold) in Indonesia include: Opel Optima, Ford Escort, Chrysler Neon, Peugeot 306, Toyota Corolla, Honda City, Honda Civic, Nissan Sunny, Mitsubishi Lancer, Daewoo Nexia, Hyundai Accent, and the Mazda 323. It is possible that the Bimantara Cakra or Nenggala models also may fall into the C segment, but the United States lacks sufficient information at this time to make any definitive statements regarding these two models.

8.170 Alternatively, it would be reasonable for the Panel to find that the relevant market segment also includes the "D" segment of "upper medium class" passenger cars. If the market segment were defined as comprising all medium class cars in both the C and D segments, additional cars that are sold (or that, but for the National Car Programme, would have been sold) in Indonesia include: Opel Vectra, Honda Accord, Peugeot 405, 406, and 606, Toyota Corona and (possibly) the Crown, Nissan Sentra, Mitsubishi Galant, and Mazda 626.

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[479] AV/14, Attachment U-21/4-B provides sales figures for passenger cars that benefited from subsidies during the period 1995-1997. The "Total" column for 1997 indicates that as of May, 1997, the total sales volume for these passenger cars was 12,413, of which the Timor Kia Sephia accounted for 7,058. AV/14, Attachment U/21-5-B provides sales figures for passenger cars that did not benefit from subsidies during the period 1995-1997. The "Total" column for 1997 indicates that as of May 1997, 14,038 of these cars were sold. Thus, the total number of passenger cars (both subsidized and non-subsidized) sold in Indonesia during the period January - May, 1997 was 26,451. The 7,058 Timor Kia Sephias sold during this period accounted for 26.68 percent of this total. Presumably, an arithmetic error on the part of the individual preparing AV/14 accounts for the difference between the 26.53 percent figure in Attachment U/21-6 and the 26.68 percent figure derived from Attachments U-21/4-B and U-21/5-B.

8.171 Indonesia makes much of the fact that the passenger car market is segmented and that car manufacturers devote substantial resources to establishing and targeting different market segments. (See Section VIII.B.3.) However, this fact is not new, and it is consistent with the United States position that the Timor Kia Sephia falls within the "C" segment of the passenger car market. Likewise, it is not a new fact that an individual auto manufacturer will try to produce and sell one or more cars within each segment of the passenger car market.

8.172 Consider, for example, Kia Motors, TPN's joint venture partner in the National Car Programme. US Exhibit 30 consists of page 211 of DRI's Asian Automotive Industry Forecast Report, November 1997. Exhibit 30 demonstrates that Kia offers products in passenger car segments A through E, and usually offers more than one car in each segment. Strikingly, however, the Sephia is Kia's sole entry in the "C" segment.

8.173 Indonesia also makes much of the fact that there are numerous differences between passenger cars. However, this, too, is not a new fact, and it is exactly the point the United States has been making throughout this case; namely, that consumer products, including passenger cars, compete on the basis of numerous differences between products. Product characteristics within similar categories will vary among competing models within general bands or market segments. However, this is not enough to render cars within the same market class as "unlike" each other.

8.174 As an example, consider US Exhibit 31. Exhibit 31 is a summary of the various features that Ford has touted as making the Escort preferable to, and distinguishable from, its competition. The United States submits that while these features may distinguish the Escort from its competition, they are not enough to render the Escort "unlike" its competition. By the same token, the fact that the Timor Kia Sephia may have features that distinguish it from its competition is insufficient to render the Timor "unlike" its competition.

8.175 Indonesia argues that so-called "non-physical characteristics" render the Timor "unlike" and non-competitive with the passenger cars of the US manufacturers that are at issue in this case. The United States questions whether, on balance, any such differences exist, and Indonesia has not presented any evidence of such characteristics.

8.176 In this regard, TPN, Ford, and Chrysler each were (or would have been) new entrants to the Indonesian passenger car market (and General Motors was only a relatively new entrant) with little, if any, developed brand image or loyalty. While Indonesian consumers may well have formulated a perception that the cars of US manufacturers are of superior quality as compared to the Timor, such perceptions likely would be balanced by the undoubted patriotic feelings that Indonesian consumers would have with respect to the Timor as the first Indonesian National Car.

8.177 On balance, Indonesia appears to be arguing that if consumer choices were determined solely on the basis of the market, the Timor would have lost out to the Opel Optima, the Ford Escort, and the Chrysler Neon. With this, the United States wholeheartedly agrees, and that is the very crux of this dispute. What this dispute is about is that the choices of Indonesian consumers were not left to the market, but instead were distorted by the massive subsidies provided by the Government of Indonesia. These subsidies enabled the Timor to undercut the prices of competitive products so significantly, that a significant number of consumers appear to have been willing to make a trade-off between quality and price. However, the fact that consumers made this choice is not enough to render the Timor "unlike" the other cars in its class for the purposes of the SCM Agreement.

8.178 Now let us turn to the specifics of Indonesia's model comparisons. At the outset the United States takes issue with Indonesia's assertion that there are four basic physical attributes or specification groupings that differentiate passenger cars and that contribute to segmenting the market. (See Section VIII.B.3, Tables 26 and 27.) Indonesia claims that these attributes are: power plant;

steering and suspension; safety features; and passenger compartment. In the view of the United States, there are three factors that segment the market: power plant, vehicle size, and overall features.

8.179 Having said that, however, let us assume that Indonesia's approach is correct and consider Indonesia's product comparisons. A close look at the comparisons reveals that (1) they fail to rebut the evidence presented by the United States that the GM Opels, the Ford Escort, and the Chrysler Neon are like the Timor Kia Sephia; and (2) Indonesia's comparisons are not even accurate.

8.180 First, however, the United States should note that Indonesia's product comparisons in Table 27 are inaccurate, because Indonesia compares the Timor S515, the base model for the Timor Kia Sephia. Indonesia fails to mention the Timor S515i, the fuel injected model which was imported under the one-year authorization and which, according to Indonesia's own Annex V response is "[t]he only Timor car produced in Indonesia." See AV/14, Attachment 28.

8.181 With respect to the category of"power plant," Indonesia finds the US cars in question to be non-comparable to the Timor. (See Table 26.) The United States does not agree that these differences render the cars in question non-comparable to the S515. However, let us insert the Timor S515i into the comparison. The Timor S515i has a double -overhead cam (DOHC), 16 valve engine. By comparison, the Chrysler Neon has only a single -overhead cam (SOHC) engine, although it also has 16 valves. The Opel Optima has only an SOHC, 8 valve engine. Based on industry estimates, these differences between the Timor S515i and the Opel Optima are worth approximately Rp. 2.5 million.[480]

8.182 Thus, while the Opel Optima and Chrysler Neon have a larger engine displacement than the Timor S515i, the S515i has a DOHC, 16 valve engine, whereas the Neon has only an SOHC, 16 valve engine and the Optima only an SOHC, 8 valve engine. As for the Escort, its engine displacement is only 99 cc's more than that of the S515i. (In this regard, the United States notes that Indonesia incorrectly lists the Neon's engine displacement as 2,000 cc. As clearly set forth in evidence submitted by the United States (Table 23), the Neon's engine displacement is 1,996 cc.)

8.183 In the view of the United States, these differences are insufficient to warrant the conclusion that, in terms of power plant, the US cars do not "closely resemble" the Timor S515i or the S515 within the meaning of the "like product" definition in the Subsidies Agreement.

8.184 Turning to what Indonesia refers to as the category of"steering and suspension", Indonesia finds the US cars to be non-comparable based on the presence of power steering and tire size. (See Table 26 and accompanying notes.) However, according to Timor sales brochures, both the S515 and the S515i have power steering as a standard feature. (See European Communities Exhibit D-4.) Moreover, according to Ford officials, power steering on the Escort is an option, not a standard feature, worth approximately US$200.

8.185 As for larger tire size, this is a designed option that depends upon anticipated road conditions and generally is defined as a standard feature of minimal value to consumers.

8.186 In short, the US cars cannot be considered "unlike" the S515 or the S515i on the basis of steering and suspension.

8.187 Turning to what Indonesia calls "safety features", with respect to brakes, Indonesia cites the fact that the Neon has antilock brakes. However, this is an optional feature on the Neon, as clearly set forth in Table 27. With respect to the Escort, Indonesia claims that the Escort has rear disc brakes,

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[480] See US Exhibit 32.

but this is incorrect. As set forth in US Exhibit 33, page 3, the Escort has rear drum brakes, just like the Timor. Finally, there are no differences between the Opel Optima and the Timor with respect to brakes.

8.188 With respect to airbags, according to Ford officials, Ford did not include airbags in its Indonesia launch plans for the Escort. The Neon, however, would have had airbags.

8.189 With respect to fuel economy, the United States has some difficulty understanding how this constitutes a "safety feature." Nevertheless, according to the US Department of Energy, the fuel economy of the Sephia is comparable to, and in some cases better than, that of the Escort and the Neon. US Exhibit 34 contains excerpts from the US Department of Energy Fuel Economy Guide: Model Year 1997. US Exhibit 35 summarizes the data from this guide with respect to the Sephia, the Escort, and the Neon. As can be seen, the Sephia actually has superior mileage to the versions of the Escort and Neon that have automatic transmissions. Note also that Indonesia does not provide any source for the fuel economy figures contained in Table 27.

8.190 Turning from fuel economy to vehicle weight, in a note to Table 27, Indonesia cites only the fact that the Opel Vectra is heavier than the Timor, thus conceding that Timors, Neons, Escorts, and Optimas have comparable weights.

8.191 Finally, in the same note to Table 27, Indonesia cites the fact that the Vectra has a larger fuel tank than does the Timor, thereby conceding that Timors, Neons, Escorts, and Optimas have comparably sized fuel tanks. In this regard, the United States would note that it does not believe that fuel tank size plays much of a role, if any role, in consumer purchasing decisions.

8.192 In summary, insofar as "safety features" are concerned, Indonesia's analysis is inaccurate and fails to rebut the US evidence that the cars of US manufacturers are "like" the Timor Kia Sephia.

8.193 Finally, with respect to the category of "passenger compartment," in Table 26, Indonesia concedes that Timors, Neons, Escorts, and Optimas are comparable.

8.194 Thus, Indonesia's own comparisons, when corrected for inaccuracies, demonstrate that the US cars in question are "like" the Timor. However, the United States should note that Indonesia ignores or downplays certain facts that, according to Indonesia, should form a part of any "like product" analysis. We already have mentioned the fact that the engine of the Timor S515i has certain attributes that make it more desirable than the engines in the Optima and the Neon. In addition, Indonesia fails to cite the fact that the Timor S515i has tilt steering, mud flaps, colour key mirrors and bumpers, and a foldable mirror, all of which are attractive features to consumers.

8.195 Moreover, Indonesia ignores the fact that the US manufacturers, as new (or relatively new) entrants into the Indonesian passenger car market, have little, if any, brand loyalty base or a well-developed brand image. Ford, for example, has only one after-sales service outlet in Indonesia.

8.196 Finally, the United States would like to call the Panel's attention to US Exhibit 36, which contains excerpts from the Catalogue de la Revue Automobile '96, described by industry officials as an authoritative source. In the entry for the Sephia, the Sephia is described as "techniquement parenté aux Mazda 323/Ford Escort USA/Mercury Tracer." Translated, this means that the Sephia is, among other things, technologically related to the Escort.

8.197 As the United States has explained, the Escort is Ford's entry in the "C" segment of the passenger car market. Given the fact that the Sephia is technologically related to the Escort, it seems fair to say that the Timor Kia Sephia falls within that same segment and is a "like product" to the other cars in that segment.

(f) Indonesia's arguments concerning the burden of proof are incorrect

8.198 Indonesia claims that the United States has failed to satisfy its burden of proof. In the view of the United States, it has more than satisfied its burden as articulated by the Appellate Body in *Wool Shirts*, of presenting a *prima facie* case of serious prejudice. The first and second submissions of the United States establish all of the elements for a serious prejudice case. Instead, it is Indonesia that has failed to rebut the US case. Of course, Indonesia is hard put to rebut the evidence cited by the United States, because much of it is Indonesia's own evidence, submitted in the course of the Annex V process.

8.199 Indonesia presents a new argument that the burden of proof on complainants is higher in this case because Indonesia is a developing country and the ability to bring a serious prejudice case against it allegedly is a derogation of its "right" to provide local content subsidies. (See section VIII.B.3(a)(3).) This is an expansion on Indonesia's earlier argument that "like product" must be interpreted differently in this case because of Indonesia's developing country status.

8.200 The United States addressed Indonesia's earlier argument in section VIII.B.3(a)(2). Indonesia's expansion of its argument brings the argument even more clearly within the scope of the *Wool Shirts* case, where the Appellate Body rejected India's argument that the burden of proof changes simply because a particular provision may be labeled as an exception to something else. Significantly, in its submission, Indonesia does not mention the *Wool Shirts* report when it advances its "derogation" argument.

(3) Indonesia's arguments

(a) The European Communities and the United States have not met their clear burden of demonstrating serious prejudice to a like product on the basis of positive evidence

8.201 The European Communities and the United States implicitly or directly accuse Indonesia of making diversionary arguments on the threshold like product issue. It is they, however, who are engaging in such tactics. Both complainants criticize Indonesia’s like product observations, but in doing so they seek to obscure a fundamentally important procedural matter. Namely, that it is they, not Indonesia, that have the burden of demonstrating what are appropriate like products within the meaning of the Subsidies Agreement. Their failure - indeed, their inability - to demonstrate that the Timor is like any European Communities or US car is fatal to their serious prejudice claims.

8.202 Moreover, even if the European Communities and US cars were found to be like the Timor, no serious prejudice would exist or would arise because such cars do not compete with the Timor. The Timor is a no-frills budget car which has tapped a new class of buyers and created a niche at the bottom of the highly segmented passenger car market.

(b) Complainants have not met their substantial burdens of proof with respect to the like product issue

8.203 It is obvious that neither the European Communities nor the United States has met its clear burden of establishing appropriate like products or of demonstrating by positive evidence that any appropriate and relevant like products have suffered or are threatened with serious prejudice. As discussed below, their failure to satisfy the applicable burdens of proof renders their SCM Agreement-based arguments an empty exercise.

8.204 Both complainants have rejected in the most general terms its position that none of the vehicles they sell (or allegedly would have sold) in Indonesia are like the Timor, but, as discussed in detail below, neither has attempted in any meaningful way to address and rehabilitate the fundamental

flaws in its "like product" analysis. This action and inaction reflects an altogether unacceptable disregard for the appropriate and recognized requirement that a complainant has the burden of establishing acceptable "like products" for analytical purposes.[481]

8.205 The failure of the European Communities and the United States to meet their burden of proof on the like product issue eviscerates their entire serious prejudice arguments because they have a correlative obligation to prove serious prejudice to their like products by positive evidence.[482] No amount of creative argumentation or irrelevant data can satisfy the applicable positive evidence standard where, as here, a complainant fails to carry its burden of establishing the proper universe of like products. In order to have any meaning and to support an affirmative determination, the indicia of serious prejudice must flow from apples-to-apples comparisons. As discussed elsewhere in this submission, Complainants have, however, developed and adduced apples-to-oranges "evidence" that is based on faulty like product analyses.

(c) The term "like product" must be very narrowly construed and applied in this proceeding

8.206 Footnote 46 to the Subsidies Agreement provides:

> Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

8.207 The somewhat amorphous and skeletal phrase, "characteristics closely resembling," may be fleshed out through reference to prior GATT and WTO cases, but it is well established that the "like product" concept is fluid and its meaning depends on the context in which it is used.[483] As the WTO Appellate Body has stated:[484]

> No one approach to exercising judgment will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are

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[481] See Japan-Taxes on Alcoholic Beverages (1 November 1996),WT/DS8/R, 117, para. 6.14 (complainant has burden of proof to show like product in Article III:2 dispute); see generally Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items (25 November 1997), WT/DS 56/R, 90-91, para. 6.35.

[482] The positive evidence standard of the Subsidies Agreement is especially significant in this case because an affirmative finding of serious prejudice would operate to deprive Indonesia, as a developing country, of its right to provide certain subsidies. A derogation of Indonesia's right in this case places an exceedingly high burden of proof on Complainants. See generally Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140, 164, para. 5.20; Japan-Restrictions on Imports of Certain Agricultural Products (22 March 1988), BISD 35S/163, 226-27, para. 5.1.3.7; EEC-Restrictions on Imports of Dessert Apples--Complaint by Chile (22 June 1989), BISD 36S/93, 125, para. 12.3.

[483] See, e.g., Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (10 November 1987), BISD 34S/83 (paras. 5.5 and 5.6 at pp. 113-115); Canada-Import Restrictions on Ice Cream and Yoghurt (5 December 1989), BISD 36S/68 (para. 67 at p. 87); United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (paras. 5.71-5.75 at pp. 293-294).

[484] Japan-Taxes on Alcoholic Beverages, WT/DS8/AB/R (1 November 1996), Report of the Appellate Body, at p. 21.

> applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.

8.208 Factors which have been considered in applying a case-by-case analysis include a product's end-uses in a given market; consumer's tastes and habits, which change from country to country; and the product's properties, nature and quality.[485] The tariff treatment of products is another factor that has been considered.[486] Thus, although interpretations of the phrase in one context can promote a better appreciation of the phrase in another context, it is essential to relate the specific interpretation and application to the purpose of the article being construed.[487] Here, the term "like product" must be very narrowly defined.

8.209 At the Havana Conference, it was stated that the words "like product" meant the same product in the context of Article VI of the GATT (antidumping and countervailing duties).[488] The 1959 Report of the Group of Experts on "Anti-dumping and Countervailing Duties" stated that, in the dumping context, the "term should be interpreted as a product which is identical in physical characteristics subject, however, to such variations in presentation which are due to the need to adapt the product to special conditions in the market of the importing country (i.e., to accommodate different tastes or to meet specific legal or statutory requirements)."[489] The exact same definition set forth in footnote 46 of the Subsidies Agreement first appeared in the 1967 and 1979 anti-dumping and countervailing duty agreements.[490] This history amply demonstrates that the "like product" concept is to be very narrowly construed and restrictively applied in anti-dumping and subsidy proceedings.[491] This is because the imposition of discriminatory anti-dumping and countervailing duties are exceptions to the general most-favoured-nation obligation of Article I of the GATT.[492]

8.210 The same logic applies with equal force here. The numerous developing country carve-outs in the Subsidies Agreement (e.g., Article 27) reveal the WTO Members' recognition and acceptance of the necessity of subsidy measures to promote critical development programmes in such countries. In other words, the universe of benefits extended to developing countries under the Subsidies Agreement includes the right (albeit conditional) to provide subsidies. Therefore, because an affirmative finding of the threat of serious prejudice to a "like product" would operate to deprive a developing country

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[485] See, e.g., Working Party Report on Border Tax Adjustments (2 December 1970), BISD 18S/97 (para. 18 at pp. 101-102); United States-Taxes on Petroleum and Certain Imported Substances (17 June 1987), BISD 34S/136 (para. 5.1.1 at p. 154); United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (para. 5.24 at p. 276); United States-Standards for Reformulated and Conventional Gasoline, WT/DS2/R (20 May 1996), Report of the Panel, at pp. 36-37, para. 6.8.

[486] See, e.g., Working Party Report on the Australian Subsidy on Ammonium Sulphate (3 April 1950), BISD II/188 (para. 8 at p. 191); EEC-Measures on Animal Feed Proteins (14 March 1978), BISD 25S/49 (para. 4.2 at p. 63); Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (10 November 1987), BISD 34S/83 (para. 5.6 at p. 115); United States-Standards for Reformulated and Conventional Gasoline, WT/DS2/R (20 May 1996), Report of the Panel, at p. 37, para. 6.9.

[487] See, e.g., EEC-Imports of Beef from Canada (10 March 1981), BISD 28S/92 (para. 4.2 at p. 98); United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (paras. 5.24 and 5.25 at p. 276 and para. 5.71 at pp. 293-294).

[488] E/CONF.2/C.3/SR.30, p. 5.

[489] L/978, adopted on 13 May 1959, BISD 8S/145 (para. 12 at p. 149).

[490] See BISD 15S/24, 25; BISD 26S/171, 172; BISD 26S/56, 65 fn. 1.

[491] See generally Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (10 November 1987), BISD 34S/83 (para. 5.6. at p. 115).

[492] See United States-Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada (11 July 1991), BISD 38S/30 (para. 4.4. at p. 44).

Member of this generally available right, "like product" must be narrowly construed.[493] A derogation of Indonesia's right in this case therefore places an exceedingly high burden of proof on Complainants[494], and Complainants have not met this burden.

(d) With regard to Timor sales, no like product of the European or the United States has been seriously prejudiced

8.211 Notwithstanding their claims and criticisms of Indonesia's like product approach, neither the European Communities nor the United States sells any car models in Indonesia that are like the Timor. For the purposes of this proceeding, like product determinations must be made with reference to numerous physical and non-physical characteristics and consumer perceptions and preferences. Complainants' like product arguments are woefully inadequate because they fail to address the full range of relevant characteristics and perceptions.

(e) The European Communities assertions concerning the Opel Optima and the Peugeot 306 are incorrect and misleading

8.212 The European Communities asserts, in effect, that Indonesia's approach to the like product concept is "clearly too restrictive" because at least one of the 60 different models of passenger cars sold in Indonesia must be like the Timor. Putting aside where the burden of proof resides, and the European Communities's failing in that regard, the European Communities's point is very wide of the mark. The issue here is whether any EC passenger cars are like the Timor, not whether any other cars are like the Timor.

8.213 The European Communities's recycled serious prejudice arguments are a hodgepodge of general and specific data. The European Communities has proffered general market share data covering the entire passenger car market, while also making price undercutting, sales and market share arguments limited to the Opel Optima and the Peugeot 306. The European Communities tips its hat to the like product concept by narrowing the focus to two models it claims are within the same segment as the Timor, but, to date, it has furnished no specific information or data to support the "likeness" of these products. Again, and at the risk of being repetitive, this makes European Communities data on market share, sales and price undercutting useless. Moreover, as shown in Tables 26 and 27, the Timor is not like the Opel Optima or the Peugeot 306.

(f) The United States has sold no like products in Indonesia and its assertions regarding the GM Opels, Ford Escort and Chrysler Neon are misplaced and speculative

8.214 The United States cannot demonstrate serious prejudice because it has not satisfied the essential like product predicate. As demonstrated in Tables 26 and 27, the Ford Escort, Chrysler Neon and Opel Optimas and Vectras are not like the Timor.[495]

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[493] See generally Japan-Restrictions on Imports of Certain Agricultural Products (22 March 1988), BISD 35S/163 (para. 5.2.2.3 at p. 230); Canada-Import Restrictions on Ice Cream and Yoghurt (5 December 1989), BISD 36S/68 (para. 59 at p. 84); EEC-Restrictions on Imports of Apples--Complaint by the United States (22 June 1989), BISD 36S/135 (para. 5.15 at p. 164); Norway-Procurement of Toll Collection Equipment for the City of Trondheim (13 May 1992), BISD 40S/319 (para. 4.5 at p. 336).

[494] See generally Canada—Administration of the Foreign Investment Review Act (7 February 1984), BISD 30S/140 (para. 5.20 at p. 164); Japan-Restrictions on Imports of Certain Agricultural Products (22 March 1988), BISD 35S/163 (para. 5.1.3.7 at pp. 226-227); EEC-Restrictions on Imports of Dessert Apples--Complaint by Chile (22 June 1989), BISD 36S/93 (para. 12.3 at p. 125).

[495] The United States attempts to buttress its position by asserting that "there is plenty of evidence that in the US market the Sephia is considered to be in the same category as the Escort and Neon." This is unavailing

8.215 Further to the like product issue, the United States suggests that the legal analysis should be confined to consideration of the most basic physical characteristics and end uses of passenger cars. Such an analysis would be inappropriate, however, because it is overly simplistic.

8.216 The United States takes Indonesia to task for extending its analysis beyond the definition of "like product" found in footnote 46 to the Subsidies Agreement, but this is unjustified and, at best, disingenuous. The United States states: "Obviously, this definition provides only general guidance, and a case-by-case analysis is necessary to determine whether a particular product is 'like' another. …Factors which should be considered in applying a case-by-case analysis include 'a product's end use in a given market, consumer's tastes and habits, which change from country to country, and the product's properties, nature and quality."[496] The United States also has noted its agreement with Indonesia that "consumers consider numerous physical and non-physical characteristics in making their purchasing decisions." This irrefutable fact is amply borne out by the following statement appearing in Ford Motor Company's 1996 annual report to the US Securities and Exchange Commission:

> Ford's share [of industry sales] is influenced by the quality, price, design, driveability, safety, reliability, economy and utility of its products compared with those offered by other manufacturers, as well as by the timing of new model introductions and capacity limitations. Ford's ability to satisfy changing consumer preferences with respect to type or size of vehicle and its design and performance characteristics can affect Ford's sales and earnings significantly.[497]

8.217 The wide range of acknowledged factors that must be considered in identifying which products are like the Timor further points up the failure of the US (and the EC) to satisfy the burden of proof discussed above.

(g) Indonesia's position on the like product issue does not render the Subsidies Agreement inapplicable to consumer products

8.218 The European Communities and the United States separately argue, in essence, that Indonesia's like product analysis is too restrictive because requiring identity between passenger cars would effectively exclude consumer products from the scope of the Subsidies Agreement. Those arguments are fallacious.

8.219 Indonesia has never claimed that products must be identical to be considered like one another. Indeed, Indonesia agrees that some differentiation can exist among like products. It is critical to emphasize, however, that the concept of differentiation must be carefully circumscribed, taking due account of the types of products at issue. For example, while relatively minor and inconsequential differences exist among many consumer products - such as blenders, can openers and toaster ovens - passenger cars are very highly differentiated products. Two cars might even closely resemble one another in terms of their most basic physical characteristics, but yet still be highly differentiated on the basis of numerous other physical and non-physical characteristics, including design, quality,

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for three reasons. First, the Kia Sephia marketed in the United States is a much more advanced car than the Timor--the differences are so great that the Sephia is not "like" the Timor. See Indonesia Exhibit 42 at pp. 8-9. Second, analysts' perceptions of the US market have no relevance to the Indonesian market. Finally, even if such perceptions were relevant, not all analysts put the Sephia in the same category as the Escort and Neon. See Indonesia Exhibit 12.

[496] United States citing Japan-Taxes on Alcoholic Beverages (1 November 1996), WT/DS8/R, Report of the Appellate Body, 22.

[497] Ford Motor Company 1996 Annual Report to US Securities and Exchange Commission in Form 10-K at 5 (Indonesia Exhibit 44).

durability, driveability, safety, reliability, brand loyalty, brand image/reputation, status, after-sales service, fuel consumption and resale value.[498] This multitude of differentiating features among cars, as well as their much higher cost, distinguishes them from nearly all other consumer products. Thus, although it may be difficult to determine appropriate like product categories for the purposes of this proceeding, that difficulty does not support the sweeping assertions of the European Communities and the United States that the adoption of Indonesia's specific approach to the like product issue in this case would make it impossible to bring a serious prejudice case against a subsidized consumer product.[499]

8.220 Product differentiation is significant to the like product issue for another reason. It is recognized that where there is high degree of product differentiation, products are less substitutable, and price is less likely to be a determining factor in purchasing decisions. The exceptionally high degree of product differentiation between the Timor S515 and the European Communities and United States group of purportedly like cars makes them non-substitutable. This is important because, as the panel in Japan-Taxes on Alcoholic Beverages recognized, all like products are "directly competitive or substitutable products."[500] Thus, because the Timor and none of the proposed comparison models are substitutable or "directly competitive," they cannot be considered like products.[501]

(h) Market segment

8.221 Numerous physical and non-physical attributes and consumer perceptions determine the market segment into which any given model falls. These various factors, include, but are not limited to: brand loyalty; quality; brand image/reputation; reliability; design; durability; utility; resale value; ride and comfort; driveability; standard features; safety features; available options; exterior size; interior space; fuel economy; after-sales service; engine size and technology; transmission type; and suspension type.

8.222 The physical attributes and specifications of the Timor set forth by Indonesia in Table 27, as well as the non-physical attributes and perceptions listed above, place the Timor in the market segment composed of budget small passenger cars. The Timor taps new entrants to the car market through this market segment. The same physical and non-physical attributes and perceptions place the Ford Escort, Opel Optima and Vectra, and Chrysler Neon (and Peugeot 306) at the top of the more elevated small car segment.

8.223 The relative positions of the Timor and the United States (and the European Communities) comparison models are amply demonstrated by reference to just their most basic physical differences (These positions are reinforced and made wider by the different non-physical attributes and

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[498] For example, as shown in Table 27, the Timor S515 and Mercedes-Benz C180 have many physical similarities, but one cannot reasonably consider them to be like products.

[499] Those assertions also are belied by the many successful countervailing and antidumping duty proceedings in the EC, the US and other countries that have involved consumer products. The local authorities there have used the same or a very similar like product approach as that appearing in the Subsidies Agreement. See generally Certain Electric Fans from the People's Republic of China, USITC Pub. 2461 (December 1991); Certain Personal Word Processors from Japan, USITC Pub. 2411 (August 1991); Top-of-the-Stove Stainless Steel Cooking Ware from Korea and Taiwan, USITC Pub. 1936 (January 1987).

[500] Japan-Taxes on Alcoholic Beverages (1 November 1996),WT/DS8/R, 121, para. 6.22. Although the Panel there was addressing Article III and the Interpretive Notes in Ad Article III, its general statement in this regard applies with equal force here.

[501] The notion of competition and its importance is clearly reflected in the text of the Subsidies Agreement. Competition is the motive force underlying all of the indicia of serious prejudice presented in Article 6.3: the displacement or impeding of imports, significant price undercutting, significant price suppression, price depression, lost sales, or lost market share.

perceptions of each model.) There are four basic physical attributes or specification groupings that differentiate passenger cars and contribute to segmenting the market: power plant; steering and suspenion; safety features; and passenger compartment.

8.224 The power plant grouping includes: engine configuration and engine size; transmission type; horsepower; and torque. The steering and suspension grouping includes: suspension type; drive wheels; steering system; tyre size; and turning cycle. The safety feature grouping includes: braking system; fuel tank capacity and mileage; curb weight; and passive restraint. The passenger compartment grouping includes: interior dimensions and number of passengers.

8.225 The following table highlights the most significant physical differences that make the Timor "unlike" the proposed comparison models:

Table 26

United States and European Communities - Proposed Comparisons

	Ford Escort	Peugeot 306	Chrysler Neon	Opel Vectra	Opel Optima
Power Plant[502]	N	N	N	N	N
Steering and Suspension[503]	N	N	N	N	N
Safety Features[504]	N	N	N	N	N
Passenger Compartment[505]	Y	Y	Y	N	Y

Y = Comparable to the Timor S515

N = Not Comparable to Timor S515

8.226 The full data from which the analysis in Table 26 is derived are presented in the table below:

[502] In comparison to the Timor, these cars have larger engines with greater horsepower and torque. The Neon has an automatic transmission, which is also available for the Peugeot.

[503] In comparison to the Timor, the Escort, Vectra and Optima have power steering and the Peugeot, Neon, Vectra and Optima have larger tires.

[504] In comparison to the Timor, the Neon, Vectra, and Peugeot have ABS; the Escort has rear disc brakes; the Escort, Neon, Vectra and Optima have air bags; Escort and Neon have superior fuel economy; the Opel Vectra is heavier; and fuel tanks of the Vectra and Peugeot are larger.

[505] Interior space (based on exterior measurements) and the number of passengers accommodated are approximately the same, except for the Vectra, which seats an additional passenger.

Table 27

Comparison of Cars

Item	Timor S515	Ford Escort	Chrysler (Dodge Neon)	Opel Vectra	Opel Optima	Peugeot 306	Mercedes-Benz C-180
1. Engine Size (cc)	1,498	1,597	2,000	1,998	1,796	1,761	1,799
2. Engine Configuration and Number of Valves	SOHC, 4 Cyl. Carburetor, 16 Valves	DOHC, 4 Cyl. Injection, 16 Valves	OHC, 4 Cyl. Injection	SOHC, 4 Cyl. Injection	SOHC, 4 Cyl. Injection	SOHC, 4 Cyl. Injection	4 Cyl. Injection
3. Suspension Front: Independent, MacPherson Strut	Yes	Yes	Yes	Yes	Yes	Yes	
Rear: Fully Independent, Multi-linked	Yes	Yes	Yes	Yes	Yes	Yes	
4. Brakes 1. Front 2. Rear 3. ABS	Disc Brake Drums	Disc Brake Disc Brake	Disc Brake Drums Yes	Disc Brake Drums Yes	Disc Brake Drums	Disc Brake Drums Yes	Disc Brake Disc Brake Yes
5. Drive (Front Wheel)	Yes	Yes	Yes	Yes	Yes	Yes	No
6. Steering	Rack & Pinion, with collapsible column	Rack & Pinion, power-assisted		Rack & Pinion, power steering	Rack & Pinion, power steering	Adjustable Column (angle) control under steering wheel, power steering	
7. Transmission (Manual 5 or Automatic)	Manual 5 Speed	Manual 5 Speed	Automatic 3 Speed	Manual 5 Speed	Manual 5 Speed	Manual 5 Speed	Manual 5 Speed
8. Horsepower (kw/rpm)	58/5,500	75/5,500	97/6,000	80.9/5,400	66/5,400	70/6,000	122/5,500
9. Torque (kgm/rpm)	122/2,500	134/3,000	129/5,000	173/2,600	163/3,200	148/3,000	199/3,750
10. Fuel Tank Capacity (litre)	50	55	57	61	52	80	75

Table 27 - Continued

Item	Timor S515	Ford Escort	Chrysler (Dodge Neon)	Opel Vectra	Opel Optima	Peugeot 306	Mercedes-Benz C-180
11. Overall Fuel Efficiency (km/ltr)							
- Urban	12.3	9.5	24.2			5.8	
- Suburban	13.9	29.7					
12. Curb Weight	1,055	1,110	1,102	1,245	980	1,100	1,280
13. Height	1,390	1,346	1,320	1,425	1,410	1,383	1,389
14. Width	1,692	1,875	1,687	1,841	1,688	1,689	1,720
15. Length	4,360	4,295	4,295	4,477	1,239	4,232	4,487
16. Wheel Base (mm)	2,500	2,523	2,600	2,637	2,517	2,580	2,690
17. Turning Cycle (metres)	4.95	5		5.33	4.99	5.45	5.37
18. Tyre Size	175/70R13	175/70R13	185/65R14	195/60R15-87H	195/60R15	185/60R14	195/65R1591H
19. Number of Passengers	4	4	4	5	4	4	4
20. Air Conditioning	Yes	Yes	Yes	Yes	Yes	Yes	Yes
21. Air Bags	No	Yes	Yes	Yes	Yes	No	Yes

(i) The Neon is not "like" the Timor

8.227 In addition to the differences already noted, data presented by the United States shows that the Neon is downright luxurious compared to the spartan Timor. According to the United States, the Neon includes the following equipment as standard features:

- compact disc player;
- an electric sunroof; and
- the new, low-force airbags.[506]

8.228 These items are not even offered as options on the Timor. Yet they are standard on the one United States-made car the United States claims is like the Timor. Also, even the limited physical data on the Neon provided by the United States demonstrates that there are other significant physical differences between the Neon and the Timor. (See Table 23.)

8.229 Moreover, the United States effectively concedes that the Timor is perceived in Indonesia just as Indonesia has described it to this Panel - as a lower-quality, budget car.[507] Of course, as Indonesia has discussed and the United States has acknowledged, consumers' perceptions are critical to their purchasing decisions.

8.230 Particularly instructive is the United States' acknowledgement that the Sephia and the Timor are not the same car. In an attempt to sidestep the issue, the United States states that "the only difference ... is the 'Timor' sticker and, perhaps, the country of origin of some of the parts." The United States then notes in passing that "the version of the Sephia sold in the United States has a slightly larger engine than the version sold in Indonesia."

8.231 Furthermore, the United States engages in a far more egregious manipulation of data when it discusses the power of the two cars. We bring to the Panel's attention the fact that the United States has presented misleading data in a side-by-side comparison of the Timor and the Neon. The United States presents a horsepower figure (which the United States labels "HP") in describing the Timor's power output, but a kilowatt-at-rpm figure for the Neon without noting the change in the measurement. The result is an 85 to 98 comparison, instead of the appropriate 85 to 129 horsepower comparison, which, of course, undercuts the United States' position. Moreover, we note that, insofar as the Neon is a US-made car, Chrysler markets it based on horsepower. We trust that the United States did not use this bait and switch intentionally to mislead the Panel, hoping that the improper comparison would go unnoticed.

8.232 Indonesia already has demonstrated conclusively what the United States still seeks to avoid admitting: even the Sephia is not "like" the Timor. The Timor is the Sephia of years gone by. Unlike any producer from the United States, the European Communities or Japan, Kia was willing to license its outdated technology at a fair price, but not even Kia was willing to licence its current technology.

(b) CKDs as "like" finished Timors

8.233 According to the parties, the GM Opel Optima and Vectra, the Ford Escort, the Peugeot 306 and the Chrysler Neon, among other models, are (or would be) imported into Indonesia in Completely-Knocked-Down ("CKD") (rather than CBU) form. Once in Indonesia, they are assembled and sold. The **European Communities** and the **United States** argue that these imports in

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[506] US Exhibit 24, p. 18 lists these items as standard equipment for the Neon.
[507] Id., p. 35 (article notes potential buyers' concerns about the Timor's quality and after-sales service).

CKD form are "like" finished Timors. **Indonesia** disagrees. The following are the parties arguments in this regard:

(1) Arguments of the European Communities

8.234 The proposition that CKD cars must be considered as "like" to assembled complete passengers where the CKD kit already has the "essential character" of the complete car is supported by a generally accepted principle of customs classification, now contained in Rule 2(a) of the General Rules for the Interpretation of the 1996 Harmonised System. According to this principle:

> 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

8.235 Given that Indonesia grants import duty relief for the importation of parts and components for the assembly of passenger cars when the local content of the cars into which they are assembled is more than 20 per cent, imported CKDs may be considered as having the “essential character” of a complete car in those cases where they have not benefited from import duty relief.

8.236 The criteria applied by Indonesia in order to classify the same products when imported into Indonesia still remain unclear. Indeed, 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).

8.237 At any rate, whether or not Indonesia adheres in practice to General Interpretative Rule 2(a) is totally irrelevant to this dispute. The European Communities has invoked General Interpretative Rule 2(a) in support of its contention that CKD kits and CBU cars have "closely resembling characteristics" and, therefore, are "like" products for the purposes of the SCM Agreement. That argument has a general relevance and remains valid, irrespective of whether the importing Member concerned in a particular dispute complies with that rule or not.

8.238 In response to a question from the Panel regarding the condition in which the CKD kits are imported, and the nature and amount of value added in Indonesia, the **European Communities** stated the following:

8.239 Virtually all EC cars (of all models) are exported to Indonesia as CKD kits. The kits already include almost all the parts and componentes necessary for assembling the cars. The only parts and components which are purchased in Indonesia are low cost universal components, such as batteries and tyres, or accessories such as radios, CD-players and loudspeakers. As a result, the percentage of local added value is very low in all cases. According to the data provided by Indonesia in response to a question raised by the United States during the consultations, (see table below) in 1996, the local content percentage of the EC models assembled in Indonesia ranged from 6.4 per cent to 8.2 per cent.

Table 28

Local Content

Kind Of Vehicles	Original country	Local Content (%)		
		1994	1995	1996
I. Commercial Car				
Category I	Japan	12.201 - 61.016	6.398-48.127	6.470 - 45.398
	United States	29.078	-	-
	European Community	-	5.760	-
Category II	Japan	31.815 - 37.502	23.404 - 33.672	24.610 - 33.976
	United States	-	-	-
	European Community	21.604	25.353 - 28.109	22.005 - 22.517
Category III	Japan	31.164 - 36.621	30.431 - 36.060	25.295 - 34.819
	United States	-	-	-
	European Community	23.061 - 31.634	29.273 - 30.964	22.529 - 23.280
Category IV	Japan	1.000 - 31.994	2.725 - 30.796	3.977 - 30.162
	United States	2.200 - 11.800	2.200	-
	European Community	-	4.682	4.689
II. Passenger Car	Japan	5.000 - 42.968	6.231 - 42.248	6.908 - 42.165
	United States	6.000	7.536 - 11.200	7.663 - 11.066
	European Community	5.000 - 6.327	6.222 - 7.858	6.388 - 8.292
	Korea	-	5.016 - 8.304	6.529 - 8.300

(2) Arguments of the United States

8.240 The United States agrees with the European Communities that CKD passenger cars must be considered as "like to the assembled complete passenger cars in those cases where the CKD kit has already the 'essential character' of the complete car" for the reasons set forth by the European Communities. The United States would add that, to a large extent, world trade in automobiles is conducted in the form of the export and import of unassembled vehicles, as opposed to completely built-up, finished vehicles. Certainly that is the case in Indonesia, where the only passenger car that has been imported in CBU form and in sizeable quantities was the Kia Sephia during the one-year period in which the tariff and tax exemptions were in effect. Because a CKD passenger car has the essential character of a complete car, it would exalt form over substance to find that a CKD passenger car is not a like product to a finished car.

8.241 In response to a question from the Panel regarding the condition in which the CKD kits are imported, and the nature and amount of value added in Indonesia, the **United State**s stated the following:

8.242 In the case of Ford, the Escort CKD kits would have been ordered in groups of 20 vehicles; i.e., an order could be for any multiple of 20 vehicles, such as 20, 40, 60, etc. The kits would have been packaged in waterproof, pre-engineered cases to accept the exact content of the kit, such as the correct number of hoods, fenders, engines, etc. The pre-engineered cases then would have been placed in standardized cargo containers for delivery to the port and subsequent ocean shipment. The CKD kit 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.

8.243 With respect to local content, the initial local content of Ford Escorts would have been well below the 20 per cent threshold for obtaining tariff incentives under the 1993 Programme, although Ford planned on increasing the local content over time.

8.244 With respect to the Chrysler Neon, the kits would have been shipped in lots of 72 vehicles. Because under the project, as planned, Neons would have had less than 10 per cent local content, this would have resulted in 85 boxes per lot. The United States does not have a complete list of the components that would have been sourced from Indonesia. According to Chrysler officials, however, due to the low local content, the items that would have been sourced locally would have included such things as paints, oils, gasoline, and other commodities.

8.245 The United States has requested, but not received, information from General Motors concerning the precise composition of its CKD kits.

(3) Arguments of Indonesia

8.246 CKD cars are not "like" finished cars. Although various Customs regimes classify for tariff purposes incomplete, unfinished or unassembled products and finished products under the identical HTS number, this fact in and of itself does not make a completed "ready-to-sell" automobile a like product to an incomplete, unfinished or unassembled car that after importation requires the addition of critical components, labour, capital resources and equipment before it is "ready-to-sell".

8.247 Designation of unassembled and assembled products as like products results in comparisons between articles that are physically dissimilar with different customers and customer expectations. These resultant apples-to-oranges comparisons are economically and legally meaningless.

8.248 The phrase "essential character" is a tariff classification concept. It is not a concept that can be used as the dispositive factor when complainants attempt to cobble together an unworkable comparison analysis.

(c) "Imports" from/"exports" by complainant

8.249 In response to a question from the Panel, the **United States** addressed the question of whether serious prejudice to the interests of the United States could arise in terms of displacement/impedance and price undercutting where the products being displaced/impeded or whose prices were being undercut were not of US origin. The following are the **United States'** arguments in this regard:

(1) Arguments of the United States

8.250 With respect to the Escorts that Ford planned to import into Indonesia, according to Ford's project plan for Indonesia, they would have been sourced from Europe. With respect to the Opel Optimas and Vectras imported into Indonesia, it is the understanding of the United States that imports of Opel Optimas and Vectras have ceased as a result of the National Car programme, although it is possible that cars from inventory may still be available for sale in Indonesia. Prior to the introduction of the National Car programme, Opels were sourced from Europe. With respect to the Chrysler Neons to be imported into Indonesia, they would have been sourced from the United States; specifically, from Chrysler's plant in the state of Illinois.

8.251 It is the understanding of the United States that there are no passenger cars of US origin, in CBU or CKD form, that currently are imported into Indonesia. See AV/13, US Answer to Question #6. While the stray import of a US-origin passenger car cannot be ruled out, as demonstrated below, the US manufacturers cancelled their plans to export passenger cars to Indonesia due to the introduction of the National Car programme. Therefore, at present, vehicle exports (other than trucks) of US origin consist of kits of GM (Opel) Blazers and Jeep Cherokees, both of which fall into the category of "light commercial vehicles."

8.252 It is the view of the United States that serious prejudice to the interests of the United States in terms of displacement/impedance and price undercutting may arise where the products being displaced/impeded or whose prices are being undercut are not of US origin. The reasons for this are as follows:

8.253 Article 6.1 of the SCM Agreement refers to "[s]erious prejudice in the sense of paragraph (c) of Article 5 ... ." Article 5(c), in turn, refers to "serious prejudice to the interests of another Member". In addition, footnote 13 to Article 5(c) states as follows: "The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice." The second sentence of Article XVI:1 states as follows: "In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization." Thus, one has to start with Article XVI:1.

8.254 The second sentence of Article XVI:1, by its terms, does not limit a Member's right to complain about serious prejudice to situations where the products that are being affected by subsidies are of that particular Member's origin. Instead, Article XVI:1 refers to a Member's "interests", the ordinary meaning of which is "the state of being concerned or affected esp. with respect to advantage or well-being". Because General Motors and Ford are undeniably US companies, the United States has a legitimate concern with respect to the well-being of those companies. Thus, actions that affect those companies, or products produced and sold by those companies, affect the interests of the United

States within the meaning of Article XVI:1. In other words, under Article XVI:1, the United States has an "interest" in exports from the EC of the products of US companies, such as General Motors and Ford. The standard of Article XVI:1, through footnote 13, is incorporated into Part III of the SCM Agreement as a basic principle. Had a different result been intended, the drafters could have easily used different language.

8.255 It is true that some of the provisions of Article 6 do and some do not mesh perfectly with this basic principle. Paragraphs (a) through (c) of Article 6.3, for example, simply refer to the effects on like products from "another Member", as opposed to products from the complaining Member, and are consistent with the basic principle of Article XVI:1 and Article 5(c). Paragraph (d) of Article 6.3 does not refer to the effects on like products at all.

8.256 On the other hand, Article 6.7, which describes situations in which serious prejudice shall not arise under Article 6.3, refers to imports or exports from the complaining Member. In the view of the United States, however, the specific rules in Article 6.7 should be interpreted in light of the basic principle in Article XVI:1, as incorporated into Article 5©, and should not be used to override the basic principle.

(2) Arguments of Indonesia

8.257 **Indonesia** argues that the fact that no products of US origin are sold in Indonesia means that the United States has no claim of serious prejudice. The following are **Indonesia's** arguments in this regard:

8.258 The United States admits that:

> "there are no passenger cars of United States origin, in CBU or CKD form, that currently are imported into Indonesia";
>
> Opel Optimas and Vectras imported into Indonesia were and would be sourced from the European Communities, not from the United States; and

even if the so-called "plans" of the Big Three were relevant, only one United States company - Chrysler - ever considered exporting a US-made product from the United States to Indonesia (a CKD Neon). Opel sources from the European Communities and the United States admit that Ford would have sourced any Escorts destined for Indonesia from Europe.

Thus, the United States has reduced its serious prejudice claim to one, quite simple, inadequately substantiated allegation: But for the Indonesian measures, Chrysler would have gone forward with its supposed "plans" to try to sell the Neon in Indonesia. Even if this were true, it would not amount to serious prejudice. Therefore, the Panel should reject the United States claims and reject its complaint.

4. Article 6.3(a) of the SCM Agreement - displacement/impedance of imports

(a) Arguments of the European Communities

8.259 The **European Communities** claims that the subsidies at issue cause "serious prejudice" to the interests of the Community in the way described in paragraphs (a) and (c) of Article 6.3 of the SCM Agreement. The following are the **European Communities'** arguments in support of this claim:

8.260 In accordance with Article 6.3 of the SCM Agreement, serious prejudice in the sense of Article 5 © may arise:

> .... in any case where one or several of the following apply:
>
> (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
>
> (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another member in the same market or significant price suppression, price depression or lost sales in the same market";
>
> (d) the effect the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidised primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over period when subsidies have been granted.

8.261 The use of the alternative conjunction "or" in the chapeau of Article 6.3 clearly indicates that the presence of one of the factors listed in that provision may be sufficient to establish the existence of serious prejudice.

8.262 The Community claims and will demonstrate here below that the subsidies under consideration cause serious prejudice to the interests of the Community in the manner described in paragraphs (a) and (c) of Article 6.

(1) Subsidized National Cars have displaced and impeded imports of passenger cars from the European Communities

8.263 Although PT TPN entered the Indonesian market only in October 1996, by the end of that year sales of the Timor S-515 already accounted for more than 10 per cent of the total annual sales of passenger cars in that market during 1996. During 1997, sales of the Timor S-515 have continued at a steady pace. As shown in the table included in Annex C-2, by the end of the first semester of 1997, the market share of the Timor S-515 had reached 26.52 per cent. In other words, thanks to the massive subsidisation provided by the Indonesian Government, PT TPN has been able to capture more than a quarter of the Indonesian market for passenger cars in just nine months.

8.264 PT TPN's successful entry into the Indonesian market has taken place, to a significant extent, at the expense of imports from the Community. Indeed, sales of the heavily subsidized Timor S-515 have both "replaced" existing imports of Community passenger cars and "impeded" a further increase in Community imports.

Table 29

Sales of Passenger Cars - Market shares

	1993	1994	1995	1996	1997*
Timor	-	-	-	10.10	26.52
EC**	9.9	18.28	23.72	24.09	16.15
Japan***	89.8	81.52	69.08	59.85	50.49
Other	0.2	0.21	7.19	5.95	6.83

* April-May 1997
** Includes sales of the Opel Optima and the Opel Vectra
*** Includes sales of the Ford Laser and the Ford Telstar

Source: AV/3 (data derived from attachments A-39/1-A through A-39/5-B).

8.265 Since 1992 and until 1996, exports of passenger cars from the Community grew at a faster pace than demand, resulting in a significant gain in terms of market share. As shown in Table 29, the market share held by passenger cars imported from the Community nearly doubled between 1993 and 1994, from 9.9 per cent to 18.28 per cent, and increased again the following year to 23.72 per cent.

8.266 In 1996, this trend was abruptly interrupted by the entry into the market of the Timor S-515. Thus, the Community's share for 1996 was only marginally higher (24.09 per cent) than its share for 1995 (23.72 per cent). During the first half of 1997, the share held by European Communities imports fell dramatically to only 16.15 per cent, the lowest level since 1993.

Table 30

Sales of the Opel Optima and the Peugeot 306 - Units

	1995	1996	1997*	1997**
Opel Optima	419	359	165	257
Peugeot 306	-	1,017	443	656
Total	38,826	42,345	26,607	49,568

* April-May
** August 1997, based on data from the EC industry

Source: AV/3 (Attachment A-39/1-B).

Table 31

Market shares of the Opel Optima and the Peugeot 306

	1995	1996	1997*	1997**
Opel Optima	1.08	0.85	0.62	0.52
Peugeot 306	-	2.40	1.66	1.32

* April-May
** August, based on data from the EC industry.

Source: AV/3 (Attachment A-39/1-B).

8.267 Tables 30 and 31 show the impact of the introduction of the Timor S-515 on the sales of the Opel Optima and of the Peugeot 306, the two Community models which are the closest in terms of specifications and price to the Timor S-515.

8.268 The Peugeot 306 was not sold in Indonesia during 1995. In 1996, Peugeot sold 1,017 units of this model, 400 units less than it had originally planned. During the first eight months of 1997 the number of cars sold was only 656 (984 units on an annualized basis, i.e. 33 units less than in 1996). And this despite a substantial increase in overall demand. Indeed, by the end of August 1997, total sales of passenger cars in Indonesia already exceeded by almost 20 per cent the volume sold during the whole of 1996. As a result, the market share of this model shrank from 2.4 per cent in 1996 to just 1.3 per cent during the first eight months of 1997.

8.269 The sales of the Opel Optima fell from 419 units in 1995 to 359 units in 1996. During the first eight months of 1997, Opel sold 257 units of this model. In terms of market share, this represent a decline from 1.08 per cent in 1995 to 0.85 per cent in 1996 and to only 0.52 per cent during the first eight months of 1997. Due to the depressed sales situation, Opel has not ordered any new CKD Optimas from the European Communities since 1996.

8.270 The negative effects of the National Car Programme are not limited to those felt by those Community brands/models that were already present in the Indonesian market. The National Car Programme has also preempted other Community brands/models from entering the Indonesian market.

8.271 Thus, for instance, when the National Car Programme was adopted, Ford was about to start importing CKD Escorts made at its plant in Saarlouis (Germany). With that purpose, Ford had already invested close to US$1 million worth of tooling in Indonesia. The market upheaval caused by the launching of the National Car Programme forced Ford to suspend indefinitely those plans.[508]

8.272 Similarly, prior to the approval of the National Car Programme, General Motors/Opel had advanced plans to expand and upgrade its assembly facilities in Indonesia. According to those plans, the Opel Optima and the Opel Vectra were to be replaced by new Opel models. In June 1996, General

[508] According to a business plan adopted in 1995, Ford would have exported to Indonesia the following quantities of CKD Escorts:

1996	1997	1998	1999	2000	2001	2002	2003
1,323	3,468	5,156	7,370	12,026	13,867	16,026	18,433

Motors/Opel announced that the planned investments were put on hold because of the situation created by the National Car programme.[509] Since then, General Motors/Opel has discontinued the production in Indonesia of the Opel Vectra. As shown above, although the Opel Optima is still being assembled in Indonesia, sales of that model are dwindling.

8.273 Indonesia makes partial and misleading statements which aim at minimising the importance of the European Communities interests in this case and, thereby, also the seriousness of the prejudice suffered by the European Communities. Thus, Indonesia argues that:

- in 1995 European Communities brands accounted for only 3.3 per cent of total vehicle production in Indonesia;

- exports of motor vehicles and parts to Indonesia were under US$300 million in 1995;

- European Communities exports consist of Mercedes and BMWs which do not compete with the "small, low technology Timor".

8.274 The percentage mentioned by Indonesia relates to the total market for motor vehicles. The European Communities complaint concerns only the market for passenger cars. In that market the European Communities share reached 24 per cent in 1996.

8.275 Admittedly, in absolute terms the European Communities exports of passenger cars to Indonesia are small. The reason for this, however, is that the Indonesian market itself is still very small (42,346 units in 1996). Indonesia's market for passenger cars nevertheless has considerable growth potential, especially in the middle and small segments. The National Car programme threatens to dislodge the European Communities exporters from the positions they have taken already in that market and prevent them from taking advantage of that growth.

8.276 In any event, it is obvious that the existence of "serious prejudice" in the sense of Articles 5 and 6 of the SCM Agreement is not dependant upon the absolute size or monetary value of the "prejudice". The "seriousness" of the prejudice must always be assessed in relation to the market concerned.

8.277 Sales of models in the high segment of the market still account for a majority of the European Communities exports to Indonesia. To a large extent, this reflects the structure of the Indonesian market, where cars falling within the small and middle segments have accounted traditionally for a smaller share than in more mature markets. Nonetheless, contrary to the impression that Indonesia would like to convey to the Panel, the European Communities does not export to Indonesia only Mercedes and BMWs. In 1996, sales of the Peugeot 306 and the Opel Optima accounted for 15 per cent of the EC exports.

8.278 Indonesia alleges that:

- "... sales of passenger cars carrying EC brand names increased from 8,554 units in 1995 to 9,526 units in 1996"

- "... the market share developments are meaningless ... Market share and demand growth are not necessarily correlated. Many extraneous factors influence this relationship, including changes in customer preferences..."

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[509] See e.g. "GM Halts Indonesia move over national car policy", Financial Times, 13 June 1996 (EC Exhibit C-10).

- "... Timor tapped a new class of buyers and created a new market niche at the bottom"

8.279 Comparison of the sales figures for 1995 and 1996 can be misleading, since the Timor S-515 only entered the market in October 1996. A comparison of the corresponding figures for 1996 (10,075 units) and 1997 (10,714 units on an annualized basis[510]) shows that the increase in sales of European Communities imports was less "substantial" than claimed by Indonesia (ca. 6 per cent). Furthermore, even that modest overall increase masks the fact that during 1997 sales of the Opel Optima have stagnated and sales of the Peugeot 306 have fallen in absolute terms.

8.280 In any event, displacement or impedance of imports in the sense of Article 6.2 of the SCM Agreement may exist not only where imports fall in absolute terms but also in cases where there is a decrease in their market share. This is implicit in the notion of "impedance", which purports to cover the situation where subsidized goods do not displace any pre-existing imports but rather pre-empt imports (including additional imports) from taking place.

8.281 The argument that a loss of market share may constitute serious prejudice is further confirmed by Article 6.4 of the SCM Agreement, which provides that:

> For the purposes of paragraph 6.3 (b), the displacement or impeding of exports shall include any case in which .... it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in the normal circumstances shall be at least one year. 'Change in relative shares of the market', shall include any of the following situations: (a) there is an increase in the market share of the subsidized product ...

Although, by its own words, Article 6.4 applies to third-country market situations, there is no reason why the same type of analysis should not be appropriate also in the case of displacement or impedance of imports from the market of the subsidizing country.

8.282 It is worth recalling that, in accordance with Article 15.4 of the SCM Agreement, market shares are one of the relevant factor in establishing whether subsidies imports have caused "injury to the domestic industry" of another Member for the purposes of both Article 5 (a) and Part V of the SCM Agreement.

8.283 Indonesia's contention that "... market share and demand growth are not necessarily correlated" and that "... many extraneous factors influence this relationship, including changes in customer preferences..." is but a mere truism. The European Communities has shown that the fall in market share of European Communities imports has taken place simultaneously with a parallel increase in the market share of subsidized domestic products which have undercut significantly the prices of the European Communities imports. Furthermore, that decrease has interrupted brusquely an upward trend. All this is more than sufficient evidence to conclude that the decline in the market share of European Communities imports has been caused by the subsidies at issue and not by any other "extraneous factor". Especially, since Indonesia has not provided any evidence whatsoever that "other factors" may have caused the sudden decrease in the market share of European Communities imports.

8.284 Indonesia's proposition that the Timor has generated entirely its own demand is purely speculative and cannot be demonstrated. Demand for passenger cars, and in particular for passenger

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[510] Based on Indonesia Exhibit 40.

cars within the same segment as the Timor, had grown steadily over the past few years. It would have continued to increase even without the National Car Programme. That "natural" increase of the market has been captured by the Timor S-515, at the expense of other non-subsidized cars, together with any additional demand allegedly created by the National Car Programme.

8.285 Indonesia's argument that the Timor has "tapped into a new class of consumers" and created its own demand is, in fact, again the same proposition as Indonesia's threshold argument that the Timor is not "like" the European Communities cars. The notion of "competitive" products is broader and encompasses that of "like" products. If the European Communtiy cars are "like" the Timor, it follows necessarily at they compete with the Timor for the same customers. It is conceivable that, due to its very low subsidized price, the Timor may have generated some additional demand for passenger cars. Yet, the Timor has captured not only that additional demand but also sales to customers which, in the absence of the National Car Programme, would have purchased other "like" non-subsidized passenger cars.

(b) Arguments of the United States

(1) Information concerning serious prejudice

(a) The Timor Kia Sephia rapidly acquired a substantial share of the Indonesian market and significantly undercut the prices of other passenger cars in its class

8.286 The introduction of the National Motor Vehicle programme and the announcement that a "national motor vehicle", the Timor Kia Sephia sedan, would soon be on the market at a price of Rp. 35 million had an immediate impact on the market. Soon, there were reports in the press that, as of the beginning of 1996, car sales were falling as Indonesians postponed new vehicle purchases in anticipation of Timor's entry.[511] "Car industry executives predicted that while the Indonesian new car market was growing, the cheap Timor 'national car' would lead people to switch brands rather than promote dramatic industry-wide sales growth".[512]

8.287 These predictions proved accurate. Although the success of the Timor Kia Sephia was not as great as TPN officials predicted, it nonetheless captured a sizeable share of the Indonesian passenger car market. Attachment A-39/6 to AV/3 provides the market share of the Timor Kia Sephia. According to Attachment A-39/6, the Timor Kia Sephia went from a market share of zero in February 1996 (when the National Motor Vehicle programme was announced and Kia Timor was named as the producer of the "national motor vehicle") to a 10.11 per cent market share by the end of 1996. By the end of May 1997, the end of the period covered in Attachment A-39/6, the market share of the Timor Kia Sephia had catapulted to 26.53 per cent in little more than one year.

8.288 The reason why the Timor Kia Sephia could achieve such a significant market penetration in so short a period of time is simple: the Timor Kia Sephia was, and is, the cheapest passenger car in its

[511] "Early Launching for National Car," Business Times (Singapore), July 9, 1996, p 7 (US Exhibit 14, pp. 96-97); see also "Indonesia's Ghost Car Gives Japan Makers a Shudder," Reuters World Service, 10 May 1996 (Exhibit 14, pp. 33-35).

[512] "Indonesia Car May Not Meet Local Content Clause," The Reuter Asia-Pacific Business Report, 29 July 1996 (US Exhibit 14, pp. 103-104).

class on Indonesian roads.[513] Because of the huge tariff and tax subsidies it enjoys, the Timor Kia Sephia can be sold for 50 per cent of the price of its rivals.[514]

8.289 The data on list prices for passenger cars in Indonesia provided by Indonesia through the Annex V procedure attests to the tremendous price advantage enjoyed by the Timor Kia Sephia. (Attachment A-40/1 to AV/3) As these data demonstrate, the Timor Kia Sephia significantly undercut the prices of every passenger car in its class:[515]

Table 32

List Prices

Manufacturer & Passenger Car Model	November 1996 price in rupiahs	March 1997 price in rupiahs
Timor Kia Sephia S515 metallic	33.5 million	33.5 million
Timor Kia Sephia S515i metallic		36.9 million
Opel Optima GLS 1800cc	69.5 million	70 million
Toyota Corolla M/T 1600cc	71.1 million	68.3 million
Toyota Corolla A/T 1600cc	74.8 million	71.8 million
Mitsubishi Lancer M/T 1600cc	64.0 million	65.0 million
Mitsubishi Lancer A/T 1600cc	67.0 million	68.0 million
Mitsubishi Lancer DOHC 1800cc	72.0 million	72.0 million
Honda Civic 4dr, GKP 1600cc	72.5 million	71.2 million
Honda Civic 4dr, AKP 1600cc	76.2 million	74.9 million
Peugeot 306 M/T 1761cc	62.5 million	63.0 million
Peugeot 306 A/T 1761cc	64.8 million	65.5 million
Daewoo Nexia DOHC 1500cc		43.0 million

[513] "Indon Domestic Car Sales Race up by 41 per cent in May," Business Times (Singapore), 17 June 1997 (US Exhibit 14, pp. 138-139).

[514] "Bumpy Road Ahead for Motoring Plans," South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-135). In this regard, because of the high tariffs on imported automotive parts and the 35 percent luxury tax on passenger cars, "car prices in Indonesia are among the highest in the world." "Indonesia Draws More Criticism Over Car Plan," The Nikkei Weekly, 17 June 1996, p. 1 (US Exhibit 14, pp. 80-83).

[515] The passenger cars included in the table fall within "Segment C" of the motor vehicle market. See McGraw-Hill World Car Industry Forecast Report, February 1997, pp. 284-85, included in Annex 1 to AV/2. Cars falling within a particular market segment will be of roughly the same size, be in the same price range, and share the same target customers. Segment C includes "lower medium class" passenger cars.

8.290 Significant price undercutting by the Timor Kia Sephia appears when one compares market prices instead of list prices. Annex 3 to AV/2 contains market prices for the last quarter of 1996. Using these data the market prices for passenger cars in Segment C were as follows:

Table 33

Market Prices

Manufacturer & Passenger Car Model	4th Quarter 1996 price in rupiahs
Kia Timor Sephia	35.75 million
Opel Optima GLS	59 million
Opel Optima CDX	62 million
Opel Optima CDX A-BAG	64 million
Toyota Corolla 1.6XLI	66.35 million
Toyota Corolla 1.6 SEG MT	71.35 million
Toyota Corolla 1.6 S-CRUISE MT	74.85 million
Toyota Corolla 1.6 SEG AT	75.25 million
Mitsubishi Lancer 1.6 MT	65 million
Mitsubishi Lancer 1.6 AT	70.5 million
Mitsubishi Lancer 1.8 MT	75.5 million

(b) As a result of the National Motor Vehicle programme and the introduction of the heavily subsidized Timor Kia Sephia, US motor vehicle manufacturers abandoned their plans to export passenger cars to the Indonesian market

8.291 The phenomenal market penetration of the Timor Kia Sephia came, in part, at the expense of US motor vehicle manufacturers. Prior to the introduction of the National Motor Vehicle programme and the subsidized Timor Kia Sephia, General Motors, Ford, and Chrysler each had plans to increase their penetration of the Indonesian passenger car market. However, each company had to abandon or suspend its plans as a result of the National Motor Vehicle programme.[516]

[516] In addition, the United States should note that it has additional information in its possession documenting the plans of Ford, GM, and Chrysler. However, because this information is business proprietary, the United States is reluctant to provide it to the Panel unless the Panel establishes adequate procedures to protect such information.

(i) General Motors

8.292 In the case of GM, it already had invested $110 million in an assembly plant in Bekasi, West Java, that produced about 7,000 Chevy Blazers (badged as "Opels" in Indonesia), Opel Optimas and Opel Vectras per year.[517] GM had established 34 full service dealerships and, as of November 1996, had 550 employees in Indonesia.[518] It was considering investing in plant expansion, and had approval to bring in new models for the Opel Optima and Opel Vectra.[519] Although the precise figures are confidential, GM's business plan called for sales of Opel Optimas and Vectras in excess of 1,000 cars in 1996 and around 3,000 cars in 1997, with progressive increases in subsequent years.[520]

8.293 However, because of the National Motor Vehicle programme, GM had to put its plans for additional investment in Indonesia on hold.[521] In addition, GM cut back its existing assembly plant from two production shifts to one.[522] According to Indonesia's own information, GM sold only 549 Opels in Indonesia in 1996, and only 176 in the first half of 1997.[523]

8.294 In addition to affecting sales volumes, the introduction of the subsidized Timor Kia Sephia also affected GM's prices. During the period September 1995 - September 1996, the company's transaction prices in Indonesia were reduced by $7,000 per unit.[524] Moreover, GM's Business Plan/Budget called for price increases on Opel Optimas and Vectras in line with historical price/inflation trends in Indonesia. Historically, the Consumer Price Index (CPI) has increased 8-10 per cent annually in Indonesia, and automotive pricing closely tracks the CPI. However, the introduction of the Timor Kia Sephia resulted in an artificial flattening of motor vehicle prices, while the CPI continued to increase.[525]

(ii) Ford

8.295 In the case of Ford, it had well-advanced plans to import and sell Ford Escorts in Indonesia.[526] Ford had committed to the development of a joint venture, had assigned four full-time employees in Indonesia, and was actively pursuing the acquisition of assembly facilities in Indonesia.[527] Ford had committed assets of $1 million that included production and assembly equipment, tooling, component parts, and engineering, all of which were in Indonesia prior to the announcement of the National

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[517] See, e.g.,"Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics--and a Familiar Face at the Helm," Time, 10 June 1996, p. 40 (US Exhibit 14, pp. 69-71); see also "GM Halts Plans for Indonesia Car; Firm Requests Clarification on National Car Policy," The Dallas Morning News, 12 June 1996, p. 6B (US Exhibit 14, pp. 75-76).

[518] Source: US companies.

[519] Source: US companies.

[520] These figures are slightly higher than the projections concerning the Indonesian production/assembly of Opels set forth in East Asian Automotive Growth Markets, Summer 1994, pp. 370-371, which was included as part of Annex 1 to AV/2.

[521] "GM Freezes Indonesian Investment; Policies Create an 'Unlevel Playing Field'," Automotive News, 17 June 1996, p. 38 (Exhibit 14, pp. 84-85); see also "A Furious Flap Over Favouritism," Business Week, July 8, 1996 (US Exhibit 14, pp. 92 95).

[522] Source: US companies.

[523] AV/3, Attachment A-39/5-B.

[524] Source: US companies.

[525] Source: US companies.

[526] "Ford Seeks Inroads in Booming Asian Auto Market," The Reuter European Business Report, 25 April 1996 (US Exhibit 14, pp. 29-30).

[527] Source: US companies; see also "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics -- and a Familiar Face at the Helm," Time , 10 June 1996, p.40 (US Exhibit 14, pp. 69-71).

Motor Vehicle programme.[528] Ford had an approved investment plan of $56 million, with the feasibility of future investment in assembly to be determined based upon the needs of the market and manufacturing requirements.[529] These plans were part of a broader Asian strategy which already had resulted in investments of $700 million in India, $500 million in Thailand, $350 million in China, and $100 million in Vietnam, and Ford's total investment in Indonesia easily could have been in line with Ford's investments in these other countries in the region.[530]

8.296 In terms of projected sales volume, the Escort was projected to achieve 5.2 per cent, 10 per cent, 10.5 per cent, and 11 per cent in the first four years after its introduction in 1996, or approximately 15,000 units over the first four years.[531]

8.297 However, like GM, Ford had to scrap its plans in light of the National Motor Vehicle programme.[532] As a result, the projected 15,000 sales of Ford Escorts will not take place. Based on the company's estimates, if Ford had gone ahead with its plans and imported and sold Escorts in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Escort by more than US$5,000.[533]

(iii) Joint letter from Ford and General Motors

8.298 The **United States** submitted a joint letter from Ford and General Motors, prepared in the context of this dispute, describing "data necessary to establish serious prejudice" and addressing "questions submitted by Indonesia to the United States". (US Exhibit 38.) The following is the text of this letter:

> "All of the American automotive manufacturers are global companies with manufacturing, component, and assembly operations around the world. Ford, General Motors and Chrysler were the originators of the modern automotive industry, and today actively participate in more than 130 countries, have more than 1,000,000 employees, in excess of 30,000 dealers worldwide, and annual revenues of more than $300 billion. Diverse multi-national corporations, whether American or European, develop and commit products to be assembled in various countries but are still the property of the originating corporation in their respective home country. Products that are shared by multi-national American corporations are no less American because they are distributed/assembled/manufactured in the countries when the assets are located.
>
> Ford and General Motors have consensed on this response to the Indonesian question to the USTR and to supply the requested WTO data necessary to establish serious prejudice.

[528] Source: US companies.
[529] Source: US companies.
[530] Source: US companies; see also "Ford Seeks Inroads in Booming Asian Auto Market," The Reuter European Business Report, 25 April 1996 (US Exhibit 14, pp. 29-30).
[531] Source: US companies.
[532] Source: US companies; see also "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics--and a Familiar Face at the Helm," Time, 10 June 1996, p.40 (US Exhibit 14, pp. 69-71).
[533] Source: US companies.

DATA NECESSARY TO ESTABLISH SERIOUS PREJUDICE

(1)
- Ford proposed to support the Indonesian market with American, European and Japanese sourced products.
- Ford committed to the development of a joint venture, has assigned four full-time foreign service employees to Indonesia, and was actively pursuing the acquisition of assembly facilities in the market.
- GM has invested $110 million for 3 products: Opel Optima, Opel Vectra and Opel Blazer.
- The Opel Blazer is in production and GM had approval to bring in new models for Opel Optima and Opel Vectra
- The National Vehicle Programme forced GM and Ford to liquidate inventories under difficult terms:
    - Sales were lost due to depressed market conditions
    - Significant incremental merchandising costs were incurred to relieve inventories
    - Prices/revenues were negatively impacted
- Timor had significant negative impact on GM and new foreign based suppliers particularly in the suppression of component and sales volumes.

- Future investment for Ford and GM is on "hold".
    - September 1995 to September 1996 the overall market is down (16.8%) which negatively affected volumes and prices.
        - GM transaction prices were reduced by $7,000/unit
        - Ford transaction prices were down by $6,500/unit
    - Perceived instability in the "Regulatory Framework" is negatively impacting ability to attract new investors (suppliers and dealers) and new product investment by manufacturers.
    - GM cut back their current assembly plant from 2 shifts to 1 shift of production.
    - GM anticipates a further (15%) reduction in Blazer retail sales if Kia/Timor Sportage is added to the National Vehicle Programme.

(2)
- Ford cancelled the Escort programme as a direct result of the National Vehicle Programme after having committed assets of $1.0 million. This included production and assembly equipment, tooling, component parts, and engineering all of which were in Indonesia prior to the National Vehicle Programme.
- Plans to export to third countries, both vehicles and components, are, or will be negatively affected. Reduced volumes in Indonesia as a result of the National Vehicle Programme has caused higher component costs. At the same time, Korean suppliers will enjoy higher volumes and potentially lower costs due to the monopolistic relationship in Indonesia.
- Opel Vectra and Optima are regional products. Plans to utilize domestic suppliers in Indonesia to reduce the cost base for other regional assemblies of products have been cancelled due to postponement of the Vectra and Optima production in Indonesia.

(3)
- The impact of the announcement of the National Vehicle Programme in Indonesia was a depression of sales in all potentially impacted retail market segments. The impact on these segments were:

Percentage Point Change 1996 versus 1995

Segments	June CYTD (PP Chg)	September CYTD (PP Chg)
B Segment	(50%)	(29.1%)
C Segment	+31%	+9.2%
Total Passenger Car	(1.2%)	(5.5%)
Category I	(22.6%)	(23.6%)
Category IV	(24.5%)	(25.4%)
Non-Effected Segments	+12.4%	+11.7%

- It is clear that when the National Vehicle Programme was announced, which included the sport utility "Sportage" as Timor 520i, the retail sales were depressed because consumers were waiting to evaluate the impact of the National Vehicle Programme.
- Manufacturers responded to the announcement by increasing incentives in the market to include, but not limited to, free extended warranties, free or low interest rate financing, and free service contracts that included both parts and labour, all of which were especially true in the C Segment where the impact was expected to be the most immediate.
- These merchandising efforts ***artificially*** increased the sales volumes in the C Segment, through June versus June a year ago, until inventories were considered by manufacturers to be reasonably aligned, June through September retail sales then plummeted (30.4%) versus the same period last year.
- In those segments where the National Vehicle Programme was expected to have little or no direct impact on the industry ***increased***. Through June CYTD these segments grew +12.4% and through September CYTD they maintained this growth at +11.7%.
- Ford's Escort and Sport Utility programmes were developed to be the regional basis of Ford's ASEAN and AICO strategy. Indonesia was to be a pivotal manufacturing centre for AICO complementation.

(4)
- All elements of this question were addressed above in 1 through 3 except for price suppression.
- The GM Business Plan/Budget called for price increases on Optima, Vectra and Blazer. These were in line with the historical price/inflation trends in Indonesia. These increases have not been possible to offset the CPI increases.
- Historically the CPI has increased 8-10% annually in Indonesia. This is running consistent for 1996 and the forecast for 1997. Historically, and based on economic principles, automotive pricing closely tracked the CPI as the CPI reflects the cost structure. This is an established,

normal, cost/price economic structure in the automotive industry for OEM's and component suppliers

- Due to the National Vehicle Programme announcement, prices are artificially flat or decreasing while the CPI continues to increase.
- The Timor is Korean manufactured today and is operating in a different economic structure than other manufacturers in Indonesia. This is further compounded by the unique exclusion of duties and taxes on Timor.

QUESTIONS SUBMITTED BY INDONESIA TO THE UNITED STATES

A. Indonesia, in mid-1993 took steps to deregulate the automotive industry. US automotive interests viewed this as a very positive and progressive approach to opening the Indonesian market, and when subsequent actions undertaken in 1994 and 1995 reinforced this trend, it revitalized automotive manufacturers' interest in Indonesia.

In February 1996, the Indonesian Government announced a regressive automotive policy that provides preferential tariff and tax treatments for one company. In addition the regulations precluded US or other foreign automotive manufacturers from participating due to restrictive practices relating to foreign equity participation and product naming.

Overall, the US automotive manufacturers believe the National Vehicle Programme damages Indonesia's interests and the Indonesian automotive industry.

We had firm plans to assist the development of the industry in Indonesia, and to make Indonesia a key part of our ASEAN, Asia and global plans. This is now all on hold due to the change in policy direction contained in the National Vehicle Programme. The US automotive manufacturers require renewed confidence in the Indonesian Government if they are to increase, or even maintain, their investments and commitment to Indonesia.

B. 1.
- All passenger cars are directly impacted by PT Timor and the Blazer is indirectly impacted because of the passenger car substitution effect and the associated announcement of the "Sportage".
- All of the passenger cars were impacted by volume depression, price sensitivity, and transaction price reductions in order to be as competitive as was realistically possible given the tariff and tax inequities.

2.
- The Ford Escort and Laser, and Opel Optima and Vectra are petrol engines, 4 door sedans that compete in the C Segment of the industry and are immediately impacted by PT Timor

3.
- Escort was projected to achieve 5.2%, 10.0%, 10.5% and 11.0% in the first four years after introduction in 1996 or 15,100 units over the first four years. The cancellation of Escort totally eliminated these sales.
- Laser was projected to sell 1,400 units over the same four year period.
- Total projected lost unit sales/revenues at retail for Ford is 16,500 units over the four year period.

4. - The local content plan for Escort was just under 20% at launch, progressing to over 20% within 2 years, and over 40% local content within 4 years. This was the committed local content plan that was part of the implementation plan for Escort.
- GM purchases 45% of Blazer's components locally from 67 suppliers and 55% is imported from 21 locations in 11 countries around the world.

5. - Both Ford's and GM's vehicles have worldwide component sourcing, and vehicle manufacturing/assembly was to be accomplished in Indonesia.

6. - Products that are the result of multi-national corporations and their affiliated suppliers worldwide are home country funded and should thus be considered as home country corporate products without regard to the country of sourcing.

C. 1. - Ford had an approved investment plan of $56.0 million with the feasibility of future investment in assembly to be determined based upon the needs of the market and manufacturing requirements.
- GM has invested $110.0 million in an assembly plant for Optima, Vectra and Blazer, GM's total investment plan was up to $750 million in Indonesia.

2. - Ford's total planned investment was committed to the establishment of Escort in the market with both local assembly and increasing local content, ultimately reaching 40% local content by the fourth year.
- Local content and assembly plans were being implemented for Laser and Telstar as well as future planned product introductions for Indonesia.

3. - American automotive investment plans have been placed on "hold" pending the determination of the revised regulatory environment, the National Vehicle Programme, the economic stability, and the political future of Indonesia.

4. - General Motors has invested $110 million in a plant in Bekasi, and launched the Opel Blazer, Optima and Vectra. They have established 34 full service dealerships and currently have 550 employees in Indonesia.
- GM had approval to introduce new models for both Optima and Vectra, which is now on "hold".
- Ford was in the process of launching the Ford Escort, finalizing plans to establish a joint venture in Indonesia and acquiring a manufacturing facility.
- Ford's plan was part of an Asian strategy which *already has resulted in investments of*:
  $700 million in India
  $500 million in Thailand
  $350 million in China
  $100 million in Vietnam
- Ford was developing plans to launch two major vehicle programmes in Indonesia - one with a product designed and developed primarily for Indonesia.
- The Ford's total investment in these programmes could have been in line with Ford investments in other countries in the region.

- All future investment by GM and Ford are on "hold"."

(iv) Chrysler

8.299 As for Chrysler, prior to the introduction of the National Motor Vehicle programme, it assembled Jeep Cherokees in Cikarang, West Java.[534] It had plans to introduce the Neon, but like GM and Ford, it had to abandon these plans once the National Motor Vehicle programme was introduced.

8.300 The **United States** submitted two newspaper articles in connection with its arguments regarding Chryler's plans. The texts of these articles follow:

"A FURIOUS FLAP OVER FAVOURITISM":[535]

> "A major Asian country has rigged its auto market. General Motors, Ford and Chrysler, which had high hopes of cracking the market, are up in arms. The stakes are so high that US Commerce Secretary Mickey Kantor was scheduled to visit in late June for a showdown with his trade counterparts.
>
> The country isn't Japan or China. It's Indonesia, the largest market in booming Southeast Asia. Just how the Government of President Suharto drew the wrath of Detroit's Big Three is a fascinating case study of how things work in Indonesia. The Japanese are also irritated with Suharto and are attacking his "national car" programme, which gives a prominent role to South Korea's embattled Kia Motors Corp.
>
> Indonesia has an annual per capita income of only $1,000, but the Big Three expect the market to grow rapidly as Indonesians get richer and a young population matures. Even though the Japanese control 95 per cent of the market, Ford Motor Co. sent in a management team early this year to expand a small operation that sells Ford Lasers as taxis into a manufacturer of European-engineered Escorts. General Motors Corp. and Chrysler Corp. were moving ahead with similar plans. KEEPING MUM. But the Indonesian Government spoiled the party in February. By decree, a new company run by President Suharto's youngest son, 33-year-old Hutomo Mandala Putra, will be allowed to sell imported sedans from Kia for less than half the price of competing models - that is, about $15,000 compared with $30,500 for a Toyota Corolla. The deal is typical in a country known for the pervasive business interests of the President's family.
>
> Under the arrangement, Kia will ship its four-door Sephia sedan to Indonesia without paying import duty or luxury tax. The car will come in under the Timor brand name of the new national carmaker, Kia-Timor Motor, which is 70 per cent owned by Hutomo. Kia owns the remaining 30 per cent and is contributing 30 per cent of the new company's $100 million capital. The plan is for the venture to start assembling the cars in Indonesia next year and eventually export some.
>
> Few Indonesians dare to criticize the programme, since the presidential palace deals harshly with opponents. But the new company's impact on the Indonesian market has been impossible to hide: consumers are waiting for the

[534] "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics--and a Familiar Face at the Helm," Time, 10 June 1996, p. 40 (US Exhibit 14, pp. 69-71).

[535] A Furious Flap Over Favouritism", Business Week, 8 July 1996, p.14 (US Exhibit 14, pp.99-95).

bargain-basement sedan to roll off the pier later this year. With monthly sales down at least 10 per cent, the Association of Indonesian Automotive Industries says this year's sales could fall far short of the 383,000 cars sold in 1995. That helps explain why the Japanese are threatening to take Indonesia to the World Trade Organization for a ruling on its car programme. "This is against WTO rules", complains an official of Japan's Ministry of International Trade & Industry.

In addition to the WTO threat, the Americans are trying to use the prospect of withheld investment to force Suharto to budge. With about $110 million invested, GM is still assembling Opel Vectras, Opel Astras, and Chevrolet Blazers but has delayed expansion plans. Chrysler is making Jeep Cherokees and had planned to introduce the Neon and a minivan, but now those plans are on hold. Members of Ford's recently arrived management team have been left idle, with their children enrolled in the local international school. TIT FOR TAT. Indonesian officials see poetic justice for Japan: Toyota Motor Corp. has resisted demands from its Indonesian partner, Astra International, to rev up exports of the $19,000 Toyota Kijang utility vehicle, because that would mean it would be competing with other Toyota assemblers in Asia. For its part, the Government defends the Kia deal, saying Indonesia has no time to lose if it is to get ready for lowering its trade barriers to fellow members of the Association of Southeast Asian Nations in 2003.

Getting the Timor project up and running will be difficult. It is already behind schedule, and supply will probably not meet demand, says F. Soeseno, Secretary-General of the Association of Indonesian Automotive Industries. Kia-Timor Motor will be allowed to import 40,000 of the 1.5-litre sedans until June 1997, by which time the company is supposed to have started assembly at a new plant that has yet to be built. The percentage of Indonesian-made parts is to increase steadily to 60 per cent by September 1999 - a schedule Toyota officials say will be impossible to keep. Critics also say the Timor will be hamstrung without strong distribution and service networks.

But Kia vows to make the deal work and is staking $400 million to build the assembly plant. To meet local content requirements, it plans to help 30 Korean parts suppliers form joint ventures with Indonesian companies. One reason Kia is so determined is that it is getting squeezed in the home market by Hyundai Motor and Daewoo Motor - and now the mighty Samsung group is charging into the auto industry. Some analysts believe Kia's very survival as an independent manufacturer may hinge on making the Indonesian deal work. Small wonder that Kia Executive Vice-President Kim Seung-Ahn says: "Kia is fully committed to helping Indonesia develop a national car".

Some of Kia's backers, however, say they are against the Timor deal. Ford owns 33.4 per cent of Mazda and 9.4 per cent of Kia. Mazda in turn owns 7.5 per cent of Kia. Indonesian officials hint that Ford and Mazda are quietly pleased with their backdoor entrance into Indonesia, through Kia. But both Ford and Mazda deny that. "What we would get is peanuts", says Terry Emrick, Ford's top executive in Indonesia. "It has absolutely no effect". Ford executives add that most Indonesian consumers still won't be seeing their company's branded products. STEPPING BACK. Ultimately, industry analysts expect the Government to yield to the international uproar, possibly by keeping the national car programme in place but at the same time reducing tariffs on competing models. The Americans might not be big beneficiaries if they are too heavy-handed and anger the Indonesians. Although Japan protested forcefully at first, Tokyo seems to be stepping back and letting

Washington confront Suharto, says Andrew H. Card Jr., Chief Executive of the American Automobile Manufacturers Assn. "Japan doesn't have a long history of standing at the front of the line", says Card.

Moreover, unlike the Americans, Toyota has not put its plans on hold for a new plant near Jakarta. So while the Big Three sulk, Toyota could quietly increase the local content of its Kijang beyond the 60 per cent level, allowing it to be sold free of duty and luxury taxes. "The Indonesians will in one way or another have to accommodate the Japanese", concludes John Bonnell, Director of Southeast Asia for Automotive Resources Asia Ltd. in Bangkok. So, too, are the Koreans likely to persevere. The key question is whether the Americans will prove as adept at playing the game Indonesian-style.

Anatomy of an Indonesian Controversy

A DEAL IS CUT The son of Indonesian President Suharto makes a pact with Kia Motor of South Korea to make a "national car" for the country. At first, the Sephia sedan will be assembled in Korea but brought into Indonesia duty-free.

JAPANESE OUTRAGE This undermines Toyota, which is assembling vehicles in a joint venture with Astra International. Toyota and other Japanese makers persuade the Government of Prime Minister Ryutaro Hashimoto to protest Kia's sweetheart agreement.

AMERICAN ANGER General Motors, Ford, and Chrysler, which had been contemplating making big investments in Indonesia, delay those plans. US Commerce Secretary Mickey Kantor was scheduled to arrive in Jakarta to protest the Kia deal.

BACKDOOR WINNERS? Ford owns a controlling stake in Mazda, and both companies own minority shares in Kia. The Sephia, meanwhile, is largely based on Mazda designs and parts. But Ford says this channel into Indonesia is not adequate."

* * * * *

"GM FREEZES INDONESIAN INVESTMENT; POLICIES CREATE AN 'UNLEVEL PLAYING FIELD'"[536]

"General Motors has put plans for additional investment in Indonesia on held because of that country's "national car" project.

Donald Sullivan, GM's Asian and Pacific Operations President, said here that the automaker has no intention of pulling out of Indonesia, however.

"We currently have $110 million invested in a relatively new plant in Indonesia. We're there to stay", he said at a press conference announcing details of GM's new Thai plant.

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[536] "GM Freezes Indonesian Investment: Policies Create an 'Unlevel Playing Field'", Automotive News, 17 June 1996, p.38 (US Exhibit 14, pp.84-85).

But he added, "We've been very disappointed" by Jakarta's new national car policies. Those policies, he said, create an "unlevel playing field" for auto companies in Indonesia.

Sullivan said GM had been considering investing in a plant expansion, as well as unspecified infrastructure-related areas. He did not respond to a request to say how much GM had been planning to invest.

Both Ford Motor Co. and Chrysler Corp. shelved proposed Indonesian projects earlier this year in the wake of the new policy. Chrysler was close to a decision to begin assembling Neons from knockdown kits, while Ford was considering a small assembly plant.

As previously reported, Indonesian President Suharto issued a decree in late February that granted import-duty and luxury-sales tax exemptions for a "national car", the Timor, to be produced by a joint venture between Korea's Kia Motors Ltd., and Suharto's youngest son, Hutomo (Tommy) Mandala Putra.

The tax breaks will allow the car to be priced at about half the sticker of competing models.

Under blistering criticism from Japan, the United States and the European Union, Indonesia recently revised the policy so as to allow other companies to qualify for the tax breaks if their Indonesian-assembled cars have local content of at least 60 per cent.

A second revision, though, would allow the Timor to be built in Korea for up to a year while a plant in Indonesia is constructed, if Indonesian workers do the actual assembly work in Korea.

The former revision appeared aimed at placating the Japanese, but the latter one greatly fanned Japanese resentment of the policy. Infuriated by the prospect of a car assembled in Korea being given preferential tax treatment over Japanese vehicles assembled in Indonesia, Japan last week moved closer to filing a complaint over the policy with the World Trade Organization."

8.301 Prior to the introduction of the National Car Programme, Chrysler already was assembling Jeep Cherokee and Wrangler vehicles in Cikarang, West Java. Chrysler, together with Lippo Group and Ningz Pacific, was studying an assembly joint venture in Lippo City to assemble Neon passenger cars and other passenger vehicles.[537] The planned investment in this joint venture would have been more than US$150 million. Chrysler's business plan called for initial sales of more than 15,000 vehicles per year, including 1,000 to 2,000 Neons per year, with volumes progressively rising thereafter. The Neons would have been sourced from the United States; specifically from Chrylser's plant in the state of Illinois.

8.302 Chrysler's plan for investment in Indonesia was part of a broader Asian strategy under which Chrysler already was manufacturing or selling vehicles in Thailand, Malaysia, China, Taiwan and

[537] See also Indonesia Exhibit 11.

Japan. Indeed, Chrysler recently decided to expand its Singapore operations and intensify its sales campaign in Asia, concentrating particularly on the Neon and its Jeep vehicles.[538]

8.303 However, because of the National Car Programme, Chrysler was forced to put its plans for additional investment in Indonesia on hold, and did not proceed to the final approval stage. In addition, Chrysler was forced to significantly reduce production of Jeep vehicles at its existing assembly plant. Based on Chrysler estimates, if Chrysler had gone ahead with its plans to sell the Neon in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Neon by more than US$5,000.[539]

8.304 The **United States** submitted a letter from Chrysler, prepared in the context of this dispute, summarizing Chrysler's "activities in Indonesia around the time the National Motor Vehicle Programme was announced". (US Exhibit 39.) The following is the text of the information provided in that letter:

"**Chrysler Corporation - Indonesia**

- Prior to introduction of the National Motor Vehicle Programme, Chrysler was already assembling Jeep Cherokee and Wrangler vehicles in Cikarang, West Java. Chrysler, together with Lippo Group and Ningz Pacific, was studying an assembly joint venture located in Lippo City to assemble Neon passenger cars and other passenger vehicles. Planned investment in this joint venture would have been more than $150 million. Although the precise figures are confidential, Chrysler's business plan called for initial sales of more than 15,000 vehicles per year, including 1,000 to 2,000 Neons per year, with volumes progressively rising thereafter.

- Chrysler's plan for investment in Indonesia was part of a broader Asian strategy under which Chrysler was already manufacturing or selling vehicles in Thailand, Malaysia, China, Taiwan and Japan.

- However, because of the National Motor Vehicle Programme, Chrysler had to put its plans for additional investment in Indonesia on hold, and did not proceed to the final approval stage. In addition, Chrysler was forced to significantly reduce production of Jeep vehicles at its existing assembly plant. Based on Chrysler's internal estimates, if Chrysler had gone ahead with its plans to produce and sell the Neon in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Neon by more than $5,000."

(c) Under the SCM Agreement, the one-year tariff and tax exemptions continue to provide actionable subsidies that cause serious prejudice

8.305 With respect to Indonesia's "dead measures" argument, it is premised on carving up the National Car programme into a series of individual programmes. However, there is no basis for this type of legal surgery, because all of the individual components of the National Car programme refer back to Presidential Instruction No. 2/1996, the document which gave birth to the single National Car programme. Indeed, in its first submission, Indonesia is inconsistent in this regard, sometimes referring to certain measures as "programmes" in their own right, and at other times referring to them as "aspects" of a single programme, the National Car programme.

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[538] "Still on the Right Road," Asian Business, November, 1997 (US Exhibit 24, pp. 16-23).

[539] A comparison of the specifications of the Timor S515 and the Chrysler Neon is provided in Table 23.

8.306 In addition, as a legal matter, there is no basis in the SCM Agreement for carving up the National Car programme in this manner. Article 6.1(a), the provision on which the US claim of serious prejudice is based, refers to the "total ad valorem subsidization of a product", not the "total ad valorem subsidization of a product under a particular programme". Likewise, paragraphs 2 and 4 of Annex IV refer to the "overall rate of subsidization."

8.307 In addition to being based on a faulty legal premise, Indonesia is wrong on the facts. The United States has explained above how Indonesia's "dead measures" argument is wrong with respect to the US claim regarding Article I of GATT 1994. However, even assuming for purposes of argument that Indonesia's argument is correct with respect to Article I, it is not correct for purposes of the SCM Agreement. This is because the subsidies provided under the one-year authorization are, by Indonesia's own admission, "non-recurring" subsidies. As demonstrated in the first US submission, these subsidies must be allocated to future time periods, something that Indonesia has not disputed and cannot dispute.

8.308 Because these subsidies must be allocated to future periods, they continue to benefit sales of the Timor Kia Sephia and continue to cause serious prejudice, regardless of whether the Sephias sold were imported from Korea or assembled in Indonesia. In addition, because these subsidies are allocated to future periods, they remain subsidies that can be withdrawn within the meaning of Article 7.8 of the SCM Agreement, possibly by means of TPN repaying the subsidies to Indonesia.

(d) The other components of the National Car programme cause serious prejudice

8.309 Indonesia's next argument is that the components of the National Car programme other than the one-year tariff and tax exemption could not have caused serious prejudice. This argument is equally flawed.

8.310 First, as noted above in connection with Indonesia's "dead measures" argument, there is no basis in the SCM Agreement for carving up the National Car programme into individual programmes.

8.311 Second, Indonesia argues that the Tambun plant is producing only 1,000 vehicles per year. Even if true, this does not dispel the fact that these vehicles are subsidized, nor does it reflect the anticipated annual production of the Timor Kia Sephia, which Indonesia estimated at 6,000 units per year in 1998, and 35,000 units per year in 1999. See AV/14, Attachment A-28. Nor does it reflect the fact that the passenger car market in Indonesia is relatively small. In addition, Indonesia's reference to the Cikampek plant, where the Sportage will be built, is misleading, because it is designed to make the Panel believe that the additional capacity afforded by that plant will not benefit the Sephia. However, the Sephia also will be built at Cikampek, the Tambun facility being only a temporary facility pending the completion of the Cikampek plant.

8.312 In short, through the subsidies that it currently is receiving, the Kia Timor joint venture will have the wherewithal to maintain, and expand upon, the 26 per cent market share that it already has achieved. Moreover, by means of the subsidies that it currently is receiving, the Kia Timor Sephia can continue to be sold at prices that significantly undercut the prices of like products.

8.313 Finally, Indonesia's arguments simply mischaracterize what has happened in this case. As a result of the introduction of the National Car programme and the sale at cut-rate, subsidized prices of the Timor Kia Sephia, like passenger cars of US manufacturers were driven out of the Indonesian passenger car market or precluded from entering it. The subsidies currently in effect, including the subsidies under the one-year authorization, merely ensure that US passenger cars will continue to be excluded from the Indonesian market.

8.314 Thus, this is not a "threat" case as Indonesia would have this Panel believe. To the contrary, it is a case of current and continuing serious prejudice.

8.315 The tariff and tax subsidies provided under the National Motor Vehicle programme have displaced or impeded like products of US motor vehicle manufacturers from the Indonesian market, within the meaning of Article 6.3(a). In addition, these subsidies resulted in significant price undercutting by the subsidized Timor Kia Sephia sedan as compared with the price of like products of US motor vehicle manufacturers, within the meaning of Article 6.3(c).

(e) The tariff and tax subsidies under the National Motor Vehicle programme displaced or impeded imports of passenger cars of US motor vehicle manufacturers into the Indonesian market

8.316 Under Article 6.3(a) of the SCM Agreement, serious prejudice exists where "the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member." With respect to imports of GM, Ford, and Chrysler passenger cars, this situation is precisely what occurred in Indonesia as a result of the National Motor Vehicle programme and the introduction of the subsidized Timor Kia Sephia sedan.

8.317 Attachment A/39/6 to AV/3 provides the market share of the Timor Kia Sephia. According to Attachment A/39/6, the Timor Kia Sephia went from a market share of zero in February 1996 (when the National Motor Vehicle programme was announced and Kia Timor was named as the producer of the "national motor vehicle") to a 10.11 per cent share of the market by the end of 1996. By the end of May 1997, the last period covered in Attachment A/39/6, the market share of the Timor Kia Sephia had catapulted to 26.53 per cent.

8.318 This phenomenal market penetration came, in part, at the expense of the passenger cars of GM, Ford, and Chrysler. As set forth in AV/15, in response to Indonesia's Question 6, each of these companies had plans to increase its penetration of the Indonesian passenger car market, but each company had to abandon or suspend its plans as a result of the National Motor Vehicle programme.[540] Numerous news reports substantiate the existence of these plans, as well as the deathblow dealt to them by the announcement of the National Motor Vehicle programme and the fact that the three firms would be forced to compete against the massively subsidized Timor Kia Sephia.[541]

8.319 Although the precise figures are confidential, in the case of GM, which already was selling its Opel passenger cars in Indonesia when the National Motor Vehicle programme was introduced, GM's business plan called for sales of Optimas and Vectras in excess of 1,000 cars in 1996 and around

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[540] Like other automotive manufacturers in Indonesia, the passenger cars exported to Indonesia by Ford, Chrysler, and GM (like the Timor Kia Sephia itself) would have been in the form of kits that would have undergone final assembly in Indonesia. "Because of high duties on imports, the bulk of vehicles sold in Indonesia are locally assembled by joint ventures set up with local companies." "Jakarta Policy Stalls Expansion Plans; Japanese Firms Rethink Strategy After Suharto's 'National Car' Decree," The Nikkei Weekly, 25 March 1996, p.1 (US Exhibit 14, pp. 19-23).

[541] See, e.g., "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics--and a Familiar Face at the Helm," Time, 10 June 1996, p. 40 (US Exhibit 14, pp. 69-71); "GM Halts Plans for Indonesia Car; Firm Requests Clarification on National Car Policy," The Dallas Morning News, 12 June 1996, p. 6B (US Exhibit 14, pp. 75-76); "GM Freezes Indonesian Investment; Policies Create an 'Unlevel Playing Field'," Automotive News, 17 June 1996, p. 38 (US Exhibit 14, pp. 84-85); see also "A Furious Flap Over Favouritism," Business Week, 8 July 1996 (US Exhibit 14, pp. 92-95); "Ford Seeks Inroads in Booming Asian Auto Market," The Reuter European Business Report, 25 April 1996 (US Exhibit 14, pp. 29 30).

3,000 cars in 1997, with progressive increases in subsequent years.[542] According to Indonesia's own information, however, GM sold only 549 Opels in 1996, and only 176 in the first half of 1997.[543]

8.320 In the case of Ford, the company projected sales volumes in Indonesia for the Escort of over 1,000 units in 1996, over 3,000 units in 1997, with steady annual increases thereafter.[544]

8.321 Regarding Chrysler, according to Chrysler officials the launch date for the Neon project would have been mid-1997, had the project not been cancelled due to the National Car Programme.

8.322 The United States notes, however, that the precise timing of such sales is not critical to a serious prejudice analysis in this case. Chrysler was shut out of the market, and it will continue to be shut out of the market as long as TPN continues to benefit from massive subsidies. In the meantime, the market share of the Timor shot to over 26 per cent of the total Indonesian passenger car market and significantly undercut the prices at which the Neon would have been sold. TPN is well-positioned to increase its market share while new entrants, such as Chrysler remain shut out of the Indonesian market. In the view of the United States, this satisfies the criteria for serious prejudice under Article 6.3 of the SCM Agreement.

8.323 In this regard, the United States would like to memorialize an exchange that took place at the second meeting of the Panel. The United States made the point that Indonesia appeared to be arguing that the US claim of serious prejudice could succeed only if the US manufacturers had first gone forward with their plans, notwithstanding the introduction of the National Car Programme. The United States observed that such a requirement would force companies facing massively subsidized competition to engage in commercially irrational behaviour, and that it could not have been the intent of the drafters of the SCM Agreement to make irrational behaviour by private firms a prerequisite to relief under the SCM Agreement. This is particularly true in light of the fact that one of the purposes of the SCM Agreement was to establish a more effective multilateral remedy against subsidies that cause adverse effects. Certainly, in this case it would have been foolhardy for the US companies to proceed with their plans in light of the artificial 50 per cent price advantage that the Timor Kia Sephia enjoyed due to the subsidies provided by the Government of Indonesia.

8.324 In response, Indonesia stated that it was not arguing that the US companies actually had to have made sales, but that the companies had to have had "credible" plans to enter, or expand their presence in, the Indonesian passenger car market.

8.325 In the view of the United States, the evidence provided by the United States concerning the plans of General Motors, Ford, and Chrysler more than establishes the credibility of those plans. Indonesia has not argued that the evidence presented by the United States is inaccurate, and Indonesia has not offered evidence of its own to rebut the evidence put forward by the United States.

8.326 Finally, the plans of the US companies must be put in context. In terms of population, Indonesia is the fourth largest country in the world. Indonesia is in Asia, a region in which each of the US companies has been seeking to expand its presence. General Motors already was selling passenger cars in Indonesia, and continues to sell sports utility vehicles. Chrysler also continues to sell sports utility vehicles. Ford sells taxis. In light of all of these factors, it seems implausible that

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[542] These figures are slightly higher than the projections concerning the Indonesian production/assembly of Opels set forth in East Asian Automotive Growth Markets, Summer 1994, pp. 370-371, which was included as part of Annex 1 to AV/2.

[543] AV/3, Attachment A/39/5-B.

[544] The precise figures constitute business proprietary information that the United States is reluctant to provide to the Panel absence adequate procedures to protect such information.

the companies would not have gone forward with their plans had the National Car Programme not been introduced.

8.327 In the view of the United States, the Panel's task should be to answer the following question: "Is it more likely than not, based on the evidence, that the US companies would have gone forward with their plans had the National Car Programme not been introduced?" In the view of the United States, the evidence in this case clearly warrants the answer "Yes".

8.328 Overall, prior to the announcement of the National Motor Vehicle programme, the three US companies had plans to spend more than US$750 million to increase their presence in the Indonesian motor vehicle market.[545] However, the US companies had to abandon their plans for importing and selling passenger cars in Indonesia. While each of the three companies is a highly competitive automobile manufacturer, their business decisions - unlike TPN's - are necessarily governed by commercial considerations. With the onset of the National Motor Vehicle programme, the introduction of the Timor Kia Sephia, and the prospect of competing against the Indonesian Treasury, the three US companies were forced to abandon their plans, and could only watch as the Timor Kia Sephia quickly acquired 26 per cent of the Indonesian market.

(1) The evidence on sales trends shows that the subsidies provided under the National Car programme have caused displacement or impedance

8.329 Indonesia claims that the sales numbers show no discernible impact of the Timor Kia Sephia on the sales trends of US-brand passenger cars. [546] Because this is one of the few instances in which Indonesia actually discusses facts, these "facts" warrant close scrutiny.

8.330 With respect to General Motors, the data cited by Indonesia shows that sales of GM Opels began to decline in 1996, the year in which the National Car programme was introduced. However, Indonesia does not refer to its own data, which demonstrates that during the first half of 1997, Opel sales declined even further. In addition, Indonesia totally ignores the fact that General Motors had plans to increase its sales of Opels to over 1,000 cars in 1996 and around 3,000 cars in 1997, with progressive increases thereafter. Indonesia also ignores the well-documented fact that General Motors had to cancel its expansion plans following the introduction of the National Car programme.

8.331 In the case of Ford, Indonesia simply provides sales figures for Ford Lasers, a car sold exclusively to the taxi market. Given Indonesia's insistence elsewhere that a "like product" comparison calls for passenger cars to be virtually identical, the relevance of taxi sales to a serious prejudice case involving passenger cars is puzzling, and Indonesia offers no explanation. Moreover, Indonesia provides no response concerning Ford's well-publicized plans to introduce the Ford Escort to the Indonesian passenger car market.

8.332 Finally, in the case of Chrysler, Indonesia correctly notes that Chrysler did not market Chrysler-brand passenger cars in Indonesia during 1994-96. However, Indonesia simply ignores the fact that Chrysler was planning to introduce the Neon to the Indonesian passenger car market, but that Chrysler, too, had to cancel its plans following the introduction of the National Car programme.

8.333 In addition to ignoring the evidence, Indonesia ignores the law. Article 6.4 of the SCM Agreement, which provides guidance concerning the analysis of market displacement or impedance, states as follows:

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[545] Source: US companies.

[546] The United States must emphasize that this argument was not made in connection with the US claim of serious prejudice. However, it is addressed here in anticipation of Indonesia "rethinking" its defence.

> For the purposes of paragraph 3(b), the displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in the relative shares of the market to the disadvantage of the non-subsidized like product over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances shall be at least one year). "Change in relative shares of the market" shall include any of the following situations: (a) there is an increase in the market share of the subsidized product ... .

8.334 What happened in the Indonesian passenger car market over the last year fits perfectly within Article 6.4. The subsidized Timor Kia Sephia and the non-subsidized GM Opels, Ford Escort, and Chrysler Neon effectively started with a market share of zero. Each of the companies in question had plans to increase the market share of its cars. However, through subsidies, the Timor Kia Sephia captured 26 per cent of the Indonesian passenger car market, while the other cars remained at zero. This is a classic situation of displacement or impedance.[547] Moreover, while Article 6.4, by its terms, applies to third-country market situations, there is no reason why this type of analysis is not suitable with respect to the displacement or impedance of imports from the market of the subsidizing Member.[548]

(2) The Timor does not occupy a special niche

8.335 In addition to claiming that the Timor is not "like" other cars, Indonesia argues that the Timor does not compete with Opels, Escorts, or Neons because allegedly "the Timor has tapped into a new class of consumers and created a niche at the bottom of the market". Indonesia also claims that "a consumer who purchases ... a Toyota, Opel or Peugeot is extremely unlikely to purchase a Timor, and vice versa". All of this constitutes an effort on the part of Indonesia to talk around the undeniable fact that, in one year, the Timor Kia Sephia acquired over 26 per cent of the total Indonesian passenger car market.

8.336 Significantly, Indonesia provides no evidence to support its assertions regarding a new market niche. The market data discussed on page 21 of Indonesia's second submission, which relates to all passenger cars, simply shows that the overall Indonesian passenger car market has grown slightly. It does not disprove that the Timor has, through subsidization, stolen sales from US manufacturers in the lower-medium passenger car class.

8.337 If the Timor does occupy a special niche, it is the niche of "heavily subsidized lower-medium class car". However, for serious prejudice purposes, the fact that a product is heavily subsidized, and thus can significantly undercut the prices of its competition, cannot be used as a basis for concluding that there is no competition or that the products in question are not "like" each other.

8.338 Moreover, Indonesia is simply incorrect that market share data is not an indicia of serious prejudice. Nothing in Article 6.3(a) precludes a consideration of market share data, and its use is consistent with Article 6.3(b), which also deals with displacement or impeding of imports. In this regard "displace" means "to crowd out: take the place of". Webster's Third New International Dictionary. Market share data provides a measure of the extent to which the Timor has "crowded out"

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[547] Moreover, as previously noted, if certain passenger cars are excluded from the market share calculation, the market share of the Timor Kia Sephia is increased.

[548] Indeed, Indonesia would be hard-pressed to contest the application of Article 6.4, having already argued that the Panel should analyze threat of serious prejudice under Article 6 based upon the countervailing duty standards for threat of injury contained in Article 15.7 of the SCM Agreement.

or "taken the place of' like products from US manufacturers, and thereby cause serious prejudice to the interests of the United States.

(3) The prejudice caused to like products of US manufacturers was serious

8.339 Indonesia attempts to argue that whatever harm US interests may have suffered, it is not enough to be considered "serious" within the meaning of the Subsidies Agreement. Again, however, in advancing this argument, Indonesia discusses total sales figures rather than sales of passenger cars that are "like" the Timor.

8.340 Moreover, Indonesia totally ignores the sales that the US manufacturers would have made but for the introduction of the National Car programme. GM's plan called for around 3,000 sales of Opels in 1997, Ford's plan called for roughly 2,000 Escorts in 1997, and Chrysler's plan called for between 1,000 to 2,000 Neons in 1997. Even if the US manufacturers only achieved one-half of the lower end of their projections, this still would have amounted to roughly 3,000 cars, which, in the Indonesian passenger car market, is a considerable amount. The fact that these sales have not occurred is not "trifling," as Indonesia would have this Panel believe.

(4) Indonesia has not provided anv evidence to rebut the fact that US Manufacturers had well-developed plans to enter, or increase their presence in, the Indonesian passenger car market

8.341 Finally, let us discuss the US manufacturers' plans for the Indonesian market. Significantly, Indonesia does not challenge the existence of these plans or offer evidence aimed at disproving the existence of these plans. Indeed, the only evidence offered by Indonesia on this particular issue supports the position of the United States. Submitted as US Exhibit 37 is a document entitled "Indonesia's Automotive Market," which was submitted by Indonesia as Indonesia Exhibit 11 (first submission). Pages 3-4 of US Exhibit 37 discuss the plans of each of the three US manufacturers and describe how these plans were cancelled or suspended as a result of the National Car Programme.

8.342 Rather than attempting to rebut the evidence presented by the United States (which Indonesia knows it cannot do), Indonesia instead relies on the procedural defense that the United States allegedly has not presented enough evidence to trigger Indonesia's obligation to present rebutting evidence. However, as stated by the Appellate Body in the Wool Shirts case, at page 14, the burden on the United States, as the complainant, merely is to adduce "evidence sufficient to raise a presumption that what is claimed is true." In the view of the United States, it has more than satisfied this burden by providing information obtained from the US companies and information contained in newspaper articles and trade journals.

8.343 In addition, to satisfy Indonesia's insistence that the United States provide documents straight from the companies themselves, the United States has submitted documents containing information jointly submitted by Ford and General Motors to the Office of the US Trade Representative (USTR)[549] ,and information submitted by Chrysler to USTR[550]. The United States emphasizes that there is little new information contained in these documents, because most of the information contained in these documents was also contained in the US first and second submissions. The United States trusts that the submission of these documents will put an end to Indonesia's accusations that the United States has relied on hearsay evidence.

[549] US Exhibit 38.
[550] US Exhibit 39.

(5) As a factual matter, it is simply not established that the tariff and tax benefits conferred on TPN under Decree No. 42/96 will ever be reimbursed

8.344 The **United States** argues, in connection with its arguments regarding whether the June 1996 programme is an expired measure, that it is not established that the tariff and tax benefits conferred on TPN under Decree No. 42/96 will ever be reimbursed. These arguments are set forth in Section X.B.

(c) Response by Indonesia

8.345 The following are **Indonesia's** responses to the complainants' arguments regarding displacement or impedance of imports:

(1) The complainants' presentation with respect to actual serious prejudice to their interests is irrelevant because it relates solely to the alleged effects of the terminated June 1996 Programme

8.346 The complainants' collective serious prejudice allegations encompass only the National Car programme, which they allege has three components: (i) the June 1996 programme, which provided conditional exemptions from import duties and the luxury tax for imported national cars; (ii) the February 1996 programme, which provides conditional exemptions from the luxury tax and from import duties on parts and components used for the assembly of national cars in Indonesia; and (iii) the August 1997 US$690 million loan to TPN.[551]

(2) To establish serious prejudice, complainants must prove that a subsidy exists and that it is causing or threatens to cause serious prejudice

8.347 In order to maintain a claim of serious prejudice, the complainants must establish both:

1. the existence of a measure conferring an actionable or prohibited subsidy[552]; and

2. adverse effects in the form of serious prejudice to their interests resulting from the measure conferring the subsidy.[553]

Thus, in short, the complainants must show that a subsidy exists and that it causes or threatens adverse effects resulting in serious prejudice. The complainants have not made and cannot make this showing.

(3) Complainants' allegations of serious prejudice fail because they have not demonstrated that an existing subsidy measure has resulted in actual serious prejudice

8.348 The complainants allege that their interests have suffered serious prejudice through the displacement or impedance of imports (Article 6.3(a)) and price undercutting (Article 6.3(c)) by the national car during 1996 and the first half of 1997. They rely heavily on contemporaneous sales and price data provided by the Government in the Annex V process, but fail to acknowledge that the sales

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[551] As demonstrated, complainants' arguments concerning the loan are irrelevant because the loan and related issues are not within the scope of this Panel proceeding. Also, in any case, the loan was delivered on commercial terms.

[552] See Subsidies Agreement, Article 1.1. See also Subsidies Agreement, Articles 3.1.(b), 5, 6 and 7, each of which refers to extant subsidies.

[553] See Subsidies Agreement, Articles 5(c) and 6. The phrase, "serious prejudice to the interests of another Member," includes the threat of serious prejudice. See Subsidies Agreement, fn. 13.

and price data relating to the national car during 1996 and 1997 (to date) relate exclusively to national cars that benefitted solely from the June 1996 programme. As discussed above, the June 1996 programme terminated in its entirety in June 1997. Thus, even if Complainants' assertions regarding actual serious prejudice in 1996 and 1997 were correct (which they are not), this harm would not be cognizable in this proceeding because the underlying measure complained of has already been withdrawn. Complainants' claims, therefore, are moot.[554]

8.349 At the same time, the two[555] remaining components of the National Car Programme could not have caused actual serious prejudice to either Complainants' interests. TPN did not begin assembling the national car in Indonesia under the February 1996 programme until June 1997. Moreover, the Tambun Plant at which the national car is being assembled will produce vehicles at the rate of only 1,000 units per year.

8.350 The August 1997 loan to TPN will be used to fund the construction of the Cikampek Plant, where the Sportage will be built. As discussed above, however, the Sportage will not be designated as a "national motor vehicle" and will not benefit from the tariff and tax subsidies extended under the February 1996 programme. Additionally, even if the August 1997 loan were deemed to confer a subsidy on the Sportage, actual serious prejudice could not arise because no vehicles have yet been built.

8.351 In sum, the June 1996 programme has been withdrawn and neither the February 1996 programme nor the August 1997 loan has caused actual serious prejudice to the complainants' interests. The practical effect of the foregoing analysis is to leave intact and relevant only the complainants' threat of serious prejudice allegations. As demonstrated below, like the complainants' claims of actual serious prejudice, these allegations lack merit and do not require or warrant any remedial action.

(4) The complainants' allegations regarding the cancellation of their companies' plans for the Indonesian market have not been adequately substantiated

8.352 A similar evidentiary failure plagues the European Communities and United States assertions regarding the plans and/or projections of GM, Ford and Chrysler for the Indonesian market. Complainants have attempted to provide a thin veneer of authenticity to their various claims regarding the companies' plans and/or sales projections by citing to newspaper and trade articles, but this is wholly inadequate. The positive evidence standard of the Subsidies Agreement, along with the many uncertainties of business and the inherently speculative and fluid nature of plans and projections, requires much more than this. The European Communities and US claims should be summarily dismissed because they have not been substantiated with even a single source document.[556]

8.353 A closer look at the United States' allegations concerning the plans of the Big Three is also in order. First, as a preliminary matter, Indonesia notes that it has contested and does contest the

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[554] Indeed, the Subsidies Agreement, in its entirety, is designed to provide a remedy for existing subsidy measures. This is demonstrated most clearly in Article 7.8, which directs Members maintaining a subsidy measure found to cause serious prejudice either to withdraw the measure or to remedy the adverse effects.

[555] Actually, only one measure, the February 1996 policy, remains because the August 1997 loan to TPN is outside the scope of this proceeding and, in any case, was delivered on commercial terms. In order to be thorough, however, the loan is discussed as well.

[556] See Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items (11 November 1997), WT/DS 56/R, 91, para. 6.40 ("adversary is obligated to provide the international tribunal with relevant documents which are in its sole possession"). Indonesia reserves the right to comment on any such documents or materials which might be supplied by the EC or the US.

existence of "well-developed" Big Three plans to enter or expand in Indonesia's market for passenger cars. Where are these claimed "business plans"? The United States has failed to introduce any source documentation concerning them. At most, the United States has established that company personnel have informed reporters, or reporters have speculated, that the Big Three had "plans" to invest in Indonesia and such "plans" allegedly were frustrated by the National Car Programme. This is not positive evidence; in fact, it does not even rise from the level of hear-say.

8.354 Second, the so-called "plans" appear not to be "plans" at all, but, at most, plans to develop plans. According to the United States, the "plans" break down as follows for each manufacturer. For both Ford and GM, the United States' rebuttal mentions no "plan" to export US-made autos to Indonesia. Moreover, Chrysler, the only remaining manufacturer, had no firm plan to enter Indonesia's passenger car market. Rather, according to the United States, Chrysler "was studying" a joint venture in Indonesia to assemble Neon passenger cars and other passenger vehicles.[557] Studying or considering a joint venture is not the same as having a concrete plan. And, on top of this, the United States again has failed to provide positive evidence, as it must, to support any of these claims.

8.355 The United States claim regarding Chrysler is based not on positive evidence, but on hear-say. This also is true of the European Communities allegations concerning the plans of Ford and GM. For their claims to have any merit at all, the European Communities and the United States would have to prove by positive evidence that:

first, they had documented plans to import cars like the Timor;

second, the National Car Programme in fact caused the companies to cancel their claimed plans;

third, had they continued with their plans, a substantial number of their cars would have been sold in Indonesia had the National Car Programme not been instituted; and

fourth, the National Car Programme would negatively have impacted their sales such that serious prejudice would have resulted.

8.356 However, neither the European Communities nor the United States has satisfactorily addressed these interrelated factors, much less provided even minimal support for these points. Rather, they have claimed, without adducing a single substantiating source document, that the companies had plans to enter Indonesia's market that were foiled by the Timor.

8.357 In this regard, Indonesia notes that Ford and Chrysler did not submit a single application for approval of the development of passenger car production or assembly facilities in Indonesia during the period of 1993 to the present. In sum, Ford and Chrysler have never had any real plans to produce or assemble a like product in Indonesia. Moreover, in 1993, GM submitted to Indonesia a passenger car production and assembly plan, which Indonesia approved. Not only is there no evidence to support the termination of any plans, since 1993, GM has continued to expand its operations. In fact, in November of 1997, GM submitted to Indonesia an application to significantly expand its production and assembly operations in Indonesia. Indonesia approved this application in December 1997. These facts belie the claims of the European Communities and United States regarding serious prejudice. They also demonstrate that, if any abandoned plans existed, the United States and the European Communities could introduce evidence of the plans that the Indonesian government already would have copies of - the request for approval of new or expanded operations in Indonesia. Thus,

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[557] Id. at para. 12, p. 3.

the Panel should not allow Complainants to hide their lack of evidence behind the cloak of confidentiality.

8.358 Indonesia accordingly submits that the Panel's consideration of this issue should focus on the complete lack of positive evidence to support the United States and European Communities claims, and the fact that, even accepting the United States and European Communities stories, the Big Three do not have and never had any concrete, confirmed plans to sell a car like the Timor in Indonesia.

8.359 We also urge the Panel to note the inconsistencies and the narrowing trend in the United States presentations. First, the United States argued that all of the Big Three sold or would have sold like products in Indonesia; now it argues that none of them sell like products in Indonesia and that only Chrysler was considering doing so. One wonders what tomorrow's admission will be.

8.360 In sum, Indonesia should not be penalized for what the United States claims, but has not properly established, were business plans, projections or decisions by United States-based companies. Indonesia asks the Panel to find the United States arguments baseless and to reject the United States complaint.

(5) Sales of the Timor have not affected sales in Indonesia of US-based passenger car manufacturers for three basic reasons

8.361 Sales of the Timor have not affected sales in Indonesia of US-based passenger car manufacturers for three basic reasons. First, US-based manufacturers compete in a market segment dominated by Japanese-based manufacturers.[558] To date, their marketing efforts have stumbled badly.

8.362 Second, US-based manufacturers' claimed "efforts" to sell passenger cars that compete with the Timor are either non-existent, nebulous, or purely speculative. For example, Ford makes much of the fact that it has assigned four foreign service employees to Indonesia and invested US$1 million in Indonesia.[559] Ford has 370,000 employees worldwide and its automobile segment alone registers sales of US$118 billion.[560] Obviously, Ford's commitment to Indonesia (other than to Indonesia's tax-free taxi market) is virtually non-existent. Chrysler's commitment to the Indonesian market is greater than Ford's, but it is directed not at the passenger car segment but to sales of Jeep-type vehicles. Chrysler Cherokees and Wranglers do not compete with Timor sedans. Chrysler's attempt to show serious prejudice in the Timor passenger car segment by introducing its "plans" to assemble Neons in Indonesia is unpersuasive. Chrysler statements that it "... was studying an assembly joint venture ... [p]lanned investment "... and "the precise figures are confidential ..."[561] are vague and unsupported. There is not one piece of evidence on the record of this proceeding that supports these statements.

8.363 Indonesia has bared its soul in presenting its case to this Panel and responding to the complainants' questions. Complainants should not be able to succeed before this Panel by relying on wisps of intra-corporate marketing brainstorming while failing to provide substantive real-world data to the Panel for scrutiny by all parties.

8.364 General Motors' presentation, although superficially more compelling than Ford's or Chrysler's, misses the point entirely. GM goes to great lengths to detail its investment in the Opel

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[558] As Japan has previously acknowledged in this proceeding, Japan does not market a car that competes with the Timor.

[559] US Exhibit 38, pp. 1-2.

[560] Ford 10-Q (1996) and "Ford Motor Company - The History of Ford Motor Company - An American Legend".

[561] US Exhibit 39, Page 2.

Optima, Opel Vectra and Opel Blazer, however, GM has never sold more than a few hundred of these vehicles in Indonesia. GM's claim of lost potential sales thus is purely speculative.

8.365 The history of GM's marketing efforts in Indonesia is a much better barometer of the real situation. GM's history of sales efforts in Indonesia is one of sporadic, unfocused marketing efforts that have each failed to penetrate the target market - the Japanese-dominated passenger car segment. GM has no-one to blame but itself for failure to successfully compete with the Japanese in Indonesia for a share of that value-added market. As Indonesia continually has stressed through an analysis of physical characteristics, the Optima, Vectra and Blazer do not compete with the Timor.

8.366 Third, Timor sales do not affect sales by US-based passenger car manufacturers because other issues, rightly or wrongly, have dissuaded the "Big Three" from investing the capital necessary to successfully sell passenger cars in Indonesia. The US finally has acknowledged that the Big Three's decisions to place a "hold" on their "plans" for Indonesia was based on factors other than the National Car Programme. The Indonesian market is dominated by the Japanese. The Japanese are firmly entrenched, and Japanese vehicles hold approximately 90 per cent of the market.[562] This fact alone makes it difficult for the Big Three to justify millions of dollars of capital investments. Furthermore, Indonesia's road transportation infrastructure is in the early stages of development and its personal use market represents a small percentage of a relatively small market.[563]

8.367 Simply put, the reasons the Big Three "withdrew from" or "failed to enter" the Indonesian market have nothing to do with the National Car Programme. They withdrew because (1) the market for small cars is too small to justify and sustain the necessary capital investments and, in any case, is dominated by Japan; (2) the low annual per capita income in Indonesia results in a minute high-profit market niche that is dominated by Mercedes-Benz and BMW that precludes penetration by the Big Three; (3) low-income, entry-level automobiles such as the Timor do not provide the per-unit profit necessary to generate investment returns that the Big Three enjoy in their important markets - North America and Europe; and (4) the investment incentives provided in countries such as Thailand are better than those provided in Indonesia.[564]

8.368 In conclusion, US-based manufacturers did not suffer serious prejudice due to Indonesia's National Car Programme. The Timor, because of its low-income, entry-level appeal, does not compete with US-based automobiles. US-based manufacturers' automobiles are positioned to compete in other market segments, against Japanese models in Indonesia and in the rest of the world. The Indonesian market is dominated by the Japanese, per-unit profit margins would become very thin if the US were to compete, and the higher profit per-unit market niche is dominated by BMW and Mercedes-Benz. Thus, for the Big Three to make the investments necessary to compete in Indonesia would be incompatible with the short-horizon, quarterly profit maximization principles that drive US-based manufacturers.

(6) Even if the European Communities and US cars were found to be like the Timor, no serious prejudice exists or will arise because they do not compete with the Timor

8.369 Assuming, *arguendo*, that the European Communities and US cars were found to be like the Timor, this would not be tantamount to determining that the National Car programme has caused or will cause serious prejudice to European Communities and US interests. The like product determination merely establishes the proper analytical framework in which to consider, in turn,

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[562] US Exhibit 37, Page 1.
[563] Id.
[564] Id.

whether the separate components of the programme have caused serious prejudice to complainants' interests.[565] In other words, it is not enough for complainants to show that the Timor is subsidized and that, at the same time, their commercial welfare has declined or not improved as expected. Rather, they must demonstrate the existence of a causal link between the two events. As discussed below, the European Communities and the United States have not shown and cannot show this requisite linkage because the Timor is a low-end, no-frills budget car that is not in the same market segment as the more-advanced, state-of-the-art Escort, Neon, Optima, Vectra or Peugeot 306.[566]

8.370 Available sales data for 1996 and 1997 reveal that the Timor has tapped into a new class of consumers and created a niche segment at the bottom of the market.[567] These data also show that sales in the non-Timor segments have increased, despite the introduction of the Timor. Total sales by all manufacturers increased from 38,826 cars in 1995 to 42,346 cars in 1996, for a total increase of 3,520 cars. The Timor was introduced in 1996 and 4,278 units were sold. Total sales by all manufacturers increased from 28,265 units in the first three quarters of 1996 to 53,033 cars during the first three quarters of 1997, for a nearly two-fold increase of 24,768 cars. Timor sales of 11,853 cars in the first three quarters of 1997 accounted for less than one-half of this phenomenal growth.

8.371 The sales data set forth in the following table also demonstrate that the European Communities and the US positions (and Japan's position) in the marketplace have improved since the Timor was introduced.[568]

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[565] This causation requirement is apparent from the text of the Subsidies Agreement. Article 5 provides: "No Member should cause, through the use of any [specific] subsidy …, (c) serious prejudice to the interests of another Member." (footnote omitted) Articles 6.2 and 7.1 speak of subsidies "resulting" in serious prejudice. Articles 6.3(a) and (c) respectively state that serious prejudice may arise where "the effect of the subsidy is to displace or impede the imports of a like product" and "the effect of the subsidy is a significant price undercutting …of a like product." "Effect" is defined as: "Something accomplished, caused, or produced; a result, consequence. Correlative with CAUSE." The Compact Oxford English Dictionary at p.496 (2d ed. 1987).

[566] The US also claims that the Timor J520i is like the GM Opel Blazer and will pose a threat to US light commercial vehicles. Indonesia need not, however, address this claim because the Timor J520i is not and will not be covered by the National Car Program. Certificate of Registration of Mark/Type/Variant of Motor Vehicle, No. 1039/DJ-IIMK/X/1997, Department of Industry and Trade of the Republic of Indonesia, the Directorate General for Metals, Machinery and Chemical Industry (Indonesia Exhibit 42, Attachment E).

[567] The Indonesian passenger car market can be properly examined only on a segmented basis. That market (like all other car markets) is characterized by a very high degree of market differentiation and specialization. Thus, a consumer who purchases a Mercedes-Benz or BMW or, for that matter, a Toyota, Opel or Peugeot, is extremely unlikely to purchase a Timor, and vice versa. See generally United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206, 294, para. 5.73.

Car manufacturers devote very substantial resources to establishing and targeting different market segments and smaller niches in their production, advertising and marketing. For example, GM follows a strategy of selling dozens of different models where competitors sell just a few. This "needs segmentation" approach is designed to aim vehicles more precisely at buyers based on buyers' specific demographics, attitudes and desired car features. See Daniel McGinn, Divide and Conquer: Meet the Researcher Behind GM's Controversial Marketing Strategy , Newsweek, 1 December 1997, at pp.50 and 52 (Indonesia Exhibit 42, Attachment B).

[568] Opel Optima and Vectra sales are attributed to the EC.

Table 34

	1995	1996	1997[569]	1Q/3Q 1997	1Q/3Q 1996
EC	9,213	10,075	11,093	8,320	7,653
US	2,880	3,652	4,456	3,342	2,594
Japan	23,941	21,693	34,304	25,728	16,718
Others/CBU Imports	2,792	2,648	5,053	3,790	1,300
Timor	0	4,278	15,804	11,853	0
TOTAL	38,826	42,346	70,710	53,033	28,265

Source: Gaikindo; Government of the Republic of Indonesia

8.372 In sum, the foregoing data run contrary to the European Communities and US assertions that sales of the Timor have displaced or impeded imports of the claimed like products.[570]

8.373 Finally, Indonesia notes that the operative standard for remediation is "serious prejudice." This concept does not lend itself to ready measurement and, accordingly, its meaning has not crystallized despite its relevance to many GATT proceedings. This does not, however, mean that it is without content.

8.374 Article 31.1 of the Vienna Convention on the Law of Treaties provides: "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 light of its object and purpose." "Serious" is defined as: "Weighty, important, grave; (of quantity or degree) considerable, not trifling".[571]

8.375 The European Communities and the United States point to specific, concrete sales data for only the Opel Optima and Vectra and the Peugeot 306. GM sold 549 Opels in Indonesia in 1996 and 284 Opels from January through September 1997 (379 units on an annualized basis); 1,086 Peugeot 306's were sold in 1996 and 762 (1,016 annualized) were sold through September 1997. Thus, even when taken together, the net decline in sales for the three models from 1996 (1,635 cars) to 1997

[569] Annualized on the basis of January through September 1997 sales.

[570] Of course, this standard is not even applicable if the Panel determines that cars assembled by EC or US manufacturers in Indonesia from imported kits are not like the Timor. Indonesia notes that the EC and the US rely heavily on market share trends and the US refers to Article 6.4 of the Subsidies Agreement for guidance in analyzing market displacement or impedance. First, only Articles 6.3(a) and (c) pertain to this case and they do not refer to market share as an indicia of serious prejudice. Second, historical and current market share data are meaningless, because the Timor's establishment of a new market segment has fundamentally transformed the Indonesian passenger car market. Thus, in order to have even limited meaning, market share data must be compiled on a segment-specific basis. As for the EC's suggestion that sales of the Opel Optima and Peugeot 306 should not have declined in 1997 because of a substantial increase in general demand, sales, demand growth and market share are not necessarily correlated. The EC itself has observed: "Since 1992 and until 1996, exports of passenger cars from the Community [to Indonesia] grew at a faster pace than demand, resulting in a significant gain in terms of market share."

[571] The Compact Oxford English Dictionary at p.1716 (2d ed. 1987).

(1,395 cars) will be only approximately 240 cars. These cars represent only approximately 1.5 per cent of projected total European Communities and US sales in 1997 (15,549 cars). Thus, even if the drop in sales could be attributed to the Timor (and it cannot), such a minuscule decline could hardly be considered anything other than trifling and certainly cannot serve as the basis for a finding of serious prejudice.

(7) The EC has failed to prove serious prejudice

8.376 The European Communities focuses on sales of EC-produced cars in Indonesia with passing reference to the plans of Ford and GM. (Indonesia acknowledges that the EC does not attempt to claim any United States-produced cars as its own.) The European Communities originally had argued that the Opel Vectra also is like the Timor, but now apparently concedes this was an error.

8.377 Thus, apart from the European Communities' allegations concerning Ford and GM plans, the success of the European Communities' complaint hinges on the European Communities demonstrating by positive evidence, first, that the Opel Optima or the Peugeot 306 is like the Timor and, second, that Indonesia's measures have caused serious prejudice by impacting sales of these cars.

8.378 The European Communities has not met either of these burdens. Even putting aside the many important, non-physical characteristics that must be considered in establishing like products here, Indonesia already has demonstrated, and the European Communities' like product matrix[572] confirms, that the Timor is not like the Optima or the 306 when only physical characteristics are considered. Also, the European Communities has presented no positive evidence demonstrating that the Timor has had any impact on European Communities sales. Although Indonesia has not commissioned or performed any econometric or market research on this point, the data we have seen suggest that the Japanese models, many of which are like the Optima and the 306, are continuing to dominate the market segments above the Timor. If the European Communities is losing sales, then it is losing them to the Japanese like products, not to the "unlike" Timor. Therefore, Indonesia asks that the Panel reject the European Communities' arguments and dismiss the European Communities' Complaint.

8.379 Further to the last point, Indonesia notes that, notwithstanding the positive evidence standard, none of the complainants has undertaken econometric or market studies to support their positions. A study would allow the Panel to evaluate the various other criteria the European Communities deems "too subjective" or "too vague". Yet they have not done so. Had Indonesia the burden of proof or persuasion, the Panel and Parties already would have the data in front of them. Complainants have avoided any thorough investigation or analysis of the Indonesian market because they know such analysis would confirm Indonesia's position.

8.380 Rather than engaging these important issues, the European Communities continues to advance its idea that all passenger cars are like products, i.e., Mercedes-Benzes, Bentleys, Yugos and Timors compete for the same customers. It has no choice but to do so because only by avoiding causality can it succeed.

8.381 Later, the European Communities plays fast and loose with market share data, asserting that the European Communities accounts for 24 per cent of Indonesia's market, but failing to mention that the vast majority of this share is from sales of "models in the high segment of the market" (i.e., BMWs, Mercedes-Benzes and Volvos). Moreover, the European Communities ignores the fact that Japan's sales have increased by over 50 per cent.

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[572] EC Exhibit D-3.

8.382 The truth, or "truism", as the European Communities says, is that the Timor taps a different market segment. The European Communities states that "[t]he proposition that the Timor has generated entirely its own demand is purely speculative and cannot be demonstrated". But, first, Indonesia's presentation is not speculative; it is based on a reasoned view of the market and TPN's marketing intention for the Timor. Indonesia's view, unlike that of the European Communities, accounts for the phenomenal growth in Japan's sales. Second, Indonesia's view can be demonstrated. More importantly, however, Indonesia does not bear the burden of proof here. The European Communities does. It has failed to prove its allegations, and so the Panel should reject the European Communities' assertions and dismiss the European Communities' complaint.

5. Article 6.3(c) of the SCM Agreement—Price Undercutting

(a) Arguments of the European Communities

8.383 The following are the **European Communities'** arguments regarding price undercutting by subsidized national cars:

(1) The prices of the subsidized National Cars undercut significantly the prices of like passenger cars imported from the Community

8.384 In accordance with Article 6.3 of the SCM Agreement, serious prejudice may arise, *inter alia*, where the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of the like product of another member.

8.385 The massive subsidies granted to PT TPN have allowed this company to price the Timor S-515 well below the passenger cars imported from the Communities.

8.386 Table 35 ranks all the passenger cars of up to 1,800 cc offered in the Indonesian market according to their listed sale price. They show that the Timor S-515 was the least expensive model on sale in Indonesia in November 1996 and again in March 1997, with the only exception of the Mazda MR-90, a relatively old model which was sold in very small quantities[573].

Table 35

Listed prices in Indonesia for passenger cars of up to 1800 cc

November 1996

Model	Price (thousand Rp)
Mazda MR-90	30,200
Timor S515 Solit	**33,000**
Timor S515 Metalic	**33,500**
Suzuki Baleno SY 416	43,500
Bimantara Cakra MT	45,000
Bimantara Cakra AT	48,650
Toyota Starlet	47,800
Honda City GM	50,975
Ford Laser GHIA saloon	58,800
Peugeot 306 M/T	**59,000**
Bimantara Nenggala M/T	53,100
Peugeot 306 M/T	**62,500**
Bimantara Nenggala A/T	63,500
Mitsubishi Lancer M/T	64,000
Peugeot 306 A/T	**65,500**
Mitsubishi Lancer A/T	67,000
Opel Optima GLS	70,000
Toyota Corolla M/T	71,100
Lancer DOHC	72,000
Honda Civic 4 Door NB GKP	72,490
Toyota Corolla A/T	74,800
Honda Civic 4 Door NB AKP	76,190
Toyota Corona	80,700

Source: AV/3, Attachment A-40/1.**March 1997**

[573] 102 units in 1996 and 16 during the first half of 1997. See AV/3, Attachment A-39/1- B.

Model	Price (thousand Rp)
Mazda MR-90	30,000
Timor S515 Solit	**33,000**
Timor S515 Metalic	**33,500**
Timor S515 I Solit	**36,400**
Timor S515 I Metalic	**36,900**
Bimantara Cakra MT	39,900
Daewoo Nexia DOHC	43,000
Bimantara Cakra AT	43,450
Suzuki Baleno SY 416	44,750
Toyota Starlet	48,100
Honda City GM	51,300
Bimantara Nenggala M/T	53,100
Bimantara Nenggala A/T	57,000
Ford Laser GHIA Saloon	59,000
Peugeot 306 M/T	**59,500**
Peugeot 306 M/T	**63,000**
Ford Laser GHIA Saloon	63,200
Mitsubishi Lancer M/T	65,000
Peugeot 306 A/T	**65,500**
Mitsubishi Lancer A/T	68,000
Mazda Astina	68,300
Toyota Corolla M/T	68,300
Opel Optima GLS	70,000
Honda Civic 4 Door NB GKP	71,160
Toyota Corolla A/T	71,800
Lancer DOHC	72,000
Honda Civic 4 Doors	74,860
Toyota Corona	81,200

8.387 More particularly, the data evidence that the Timor S-515 undercut significantly the prices of the closest Community models in terms of specifications. In November 1996, the price of the Timor S-515's most expensive version was 43 per cent lower than the price of the least expensive version of the Peugeot 306 and 52 per cent lower than the price of the Opel Optima. As of March 1997, the margins of price undercutting were almost identical.

(b) Arguments of the United States

8.388 The **United States** submits that the tariff and tax subsidies provided under the National Motor Vehicle programme have resulted in significant price undercutting by the Timor Kia Sephia. The following are the **United States'** arguments in this regard.

8.389 Under Article 6.3(c) of the SCM Agreement, serious prejudice exists where "the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market ... ." Article 6.5 elaborates on the analysis of price undercutting:

> For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

(1) Tariff and tax subsidies

8.390 Put simply, the Timor Kia Sephia is the cheapest car on Indonesian roads.[574] Because of the huge tariff and tax breaks it enjoys, the Timor Kia Sephia can be sold for 50 percent of the price of its rivals.[575]

8.391 The newspaper accounts are consistent with the hard data. As set forth in Table 31, above, the Timor Kia Sephia S515 sold for Rp. 33.5 million, while the Opel Optima GLS (the least expensive Opel) sold for Rp. 69.5 million. In other words, the Timor Kia Sephia sold for less than one-half the price of the Opel Optima. In March, 1997, this price gap increased slightly, as the Timor Kia Sephia sedan continued to sell for Rp. 33.5 million, while the price of the Opel Optima GLS increased slightly to Rp. 70 million. Even the fuel-injected version of the Timor Kia Sephia, the S515i, sold for only Rp. 36.9 million in March 1997.

8.392 With respect to the Ford Escort, Ford, of course, abandoned its plans to sell the Escort in Indonesia due to the National Motor Vehicle programme. However, based on company figures, the Timor Kia Sephia S515 would have undercut the price of the least expensive version of the Escort by more than US$5,000.[576]

8.393 Moreover, the Timor Kia Sephia did not significantly undercut the prices of only US passenger cars. It significantly undercut the prices of every passenger car in its class sold in Indonesia, as demonstrated in Tables 32 and 33, above.

8.394 The reasons why the Timor Kia Sephia could so significantly undercut the prices of its competition are obvious. First, the Timor Kia Sephia was not subject to import duties, whether

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[574] "Indon Domestic Car Sales Race up by 41 per cent in May," Business Times (Singapore), June 17, 1997 (US Exhibit 14, pp. 138-139).

[575] "Bumpy Road Ahead for Motoring Plans," South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-135).

[576] The United States has precise figures regarding the planned prices for Ford Escorts in Indonesia. However, these figures constitute business proprietary information that the United States is reluctant to provide to the Panel absence adequate procedures to protect such information.

imported from Korea in CBU form during 1996-1997 or as kits from July 1997 onward. Second, the Timor Kia Sephia is not subject to the 35 per cent luxury tax.

8.395 Information provided by Indonesia (Attachment A-28 to AV/3) effectively concedes that the tariff and tax subsidies under the National Motor Vehicle programme are responsible for the significant level of price undercutting. This table contains data for 1998 and 1999 regarding the Timor Kia Sephia S515i that will be assembled at the Karawang facility. Row 4 of the table (Unit Dealer Price) indicates that the effect of the tariff and tax subsidies of the National Motor Vehicle programme is to lower the price of the Timor Kia Sephia sedan by US$7,243-9,158.

8.396 The United States does not necessarily accept the accuracy of the data in this table. For one thing, it does not deal with the 1996-97 period during which the tariff subsidy was even greater due to the exemption of imports of CBU Kia Sephias from the 200 per cent tariff. Therefore, it does not reflect the price impact of this particular subsidy. In addition, during the Annex V process, Indonesia refused to explain the basis on which "unit cost" was estimated in the table, the figure from which "unit dealer cost" apparently was derived.[577] Nevertheless, the table constitutes an admission as to the tremendous impact of the tariff and tax subsidies on the price of the Timor Kia Sephia.

(c) Responses by Indonesia

8.397 The following are **Indonesia's** responses to the complainants' arguments regarding price undercutting.

(1) Price comparisons made

8.398 The European Communities and the United States claim price undercutting by the Timor, but their position is fallacious because it is based on a misleadingly simplistic comparison of list prices. The Subsidies Agreement and commercial reality require that other factors affecting price comparability be considered.

8.399 Article 6.5 of the Subsidies Agreement requires that price comparisons must take "due account … of any other factor affecting price comparability". This requirement, in conjunction with the positive evidence standard, means that Complainants have the burden of quantifying and making appropriate price adjustments for the physical characteristics and consumer preferences and perceptions that distinguish the Timor from their manufacturers' products. This task may be difficult, but it is absolutely indispensable. In the same vein, Article 6.3(c) requires that there be "significant price undercutting". As reflected in Article 6.5, the existence of any price undercutting and a determination as to its significance necessitates an apples-to-apples comparison.[578]

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[577] In AV/15, in Question 12/28(a), the United States renewed its earlier request for an explanation of the estimated unit cost for cars to be produced at the Karawang facility. (Karawang is the district in which Cikampek is located). In AV/16, p. 3, instead of answering the question, Indonesia referred the United States to Table A-30/2 of Attachment U-12. However, Table A-30/2 merely provides a list of costs in relative terms, and, as such, cannot be used as a basis for estimating unit costs in absolute terms. In other words, under Table A-30/2, if one starts with a cost of *X*, the final price will be 616.9*X*. However, Table A-30/2 does not allow one to determine what *X* is.

[578] Although not directly applicable, it is instructive to note that local authorities which administer WTO-consistent antidumping and countervailing duty regimes routinely split a like product category into numerous specific products when making price comparisons among products for injury assessment purposes. For example, in the 1992 antidumping duty investigation of Minivans from Japan, the US International Trade Commission and the parties acknowledged and wrestled with the difficult task of determining the comparability of various minivan models. The Commission, with the parties' input, eventually subdivided the unitary minivan

(2) Factors affecting price comparability

8.400 Numerous physical and non-physical factors and consumer perceptions affect the price comparability of passenger cars. These include, but are not limited to: brand loyalty; quality; after-sales service, brand image/reputation; reliability; design; durability; utility; resale value; ride and comfort; driveability; standard features; safety features; available options; exterior size; interior space; fuel economy; engine size and technology; transmission type; and suspension type. As demonstrated in Tables 26 and 27 above, there are numerous physical differences between the proposed comparison models that must be taken into account when comparing their prices. The above-identified non-physical attributes and consumer perceptions also require such an accounting.

8.401 One possible approach to quantifying the price effects of certain physical differences would be to consider the surcharges commonly assessed by dealers for enhanced features, such as a larger engine and advanced engine technology; special safety features (e.g., anti-lock brakes and air bags); trim packages; interior appointments (e.g., power windows and locks and sound system); and an automatic transmission. Of course, the usefulness of such surcharges as bases for adjustments would be constrained by their limited cross-model transferability.

8.402 Quantifying the price effects of other physical and non-physical factors and perceptions is much more difficult because specific surcharges do not exist. One way to gauge the price premium consumers willingly pay for the unique packages of features offered by the Peugeot 306 and Opel Optima would be to design and conduct targeted consumer surveys. Such surveys are commonplace in the automotive industry.[579]

6. Adjustments for factors affecting price comparability

(a) Arguments of Indonesia

8.403 As shown, numerous "other factors" affect the price comparability of the Timor, the Peugeot 306 and the Opel Optima and these factors must be taken into account when assessing the European Communities (and the United States) price undercutting claims. Indonesia respectfully notes the burden of establishing like products properly rests with complainants.

(b) Arguments of the European Communities

8.404 The European Communities has shown that:

- the Timor S-515 was the least expensive passenger car on sale in Indonesia in November 1996 and again in March 1997;

- specifically, in November 1996, the price of the Timor S-515's most expensive version was 43 per cent lower than the price of the least expensive version of the Peugeot 306 and 52 per cent lower than the price of the Opel Optima. As of March 1997, the margins of price undercutting were almost identical.

8.405 Indonesia has not provided any evidence in order to rebut the above claims. Instead, Indonesia's only arguments with respect to the existence of price undercutting are the following:

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like product category into fifteen specific products for price-comparison purposes. See Minivans from Japan, USITC Pub. 2529 (July 1992) at pp.5 and A-100 (Indonesia Exhibit 45).

[579] See generally Daniel McGinn, Divide and Conquer: Meet the Researcher Behind GM's Controversial Marketing Strategy, Newsweek, 1 December 1997 at pp. 50-52 (Indonesia Exhibit 42, Attachment B).

- Article 6.5 of the SCM Agreement requires that any price comparisons shall be made at the same level of trade, at comparable times and due account must be taken of any other factor affecting price comparability. The European Communities has not attempted to account for "any other factors" in its analysis.

- The Mazda MR-90 and the Ford Laser are sold at prices below those charged for the Timor.

8.406 All the price comparisons made by the European Communities are based on the listed retail prices provided by Indonesia itself (in Attachment A-40/1 to its Annex V Response). The European Communities understands that all the prices mentioned in that information are at the same level of trade (namely, at retail level) and correspond to the same period of time (November 1996 and March 1997). The European Communities believes that there are no relevant “other factors” (including differences in physical characteristics) which may affect significantly price comparability between, on the one hand, the Timor S-515 and, on the other hand, the Opel Optima and the Peugeot 306. Indonesia itself has not been able to identify any such "other factor", let alone any factor which may account for a level of price undercutting of 50 per cent.

8.407 Further, the European Communities is not aware of any "other factor" (including differences in physical characteristics) which may explain the massive price undercutting by the Timor. Indonesia cannot place upon the European Communities the burden of proving the negative, i.e. that no "other factor" is responsible for the price undercutting. The evidence adduced by the European Communities is more than sufficient to raise a presumption that the subsidies in dispute have caused significant price undercutting. If Indonesia considers that the price differences are due to any "other factor", it is for Indonesia to prove it.

8.408 In any event, the data contained in Indonesia's Annex V response confirm that the price undercutting is essentially attributable to the subsidies received by PT TPN. According to the following table (provided by Indonesia AV/3, Attachment A-28), the estimated dealer prices for the Timor during 1998 will be between US$22,170 and US$24,085 "without subsidy" and USD 14,927 "with subsidy". The estimated price "with subsidy" is almost the same as PT TPN's listed price for the Timor as of March 1997, which price undercut the listed price for the least expensive version of the Peugeot 306 (US$24,405) by 39 per cent. In contrast, the estimated price "without subsidy" for the Timor would have undercut the listed price of the Peugeot 306 by only between 1 and 9 per cent. In other words,according to Indonesia's own estimates, the subsidies received by PT TPN would account for between 77 and 97 per cent of the price difference between the Timor and the Peugeot 306.

Table 36

Timor Cars Manufactured In Karawang Plant

US$1 = Rp. 2430

No.	Item	1997	1998 (estimated)	1999 (estimated)	Remarks
1	Capacity (unit)	NA	63,000	63,000	
2	Output	NA	6,000	35,000	The only Timor car produced in Indonesia is the S-515i DOHC - 1500 cc.
3	Unit cost (US$) a. with subsidy b. without subsidy	 NA NA	 7,000 - 9,000 9,664 - 12,852	 7,000 - 9,000 9,664 - 12,852	
4	Unit dealer price (US$) a. with subsidy1 b. without subsidy2	 NA NA	 14,927 22,170 - 24,085	 14,927 22,170 - 24,085	
5	Sales in Indonesia a. Unit b. US$ (million)	 NA NA	 6,000 89.56	 25,000 373.18	
6	Export a. Unit b. US$ (million)	 NA NA	 0 0	 10,000 70 - 90	
7	Local content (%)	NA	40	60	
8	Subsidy (US$ million) a. import duty b. luxury sales tax	 NA NA	 15.99 - 23.12 27.47 - 31.84	 51.80 - 74.89 96.81 - 110.97	

Note: [1]Dealer price is calculated without Luxury Sales Tax, Import Duty and Registration Fee.

[2]Dealer price is calculated without Registration Fee.

8.409 As noted, the Mazda MR-90 is an old model. The European Communities believes that there have been no sales of this model since May 1997 and that between January and April of 1997 only 19 units were sold. The Ford Laser is sold exclusively for use as a taxi, free of customs duties and of sales taxes. Therefore, any comparison with the prices of models which are subject to import duties and sales taxes is meaningless.

(c) Arguments of the United States

8.410 Indonesia takes a perfunctory stab at arguing that the price analyses conducted by the United States and the European Communities are flawed. Indonesia does not assert that these price comparisons were not made at the same level of trade or at comparable times, but instead asserts that the Complainants failed to account for "any other factors" within the meaning of Article 6.5. Aside from the fact that Article 6.5 does not impose a burden on the complaining party to adjust for "any other factors," but instead identifies such factors as something for a panel to consider, the United States does not know of any such factors, and Indonesia has not identified any. Essentially, Indonesia is seeking to have the Panel impose on the United States and the European Communities the burden of proving the negative; i.e., that "other factors" do not exist.

8.411 Moreover, as stated by numerous commentators, the only factor responsible for the significant price undercutting by the Timor Kia Sephia is subsidies, and the 50-60 per cent price advantage that these subsidies confer.[580]

8.412 The United States is unaware of any other factor that would account for the massive price undercutting of like products by the Timor Kia Sephia. As numerous analysts have recognized, this price undercutting is attributable to the huge subsidies provided by Indonesia. [581]

8.413 In the view of the United States, the party that would benefit from having an "other factor" being taken into account under Article 6.5 should bear the burden of proving the existence of such a factor and its effect on price comparability. Otherwise, as the United States has already noted, the opposing party would bear the burden of proving the negative, an unreasonable burden which is typically impossible to satisfy and which the drafters of the SCM Agreement could not have intended, given that one of the purposes of the SCM Agreement was to create an operational multilateral remedy against subsidies.

8.414 In that regard, the relevant provisions of the Anti-dumping Agreement, which deals extensively with issues or price comparability, provide useful guidance on this point. Indeed, Indonesia has previously acknowledged that concepts developed in the anti-dumping context can be relevant to an analysis of serious prejudice.

8.415 Article 2.4 of the Anti-dumping Agreement deals with the topic of making a fair comparison between normal value and export price, and provides that due allowance shall be made for a variety of factors, including "any other differences which are also demonstrated to affect price comparability".

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[580] See, e.g., "Jakarta's Car Wars," Business Times (Singapore), 28 May 1996 (US Exhibit 14, pp. 46, 48); "Indonesia Draws More Criticism Over Car Plan," The Nikkei Weekly, 17 June 1996 (US Exhibit 14, pp. 80-81); "Bumpy Road Ahead for Motoring Plan," South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-133); and "Indonesia Company: Suharto Clan's Business Activities," EIU Viewswire, 28 July 1997 (US Exhibit 14, pp. 154, 156).

[581] See, e.g., "Jakarta's Car Wars", Business Times (Singapore), 28 May 1996 (US Exhibit 14, pp. 46, 48); "Indonesia Draws More Criticism Over Car Plan, The Nikkei Weekly, 17 June 1996 (US Exhibit 14, pp. 80-81); "Bumpy Road Ahead for Motoring Plan", South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-133); and "Indonesia Company: Suharto Clan's Business Activities", EIU Viewswire, 28 July 1997 (US Exhibit 14, pp. 154, 156).

In other words, the party seeking an allowance must demonstrate the effect of a factor on price comparability. The last sentence of Article 2.4 states: "The authorities shall indicate to the parties in question what information is necessary to ensure a fair comparison and shall not impose an unreasonable burden of proof on those parties." Thus Article 2.4 appears to impose the burden of proof on the party seeking an allowance or an adjustment to normal value or export price, although the burden imposed cannot be an unreasonable one.

8.416 The United States cannot speak for the practice of all Members, but certainly the practice of the US authorities responsible for administering the US anti-dumping law is to impose the burden of proof on the party seeking an adjustment, whether the party be an exporter seeking an adjustment that will lower a dumping margin or a domestic party seeking an adjustment that will increase a dumping margin.

8.417 By the same token, an evenhanded application of Article 6.5 would be to impose the burden of proof on the party claiming the existence of any "other factor affecting price comparability". This avoids the imposition of the unreasonable burden of proving the negative.

8.418 The United States would also note that Article 6.5 refers to "due account being taken of "other factors". The ordinary meaning of "due" is "fitting or appropriate". As the United States has previously stated, it is unaware of any factors other than the subsidies provided by Indonesia that would account for the massive price undercutting reflected in sales of the Timor Kia Sephia. Also, as previously stated, even Indonesia's own data show that subsidies cause the price of the Timor Kia Sephia to be between US$7,200-9,100 lower than would otherwise be the case. AV/14, Attachment A-28, note 4.

8.419 It is submitted that even if it is assumed for purposes of argument that the United States bears the burden of taking "due" account of other factors, the United States has met its burden of establishing that no account for such factors is "due" in this case.

7. Additional EC rebuttals to Indonesia's responses to serious prejudice claims

(a) The subsidies received by PT TPN pursuant to Presidential Decree 42/96 have not been withdrawn

8.420 Indonesia’s first argument is based on the wrong premise that there are two different "programmes", each providing different subsidies. In reality, however, there is but a single National Car Programme based on Presidential Instruction 2/96. Presidential Decree 42/1996 does not introduce a new "programme". The sole purpose of Presidential Decree 42/1996 was, by its own words, to extend on a temporary basis to National Cars imported from Korea the "same treatment"[582] already granted in February 1996 to National Cars assembled in Indonesia.

8.421 Moreover, Indonesia’s first argument makes the fundamental error of confusing the measure granting a subsidy with the subsidy itself. A subsidy continues to exist - and, therefore, may be "withdrawn" or its adverse effects “removed” in the sense of Article 7.8 of the SCM Agreement - for as long as it continues to benefit the sale of goods by the recipient firm, even if the measure granting that subsidy has already expired.

8.422 In the present case, the permit given to PT TPN for importing 45.000 units of the Timor S-515 duty and tax free from Korea expired as of 30 June 1997. Yet, the subsidies received by PT

[582] See Article 1 of Presidential Decree 42/1996 in EC Exhibit A-13. The translation provided by Indonesia (Attachment 6) states that imported National Cars “will be treated equally ...”.

TPN pursuant to that authorization have not been "withdrawn". Sales of passenger cars by PT TPN after 30 June 1997 have continued to benefit from those subsidies and, as a result, to cause serious prejudice to the interests of the European Communities.

8.423 In this regard, the European Communities notes and agrees with the argument made by the United States to the effect that the subsidies granted under the one-year authorization to import cars from Korea duty and tax free are non-recurring subsidies and therefore should be allocated to future time periods.

8.424 Furthermore, even if the total amount of the subsidies had to be attributed to the passenger cars imported from Korea before 30 June 1997, it remains that more than 70 per cent of those cars had not been sold yet as of that date. In fact, it can be estimated that if sales of the Timor S-515 continue at the same pace as until now, the last Timor S-515 imported from Korea under Presidential Decree 42/1996 will not be sold until March 1999. This cannot be explained away simply as an "inventory overhang".

8.425 Indonesia does not address directly the evidence of serious prejudice submitted by the European Communities. Allegedly, because it need not do so given that the Timor S-515 is unlike any other passenger car and that, in addition, the so-called “June 1996 Programme” has already expired. In reality, because Indonesia cannot provide any evidence to rebut the EC claim, which is based on evidence supplied by Indonesia itself as part of its Annex V response.

(b) Indonesia's suggestion that the fact that the import duty and luxury tax benefits with respect to CBUs imported from Korea under the June 1996 programme will be reimbursed or not provided precludes a finding of serious prejudice is incorrect

8.426 According to Indonesia, all the benefits granted under the so-called June 1996 programme were already "provided" before 30 June 1996. The relevant question, therefore, is whether those benefits continue to have effects. As long as those benefits are not effectively and definitively reimbursed by PT TPN (increased with an appropriate amount of interest), it cannot be considered that the subsidies have ceased to produce effects.

8.427 The letter that Indonesia has submitted indicating that the Timors imported as CBUs from Korea do not meet legal requirements to receive National Car benefits is a letter from SUCOFINDO to the Indonesian Government, which contains the results of an audit conducted by SUCOFINDO. The European Communities understands that the Indonesian Government has not yet taken any formal decision ordering the reimbursement based on SUCOFINDO's audit. Moreover, assuming that such decision was taken, it is likely to be appealed by PT TPN. Even if that appeal was unsuccessful, it would still be possible for the Indonesian Government to "forgive" PT TPN's debt.

8.428 In sum, PT TPN has not yet reimbursed any of the unpaid taxes and duties and it is still uncertain whether it will be required to do so in the future. Thus, there is no reason to assume that the subsidies have ceased or will cease to cause serious prejudice. In those circumstances, the Panel is required to rule on this claim, like on all other claims included in its terms of reference.

(c) The subsidies granted under the National Car Programme for the assembly of passenger cars will continue to cause serious prejudice to the Community industry

8.429 The permit issued to PT TPN for importing Timor S-515 cars duty free and tax free from Korea expired on 30 June 1997. Nonetheless, the sales of those cars, together with the sales of subsidized cars assembled by PT TPN in Indonesia, will continue to cause serious prejudice to the Community interests in the foreseeable future.

8.430 As of 30 June 1997, the number of Timors S-515 imported duty free and tax free from Korea and not yet sold was 28,391. In comparison, the total demand for passenger cars during 1996 was 42,345 units. Thus, the number of Timors S-515 imported from Korea and not yet sold as of 30 June 1997 would have been sufficient to cover almost 70 per cent of the total Indonesian demand for passenger cars during the whole of 1996. As already noted, those cars will not be subject to the Sales Tax on Luxury Goods when they are sold.

8.431 From June 1997 and until May 1998, PT TPN will assemble the Timor S-515 at the Tambun Plant. According to Indonesia, this Plant has a production capacity of 3,000 cars per year and is currently producing at the rate of 1,000 cars per year.

8.432 As from May 1998, PT TPN will start producing the Timor S-515 at its own plant in Karawang. According to the investment permit approved by the BKPM, the Karawang Plant is designed to produce 120,000 cars per year, of which 80,000 sedans. In comparison, the forecast demand for passenger cars during 1998 and 1999 is 64,000 and 72,000, respectively.[583] Thus, Karawang Plant will have more than sufficient production capacity to supply 100 per cent of the Indonesian demand during the next two years.

8.433 According to the more conservative estimates now produced by the Indonesian authorities for the purposes of this dispute, the production capacity of Karawang Plant will be 63,000 units.[584] Though less than originally planned, this capacity will still be sufficient to cover almost 100 per cent of the expected demand for 1998.[585]

8.434 According to the same estimates, the actual output of Timors S-515 will be 6,000 units in 1998 and 35,000 units in 1999, of which 25,000 for sale on the Indonesian market.[586] This means that the Indonesian Government expects that, despite an unexplained very low rate of capacity utilization, in 1999 Karawang Plant will supply over 35 per cent of the forecast total sales in the Indonesian passenger car market. In other words, the Indonesian authorities are counting on a further 10 per cent increase in PT TPN's market share between now and 1999.

8.435 As shown above, the estimated subsidization rate (on sales value) of the cars assembled by PT TPN in Indonesia is lower than the corresponding rate for cars imported from Korea but still very substantial. This will enable PT TPN to continue to undercut significantly the prices of the Community cars. In fact, according to PT TPN's own estimates, the retail price for the cars assembled at Karawang Plant, will be virtually the same as the 1997 prices for the cars imported from Korea.[587]

8.436 The European Communities has established not only that the National Car Programme has caused serious prejudice but in addition that it will continue to do so in the foreseeable future. This claim is not to be confused with a claim of threat of serious prejudice. Since the National Car Programme has already caused serious prejudice, there is no need for the EC to show that it threatens to cause serious prejudice. The EC has submitted also a claim of threat of serious prejudice, but only in the alternative, i.e. in the eventuality that the Panel was to find that the National Car Programme has not caused actual serious prejudice. (See Section VIII.B.7.)

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[583] Data from DRI's report on "East Asian Automotive Growth Markets" included in AV/2, Annex 2.
[584] AV/3, Attachment A-28.
[585] Data from DRI's report on "East Asian Automotive Growth Markets" included inAV/2, Annex 2.
[586] AV/3, Attachment A-28.
[587] In AV/3, Attachment A-28, Indonesia has indicated that the estimated unit dealer price "with subsidy" for the Timors S-515 assembled at Karawang Plant during 1998 and 1999 will be US$14,927. This price is almost identical to PT TPN current prices. Thus, according to AV/3, Attachment A - 40/1, in March 1997 PT TPN's listed retail prices for the Timor S-515 ranged from US$13,535 to US$14,861.

8.437 The European Communities has shown that:

- As of 30 June 1997, the number of Timors S-515 imported duty and tax free from Korea and not yet sold was 28,391. As mentioned above, if sales of the Timor S-515 continue at the same pace as until now, it may be estimated that the last Timor S-515 imported from Korea will not be sold until March 1999.

- From May 1998, the Timor S-515 will be assembled at Karawang Plant. According to the investment permit issued by the Indonesian Government to PT TPN, this Plant has been designed to produce 80,000 sedans per year.

- According to Indonesia's Annex V response, the actual output of Timor S-515 at Karawang Plant will be 6,000 units in 1998 and 35,000 units in 1999, of which 25,000 for sale on the Indonesian market. In comparison, until September of this year, PT TPN sold 13,476 units. This means that PT TPN expects to increase its sales by almost 40 per cent between now and 1999.

- In its Annex V Response, Indonesia has admitted that the current prices for the Timor S-515, and consequently the level of price undercutting, will remain unchanged during 1998 and 1999.

8.438 Indonesia has not advanced any evidence whatsoever to rebut the above allegations. It could hardly do so, since they are all based on data provided by Indonesia itself in its Annex V Response.

8.439 The European Communities presents a rebuttal to the argument that the measure has expired and therefore is not relevant to the Panel's work in the context of its claims under Article I:1 of GATT 1994. (See Section VII.E.2) In addition, with respect to the implications, if any, of an eventual repayment by TPN of the benefits under the programme, the European Communities makes the following arguments:

8.440 According to Indonesia, all the benefits granted under the so-called June 1996 programme were already "provided" before 30 June 1996. The relevant questions, therefore, is whether those benefits continue to have effects. As long as those benefits are not effectively and definitively reimbursed by PT TPN (increased with an appropriate amount of interest), it cannot be considered that the subsidies have ceased to produce effects.

8.441 The letter submitted by Indonesia is a letter from SUCOFINDO to the Indonesian Government which contains the results of an audit conducted by SUCOFINDO. The European Communities understands that the Indonesian Government has not taken yet any formal decision ordering the reimbursement based on SUCOFINDO's audit. Moreover, assuming that such decision was taken, it is likely to be appealed by PT TPN. Even if that appeal was unsuccessful, it would still be possible for the Indonesian Government to "forgive" PT TPN's debt.

8.442 In sum, PT TPN has not reimbursed yet any of the unpaid taxes and duties and it is still uncertain whether it will be required to do so in the future. Thus, there is no reason to assume that the subsidies have ceased or will cease to cause serious prejudice. In those circumstances, the Panel is required to rule on the serious prejudice claim, like on all other claims included in its terms of reference.

8. Additional United States arguments concerning serious prejudice the government-directed $690 million loan

8.443 As demonstrated above, the tariff and tax subsidies provided under the National Motor Vehicle programme have caused serious prejudice to the interests of the United States. The government-directed $690 million loan to TPN exacerbated the serious prejudice that already existed at the time when the Government of Indonesia ordered the banks to provide the loan.

8.444 As a result of the concessional financing provided to TPN through the intervention of the Indonesian Government, TPN's costs of doing business will be reduced even further. This continued Government backing will ensure that TPN and its joint venture, Kia Timor, continue to enjoy a competitive advantage vis-a-vis their competitors in the Indonesian passenger car market, and that imports of passenger cars from US motor vehicle manufacturers will (a) continue to be displaced or impeded from the Indonesian market; and (b) will continue to experience significant price undercutting from the subsidized Timor Kia Sephia sedan.

9. Claims of threat of serious prejudice under the SCM Agreement

(a) Claim of the European Communities

8.445 The **European Communities** claims that, in the alternative, the subsidies granted under the National Car Programme to passenger cars pose a threat of serious prejudice to the Community interests. The following are the **European Communities'** arguments in support of this claim.

8.446 As demonstrated above, the subsidies granted under the National Car Programme have caused actual serious prejudice to the Community interests and will continue to do so in the foreseeable future.

8.447 Nonetheless, assuming *arguendo* that the Panel considered that the available evidence does not warrant a finding of actual serious prejudice, the facts discussed above in order to demonstrate that the subsidies in question will continue to cause serious prejudice to the Community industry are more than sufficient to conclude that the National Car Programme poses a threat of serious prejudice to the Community interests.

(b) Claim of the United States

8.448 The **United States** claims that the subsidies under the National Motor Vehicle Programme have caused a threat of serious prejudice to the interests of the United States within the meaning of Article 6 and 27 of the SCM Agreement. The following are the **United States** arguments in support of this claim:

(1) Claim as raised

8.449 The United States has demonstrated that the National Motor Vehicle programme already has resulted in serious prejudice insofar as passenger cars are concerned. However, these subsidies also threaten serious prejudice with respect to US exports of light commercial vehicles to the Indonesian market. As indicated above, Kia Timor plans to assemble its own version of the Kia Sportage, a light commercial vehicle, to be sold in Indonesia as the Timor J520i. As discussed below, the Timor Kia Sportage also will benefit from subsidies, and likely will have the same adverse effects on US light commercial vehicles as the Timor Kia Sephia had on US passenger cars.

8.450 By way of background, note 13 to Article 5© of the SCM Agreement provides that the term "serious prejudice" includes "threat of serious prejudice". Although the SCM Agreement does not

address in detail the elements of a threat of serious prejudice case, logically, the elements for such a case should be the same as for a serious prejudice case. The principal difference between the two types of cases is that in a serious prejudice case, all of the elements already exist, whereas in a threat of serious prejudice case, all of the elements need not have come to pass.

8.451 In this case, the United States has previously demonstrated that three of the four necessary elements already exist. The government-directed $690 million loan (1) constitutes a subsidy, (2) is specific, and (3) exceeds 5 per cent ad valorem. Because the ostensible purpose of this subsidy is to fund the construction of the Cikampek facility where the Timor Kia Sportage will be assembled, the loan confers a subsidy on the Sportage.[588]

8.452 In addition, the United States has shown that US light commercial vehicles imported and sold in Indonesia are "like" the Timor Kia Sportage. As set forth in Table 25, based on a comparison of specifications, the GM Opel Blazer is sufficiently similar to the Sportage to be considered a "like product".[589]

8.453 The only remaining question is what the effects will be of the Timor Kia Sportage once it is introduced into the Indonesian market some time next year. Based on the pricing strategy employed by TPN in connection with the Timor Kia Sephia, it is reasonable to assume that TPN will take advantage of the subsidies it receives from the Government to significantly undercut the prices of its competition within the meaning of Article 6.3©. As such, a threat of serious prejudice exists.

(2) Claim not pursued due to Panel's ruling on the admissibility of the $690 million government-directed loan

8.454 The United States claim of threat of serious prejudice was limited to the impact of the subsidized Sportage on light commercial vehicles of US manufacturers. The threat of serious prejudice claim was based on the related claim that the US$690 million government-directed loan to TPN (the purpose of which was to finance the construction of the Cikampek plant at which the Sportage will be assembled) constitutes an actionable subsidy. Because the Panel has dismissed the US claim regarding the loan, the United States is not currently pursuing its claim of threat of serious prejudice.

8.455 However, while the Panel has ruled that the US claims concerning the loan are inadmissible, the loan remains relevant to this case. *Cf., Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel, and Other Items*, WT/DS56/R, Report of the Panel issued 25 November 1997, para. 6.15. Indonesia asserted at the first meeting of the Panel that after TPN's start-up phase, the market will determine the winners and the losers, as it should." Indonesia's Statement to the Panel, page 2. This statement is simply contradicted by the fact that the Government of Indonesia ordered a consortium of banks to provide a $690 million loan to TPN on preferential terms. The loan is a subsidy, and, with a 10-year term, has a 10-year allocation period. In other words, TPN will be deemed to be receiving subsidies from the loan for the next ten years. The existence of the loan belies Indonesia's claim that, as of 1999, the "market" will determine the winners and the losers. Moreover, Indonesia's claim that the Government of Indonesia played no role in the provision of the loan is so at odds with the reported facts that it calls into question the credibility of other factual assertions made by the Government of Indonesia in this case.

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[588] To date, the Government of Indonesia has insisted that the Timor Kia Sportage will not be designated as a “national motor vehicle” and will not benefit from the tariff and tax subsidies under the National Motor Vehicle programme. Be that as it may, an issue remains as to whether the tariff and tax subsidies provided to the Sephia also provide benefits to the Sportage.

[589] The United States also believes that the Jeep Cherokee and Jeep Wrangler are “like” the Sportage.

(c) Response by Indonesia

8.456 **Indonesia** responds to the threat of serious prejudice claims raised by the European Communities and the United States by arguing that these complainants must demonstrate a threat of serious prejudice by positive evidence in accordance with the provisions of paragraphs 3 through 8 of Article 6. The following are **Indonesia's** arguments in this regard:

8.457 The specific threat allegations of the EC relate solely to the putative effects of the February 1996 component of the National Car Programme and the specific threat allegations of the United States relate solely to the putative effects of the August 1997 loan.[590] As discussed above, these allegations implicate the 5 per cent ad valorem standard of Article 6.1(a), as well as the generally available serious prejudice standards of Article 6.3. This does not, however, result in the application of different types of threat analyses to these different bases for actionability.

8.458 In this case, Article 27.8 operates to apply the general standards of Article 6.3 to any Article 6.1(a) allegations. As demonstrated below, complainants have failed to show by positive evidence, as they must under either Article 6.1(a) or 6.3, that their interests are threatened with serious prejudice.[591]

(1) The actual and alleged subsidies provided pursuant to the February 1996 National Car Programme or the August 1997 loan to TPN, respectively, do not threaten serious prejudice to European Communities or US interests

8.459 Paragraphs (a) and (c) of Article 6.3 apply to the European Communities and United States threat of serious prejudice allegations. Both paragraphs expressly focus on the effect of the subsidy at issue on a "like product" of another Member. This threshold concept significantly limits the scope of the effects analysis that is to be undertaken here. As discussed above, Indonesia disagrees with the complainants' like product arguments.

(a) Complainants' threat allegations are based on inappropriate like product analyses

8.460 The complainants' threat allegations are based on inappropriate like product analyses. The EC takes an unduly expansive approach, boldly asserting that all motor vehicles falling within the category of passenger cars, as defined in Indonesia's regulations, constitute a single category of like products. The United States, in contrast, takes an unduly restrictive approach, looking only at limited engine, transmission, brake and dimension data for the Sportage and the Opel Blazer.[592] As discussed

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[590] The EC speaks generally of the continued effects of the terminated June 1996 programme and of the "estimated subsidisation rate (on sales value) of the cars assembled by PT TPN in Indonesia" and the United States asserts generally that National Car Programme subsidies threaten serious prejudice to US exports of light commercial vehicles, but such generalized pleading fails to satisfy even the most rudimentary positive evidence or due process standards.

[591] Thus, although the US Annex IV calculations regarding the August 1997 loan are flawed in several critical respects, the Government needs not here address their validity and accuracy. Also, although not within the scope of their specific threat allegations, and thus not germane, the same holds true for the application by the US and the EC of the 5%/15% tests to the February and June 1996 aspects of the National Car Programme. The calculations relating to the June 1996 programme are moot because the programme has been terminated. Similarly, the calculations relating to the February 1996 programme are moot because the only evidence of actual serious prejudice that is adduced relates exclusively to the now-terminated June 1996 programme. Article 6.1(a) is not implicated by the February 1996 programme because, as demonstrated below, Complainants have failed to satisfy the evidentiary standard imposed by Article 27.8 with respect to threat of serious prejudice.

[592] Although not relevant, this errant approach also contaminates the like product analysis relied upon by the US with respect to passenger cars. The reliance of the US and, to a lesser extent, the EC on the

above, the Sportage is not (and will not be) a national car. Moreover, the application of customary like product criteria demonstrates the specious nature of each complainant's approach.

8.461 The end-use criterion offers no guidance here because widely dissimilar vehicles, such as buses, motorcycles, vans and cars, serve to transport people and carry cargo. Indeed, animals and human-drawn means of conveyance also serve these purposes.

8.462 With respect to cars, consumer's tastes and habits and the product's properties, nature and quality are inseparable. Contrary to the positions taken by the European Communities and the United States, the markets for passenger cars and light commercial vehicles are very highly differentiated. It is widely recognized that consumers consider numerous physical and non-physical characteristics in making their purchasing decisions: quality; reputation; price; resale value; ride and comfort; standard features; safety features; available options; exterior size; interior space; engine size and technology (e.g., horsepower, in-line/V configuration, valve design); fuel efficiency; etc.[593]

8.463 Finally, that with respect to tariff treatment, passenger cars are distinguished on the basis of total cylinder capacity and fuel type (gasoline versus diesel), with Harmonized Tariff System breakpoints occurring at 1000cc, 1500cc and 3000cc.[594] In this respect, it is especially important to note that the Timor is one of the few passenger cars sold in Indonesia with a cylinder capacity of less than 1500cc.[595]

8.464 In sum, although it may be difficult to determine appropriate like product categories for the purposes of this proceeding, it should be abundantly clear that the categories urged by the European Communities and the United States are not appropriate. This is especially so considering that a restrictive interpretation of that phrase is required here. The European Communities and the United States have not met their burden of proving that products are like and of establishing acceptable like product categories.[596] As further discussed below, their failure to adduce appropriate evidence on those bases results in their failure to affirmatively demonstrate, as they must, that their interests are threatened with serious prejudice through the effects of the February 1996 programme or the 1997 loan to TPN.

DRI/McGraw-Hill market segmentation categories is also misplaced. First, the DRI/McGraw-Hill categories pertain to the European, not the Indonesian, car market. See AV/2, at Annex 1, p. 284. Second, cars with the same nameplate often differ significantly from market to market. Finally, there is disagreement among industry authorities as to how to segment the market. For example, a US industry authority places the more-advanced US version of the Kia Sephia in a "Budget" category, wholly apart from the Escort, Neon, and any Opel Optima-equivalent GM model. See Indonesia Exhibit 12.

[593] Indeed, if all that mattered was a car's general market segment, we would not observe the very significant price spreads that exist between cars in the same segment. For example, as set forth by the United States in Table 31, the March 1997 list price for a Daewoo Nexia DOHC 1500cc was 43 million rupiah, while the list price for a Honda Civic 4-door, AKP 1600cc was nearly 75 million rupiah.

[594] See HTS Category 87.03. A number of countries also consider other factors (e.g., interior space; body type; number of cylinders; height) in further subdividing this category for statistical and other purposes.

[595] It is also noteworthy that two other vehicles fitting in the HTS 1000cc to 1500cc category (the Mazda MR-90 (1400cc) and the Ford Taxi (1300cc)), are sold at prices below those charged for the Timor. See AV/14, at Attachment U-22/1 at 3; AV/13, at Attachment 7.

[596] See generally Japan-Taxes on Alcoholic Beverages, WT/DS8/R (1 November 1996), Panel Report, at p. 117, para. 6.14 (complainants have burden of proof to show like product in Article III:2 dispute).

(b) Complainants have failed to demonstrate that the effects of the February 1996 Programme or the August 1997 loan to TPN threaten serious prejudice

(1) The threat of serious prejudice standard

8.465 As a threshold matter, it is important to emphasize that the threat of serious prejudice standard must be very exacting.[597] For example, unsubstantiated conjecture, speculation and assumptions certainly could not constitute the "positive evidence" called for by Article 27.8. Moreover, the temporal dimension is also critical, given the fluidity of the economic and business environments (on both macro and micro levels). Projections and forecasts may be carefully developed, but they are all too susceptible to revision. Thus, the more remote an item is in time, the less reliable it is as a current indicator of future developments. In sum, the threat alleged must be real and imminent, and the threat standard must be applied cautiously and judiciously, especially when the rights of a developing country Member are at stake.

(2) The EC assertions

8.466 The European Communities: (i) asserts that future sales of the national cars imported under the June 1996 programme will cause (unspecified) serious prejudice; (ii) implies that national cars assembled in Indonesia under the February 1996 programme will displace or impede European Communities imports; and (iii) argues that TPN will be able and currently plans to set retail prices that will undercut significantly the prices of EC cars in 1998 and 1999. None of these points, however, supports an affirmative threat finding.

8.467 As for the European Communities' specific assertions, any overhang in the inventory of imported national cars is irrelevant to this proceeding. These cars benefitted only from the June 1996 programme, which has terminated.

8.468 The EC's future displacement/impedance[598] and price undercutting[599] arguments are also without merit. As discussed above, the European Communities' failure to develop and adduce like produce-specific evidence strips their already sketchy threat argument of any validity.

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[597] Article 15.7 of the Subsidies Agreement, which pertains to the imposition of countervailing measures, is especially instructive in this respect. It provides, in pertinent part: "A determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent." Article 15.8, in turn, extends an additional cautionary note, even where the imposition of countervailing measures is warranted: "With respect to cases where injury is threatened by subsidized imports, the application of countervailing measures shall be considered and decided with special care."

Further guidance can be found in the pronouncements of various GATT bodies that have addressed the same threat concept in the anti-dumping context. The Report of the Group of Experts on "Anti-dumping and Countervailing Duties" states: "With respect to cases where material injury is *threatened* by dumped imports, the Group stressed that the application of anti-dumping measures had to be studied and decided with particular care." (13 May 1959) BISD 8S/145 (para. 16 at p. 150)(emphasis in original). The Committee on Anti-dumping Practices stated: "[A]nti-dumping relief based on the threat of injury must be confined to those cases where the conditions of trade clearly indicate that material injury will occur imminently if demonstrable trends in trade adverse to domestic industry continue, or if clearly foreseeable adverse events occur." Recommendation Concerning Determination of Threat of Material Injury (21 October 1985), BISD 32S/182 (para. 5 at p. 183). See also Korea-Anti-dumping Duties on Imports of Polyacetyl Resins from the United States (27 April 1993), BISD 40S/205 (para. 271 at p. 293).

[598] Although not applicable here, GATT panels addressing displacement/impedance claims have imposed a high burden of proof on the complainants, requiring them to provide clear and substantial evidence to

8.469 Nevertheless, the fact that the national car does not and will not compete significantly with EC cars is borne out by historical data. For example, notwithstanding the June 1996 programme, total Indonesian sales of passenger cars carrying European Communities brand names increased from 8,554 units in 1995 to 9,526 units in 1996.[600] Moreover, taking 1996 as the reference year, the breakdown of passenger car sales by brand was as follows: Mercedes-Benz, 3,829 units (40.2 per cent of total European Communities sales); BMW, 3,608 units (37.9 per cent); Peugeot, 1,401 units (14.7 per cent); and Volvo, 688 units (7.2 per cent).[601] It simply strains credulity to suggest that the small Timor is or will be a rival of Mercedes-Benz, BMW, Peugeot or Volvo. Thus, the historical data are yet another factor refuting the European Communities' assertions that the national car threatens to cause (or, in fact, has caused) serious prejudice to the European Communities' interests.

(3) The US claim

8.470 The United States threat allegation is one-dimensional, focusing solely on the putative effects the yet-to-be-built Sportage will have on sales of the GM Opel Blazer. The United States first asserts that the August 1997 loan to TPN constitutes a specific subsidy that exceeds 5 per cent ad valorem, and claims all that is in question is what the effects will be of the Sportage when it is introduced into the market.[602] The United States then simply asserts that "[b]ased on the pricing strategy employed by TPN in connection with the Timor Kia Sephia, it is reasonable to assume that TPN will take advantage of the subsidies it receives from the Government to significantly undercut the prices of its [the Sportage's] competition within the meaning of Article 6.3(c)." This is no more than unsubstantiated, unvarnished speculation that does not even remotely approach the type of positive evidence required by the SCM Agreement. This fact, coupled with the inadequate US like product analysis discussed above, is fatal to the threat allegation of the United States.

8.471 Further, Indonesia has informed the complainants and the Panel that it will not grant National Car status to a Sportage-type vehicle.[603]

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support their claims. See French Assistance to Exports of Wheat and Wheat Flour (21 November 1958), BISD 7S/46 (para. (c) at p. 55); EC—Refunds on Exports of Sugar (6 November 1979), BISD 26S/290 (para. 4.28 at pp. 314-315 and para. (f) at p. 319).

[599] Of course, Article 6.5 requires that any price comparisons shall be made at the same level of trade and at comparable times and that due account must be taken of any other factor affecting price comparability. Neither the EC nor the US has even attempted to account for "any other factors" in its analysis.

[600] See AV/14, at Attachment U-21/1-B (does not include Opel brand). Both the US and the EC include sales of Opel in their statistics and serious prejudice calculations. The Government asks that the Panel issue a ruling regarding which of the Complainants should be allowed to claim Opel sales as its own.

The EC understandably ignores its substantial increase in sales and instead focuses on market share, claiming that its market share increased "only marginally" from 1995 to 1996 and "fell dramatically" during the first half of 1997. Such market share developments are meaningless, however. As the EC itself states: "Since 1992 and until 1996, exports of passenger cars from the Community grew at a faster pace than demand, resulting in significant gains in terms of market share." This demonstrates that market share and demand growth are not necessarily correlated. Many extraneous factors influence this relationship, including changes in customer preferences.

[601] See AV/14, at Attachment U-21/1-B.

[602] Notwithstanding the US allegation, the loan is not a subsidy because its terms are fully consistent with commercial considerations and, in any case, the loan is outside the scope of this proceeding. The Government, however, needs not debate the point here because the alleged effects do not threaten serious prejudice to US interests.

[603] In this regard, Indonesia has submitted to the complainants and to the Panel a letter to TPN from the Ministry of Industry and Trade denying National Car benefits for a Sportage-type vehicle (No. 1039/DJ-ILMK/X/1997 of 21 October 1997, Indonesia Exhibit 42, Attachment E).

C. Claim under Article 28 of the SCM Agreement[604]

1. Claim raised by the United States

8.472 The **United States** claims that Indonesia has extended the scope of its tariff and tax subsidies in a manner inconsistent with Article 28.2 of the SCM Agreement. The following are the **United States'** arguments in support of this claim:

8.473 Indonesia first introduced its system of local content-based tariff and tax incentives in 1993, well before the date on which Indonesia signed the WTO Agreement and the date on which the WTO Agreement entered into force for Indonesia. However, after the WTO Agreement entered into force with respect to Indonesia, Indonesia extended the scope of those subsidies. In so doing, Indonesia violated Article 28.2 of the SCM Agreement.

8.474 To begin with, the tariff and tax incentives provided under the 1993 programme constitute so-called "import substitution" or "local content" subsidies within the meaning of Article 3.1(b) of the SCM Agreement. First, they satisfy the definition of a "subsidy" under Article 1.1 of the SCM Agreement, because they (a) result in government revenue that is foregone; and (b) they confer a benefit by lowering a firm's tariff and/or tax bill. Indeed, Indonesia has conceded that these measures constitute subsidies. Second, these subsidies fall within the purview of Article 3.1(b) because they are "contingent ... upon the use of domestic over imported goods". Thus, these subsidies are prohibited under Article 3 of the SCM Agreement.

8.475 Although Indonesia's tariff and tax incentives satisfy the definition of a prohibited subsidy, Indonesia is not currently subject to the prohibition of Article 3.1(b), because it is a developing country. Under Article 27.3 of the SCM Agreement, "[t]he prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years . . . from the date of entry into force of the Agreement."

8.476 However, while Indonesia is not currently subject to the provisions of Article 3.1(b) prohibiting the use of local content subsidies, Indonesia is subject to the provisions of Article 28.2 of the SCM Agreement that prohibit the extension of the scope of subsidy programmes that are inconsistent with the provisions of the SCM Agreement. Article 28, which is entitled "*Existing Programmes*," applies to "[s]ubsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement ... ."[605] Article 28.2 provides the following: "No Member shall extend the scope of any such programme, nor shall such a programme be renewed upon its expiry."

8.477 Indonesia has extended the scope of its pre-WTO tariff and tax subsidies in several ways. First, Decree No. 223/1995 revised the tariff subsidies previously available under Decree No. 645/1993 with respect to passenger car parts. The revision was as follows:

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[604] **Japan**, in its first submission alleged that Indonesia had violated Article 28 of the SCM Agreement. Japan did not, however, make a claim with respect to this alleged violation.

[605] Article 28.1, SCM Agreement.

Table 37

Passenger Car Parts

Local Content Rates	Import Duty Rates Decree No. 645/1993	Import Duty Rates Decree No. 223/1995
less than 20%	100%	65%
20% to 30%	80%	50%
more than 30% and up to 40%	60%	35%
more than 40% and up to 50%[606]	40%	20%
more than 50% and up to 60%[607]	40%	10%
more than 60%	0%	0%

8.478 As the above table demonstrates, in the case of tariff incentives for passenger car parts, by creating new gradations of local content rates (i.e., the 40-50 per cent range and the 50-60 per cent range), Decree No. 223/1995 extends the range of the incentives available. For example, in the case of an assembler of passenger cars with a local content of 41 per cent, under Decree No. 645/1993, that assembler would have had to boost its local content to over 60 per cent in order to obtain the incremental benefit of an import duty rate of 0 per cent. Because 60 per cent local content may be an unattainable goal, the assembler would have had no incentive to increase local content beyond 41 per cent.[608] However, under Decree No. 223/1995, the assembler need not pass the 60 per cent local content target in order to obtain an additional subsidy; instead, it can reduce its import duty rate from 20 per cent to 10 per cent by achieving a local content rate of only 51 per cent.

8.479 Decree No. 82/1996 also extends the scope of the pre-WTO tariff incentives. Under Decree No. 82/1996, the producer or assembler of a "national motor vehicle" pays no import duties on imported parts if the vehicle has a local content of 20 per cent in the first year or 40 per cent in the second year. In the case of passenger cars, a producer or assembler of a passenger car with a local content rate of 20 per cent would have paid import duties at the rate of 80 per cent under Decree No. 645/1993, while a producer or assembler of a car with a local content rate of 40 per cent would have paid import duties at the rate of 60 per cent. Clearly, the adjustment of import duty rates from 80 per cent and 60 per cent to zero constitutes an extension of the scope of the tariff subsidy.

8.480 Second, Indonesia has extended the scope of its pre-WTO tax incentives. Recall that under Decree No. 647/1993, passenger cars with a cylinder capacity of less than 1600cc and jeeps were subject to a preferential luxury tax rate of 20 per cent, provided that the local content of such vehicles exceeded 60 per cent. Thus, Decree No. 647/1993 constituted an import substitution subsidy with respect to jeeps and certain passenger cars, the amount of the subsidy being the difference between the

[606] Decree No. 645/1993 only had a category of 40% to 60%.
[607] Decree No. 645/1993 only had a category of 40% to 60%.
[608] Indeed, most observers consider the attainment of 60% local content for passenger cars as extremely problematic. "In Defence of the National Car Project," Business Times (Singapore), 10 June 1996 (US Exhibit 14, pp. 72-74).

preferential 20 per cent rate and the 35 per cent rate applicable to the corresponding vehicles with a local content of 60 per cent or less.

8.481 However, Regulation No. 36/1996 increased the amount of the tax subsidy and expanded the types of vehicles eligible for the subsidy. Under Regulation No. 36/1996, the luxury tax is reduced from 20 per cent to zero for motor vehicles with a local content in excess of 60 per cent. In addition, instead of limiting the tax subsidy to jeeps, Regulation No. 36/1996 makes the tax exemption applicable to all light commercial vehicles. Finally, a "national motor vehicle" is subject to a luxury tax of zero even though it is only required to have a local content of 20 per cent in the first year and 40 per cent in the second year.

8.482 In summary, that Indonesia has significantly extended the scope of its pre-WTO local content subsidies. In so doing, Indonesia has acted inconsistently with the provisions of Article 28.2 of the SCM Agreement.

8.483 Indonesia has not contested the United States' description of the precise manner in which Indonesia extended the scope of these subsidies. Indonesia makes two arguments in response: (1) because Article 27.3 does not contain an express standstill provision comparable to the standstill provision concerning export subsidies in Article 27.4, the drafters must have intended to preclude a standstill provision for local content subsidies; and (2) local content subsidies used by developing country Members are not "inconsistent with the provisions of the Agreement" within the meaning of Article 28.1. The United States submits that both arguments are wrong.

8.484 The first argument ignores the text of Article 28 and the drafting history of Article 27.3. With respect to the text, Article 28, by its terms, applies to all Members, not merely developed country Members. If the drafters had intended that Article 28 apply only to developed country Members, presumably they would have said so explicitly. Instead, the provisions of Article 28 apply to all Members, except as modified by other provisions of the Agreement. While Article 27.3 may modify the deadlines in Article 28.1(b) for eliminating subsidies that are inconsistent with the SCM Agreement, Article 27.3 does not modify the notification requirements of Article 28.1(a) or the standstill requirements of Article 28.2.

8.485 Concerning the drafting history of Article 27.3, in the discussion of the TRIMs Agreement, above, the United States has demonstrated how Article 27.3 was a last minute insertion into the text of the SCM Agreement that was intended to avoid prohibiting those local content subsidies that would be permitted under the transition provisions of the TRIMs Agreement. In making this last minute insertion, not all of the necessary conforming changes were made. For example, Article 27.7 of the SCM Agreement clarifies that the expedited procedures of Article 4 do not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. Article 27.7 should have been revised to include a reference to local content subsidies, but it was not, and one must read this omitted reference into Article 27.7, as all the parties in this case have done.

8.486 Therefore, the absence of a standstill provision in Article 27.3 comparable to the provision in Article 27.4 should not be interpreted as a deliberate decision by the drafters to exclude developing country local content subsidies from the general standstill obligation of Article 28.2. This is especially true in light of the comparable standstill provision in Article 5.4 of the TRIMs Agreement.

8.487 Turning to Indonesia's argument that local content subsidies of developing country Members are not "inconsistent with" the provisions of the SCM Agreement, "inconsistent with" simply is not a synonym for "prohibited by." If the drafters had intended that Article 28.1 encompass only subsidies that are prohibited by the SCM Agreement, they easily could have used the more precise phrase "prohibited by".

8.488 Finally, Indonesia's limited interpretation of Article 28 is inconsistent with the object and purpose of the SCM Agreement, which was to increase disciplines on the use of export and local content subsidies. Although the deadline for elimination of these subsidies is phased in for certain classes of economies, nowhere is there a provision in the SCM Agreement that expressly condones the unilateral extension of, or increase in, these types of subsidies during the phaseout period. To the contrary, the only two provisions in the SCM Agreement that expressly address this issue, Articles 27.4 and 28.2, condemn such extensions or increases.

8.489 In summary, Indonesia has failed to rebut the existence of a violation of Article 28.2 of the SCM Agreement.

2. Response of Indonesia

8.490 **Indonesia** responds to the claim under Article 28.2 of the SCM Agreement by arguing that Article 27.3 of the Agreement permits Indonesia, as a developing country, to maintain the subsidies granted under the 1993 and February 1996 Programmes. The following are **Indonesia's** arguments in this regard:.

(a) Indonesia is subject to Article 27.3

8.491 Entitlement to the subsidies granted under both the 1993 and February 1996 programmes and the level of the subsidy granted to each recipient depends upon the percentage of locally sourced parts and components in a particular car model or automotive component. Therefore, as noted, these subsidies technically fall within the scope of Article 3.1(b) as "subsidies contingent (whether solely or as one of several other conditions) upon the use of domestic over imported goods". As discussed above, Indonesia, as a developing country, is within the ambit of Article 27.3 of the Subsidies Agreement, and thus benefits from an exemption from the prohibition of Article 3.1(b) for a five year period.

(b) Article 27.3 does not preclude the introduction or expansion of domestic content subsidies

8.492 Article 27.3 does not preclude Indonesia, as a developing country, from introducing or expanding domestic content subsidies. The Article states in full:

> The prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years ... from the date of entry into force of the WTO Agreement.

Article 27.4 in contrast precludes a "developing country Member referred to in paragraph 2(b)" [of Article 27] (i.e., developing countries other than least-developed countries and countries with per capita GNP of less than $1,000 per annum) from "increas[ing] the level of its export subsidies."

8.493 Under the rules of treaty interpretation reflected in the Vienna Convention on the Law of Treaties, the inclusion of a prohibition on new or expanded export subsidies under Article 27.4 and the absence of any such prohibition as to domestic content subsidies under Article 27.3 can only mean that there is no such preclusion under Article 27.3. If the drafters of the Subsidies Agreement had intended to preclude the introduction or expansion of domestic content subsidies, they would have done so expressly in Article 27.3, as they did with respect to export subsidies in Article 27.4.

(c) The domestic content subsidy is not within the scope of Article 27.4 because it is not an "export" subsidy and Indonesia Is an Annex VII developing country

8.494 The relevant part of Article 27.4 reads as follows:

> 27.4 Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. (Emphasis added; footnote omitted.)

8.495 By its terms Article 27.4 applies only to "export" subsidies. "Export subsidies" is a term of art referring to subsidies defined in Article 3.1(a) of the Subsidies Agreement:

> subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I. (Footnotes omitted.)

The term does not include domestic content subsidies, which are defined separately in Article 3.1(b).

8.496 The distinction between export and domestic content subsidies is also explicit in Article 27, which sets out special and differential treatment for each of the two types of subsidies. Articles 27.2 and 27.4 deal with export (Article 3.1(a)) subsidies, while Article 27.3 deals with domestic content (Article 3.1(b)) subsidies. Accordingly, the condition set out in Article 27.4 does not apply to Indonesia's Article 3.1(b) domestic content subsidy.

8.497 Moreover, even if Article 27.4 did apply to domestic content subsidies (which, to repeat, it does not), the preclusion against increasing the level of subsidies would not apply to Indonesia. Article 27.4 applies to "[a]ny developing country Member referred to in paragraph 2(b) [of Article 27]." By its terms it does not apply to Article 27.2(a) developing country Members—those "referred to in Annex VII" of the Subsidies Agreement.[609] Indonesia is an Annex VII developing country Member - it is so listed in paragraph (b) of that Annex. For this reason as well, Indonesia's domestic content subsidy is not covered by the provisions of Article 27.4.

(d) The domestic content subsidy is not within the scope of Article 28.2 because it is not inconsistent with the SCM Agreement

8.498 Article 28.2, regarding extension of subsidy programmes, does not apply to Indonesia as a developing country. Article 28 is a phase-out provision for subsidy programmes that existed on the date the WTO entered into force and that were inconsistent with the Subsidies Agreement. The Article reads in full:

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[609] Complainants cannot successfully assert that the second sentence of Article 27.4 is not limited to developing country Members referred to in paragraph 2(b) of Article 27. The first sentence of Article 27.4 expressly refers to paragraph 2(b) countries. The third sentence refers to desired extension of the eight-year phase-out requirement for export subsidies. It can apply only to paragraph 2(b) countries because paragraph 2(a) (i.e., Annex VII) countries are not required to phase out their export subsidies within eight years. In addition, the second sentence itself speaks of eliminating export subsidies "within a period shorter than that provided for in this paragraph." (Emphasis added.) That period can only be the eight-year period for phase-out of export subsidies by paragraph 2(b) countries. Accordingly, analysis of the text of the second sentence of Article 27.4 and of its context confirm that the entirety of Article 27.4 applies only to paragraph 2(b) countries.

> 28.1 Subsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement shall be:
>
> (a) notified to the Committee not later than 90 days after the date of entry into force of the WTO Agreement for such Member; and
>
> (b) brought into conformity with the provisions of this Agreement within three years of the date of entry into force of the WTO Agreement for such Member and until then shall not be subject to Part II.
>
> 28.2 No Member shall extend the scope of any such programme, nor shall such a programme be renewed upon its expiry. (Emphasis added.)

8.499 Article 28.2 applies only to subsidy programmes which are inconsistent with the provisions of the Subsidies Agreement. Thus, the reference in Article 28.2 to "any such programme" can only refer to subsidy programmes which are "inconsistent" with the Agreement and must be "brought into conformity" with its provisions.

8.500 Indonesia's domestic content subsidies under the 1993 incentive programme were in effect on 1 January 1995 (the date the WTO Agreement entered into force) and were not then (and are not now) inconsistent with the provisions of the Subsidies Agreement. Only subsidies which are prohibited are inconsistent with the Subsidies Agreement. A Member shall "neither grant nor maintain" a prohibited subsidy (Article 3.2), and if one is found to exist, the Member is to "withdraw the subsidy without delay" (Article 4.7). "Actionable" subsidies (including subsidies by developing countries that are not prohibited by virtue of Article 27.3), on the other hand, are not inconsistent with the Agreement. They may be granted, but if they are subsequently determined to result in adverse effects to the interests of another member, "the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy" (Article 7.8). In other words, actionable subsidies are consistent with the Agreement, but any adverse trade effects caused by them must be remedied.

IX. ARTICLE X CLAIMS

A. Claims Under Article X:3(a) of GATT 1994

1. Claims Raised by Japan

9.1 **Japan** claims that the extended National Car Programme was administered in violation of Article X:3(a) of GATT 1994. The following are **Japan's** arguments in support of this claim:

> (a) Article X:3(a) of the GATT 1994 requires uniform, impartial and reasonable administration of regulations

9.2 Article X:3(a) of GATT 1994 establishes that:

> Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.

Laws, regulations, decisions and rulings under Article X:1 include, in particular, those pertaining "to rates of duty, taxes or other charges".

9.3 The Appellate Body report in the EC - Bananas III case emphasized that Article X:3(a) does "not apply to the laws, regulations, decisions and rulings themselves, but rather to the administration of those laws, regulations, decisions and rulings.".[610]

(b) Indonesia granted benefits to automobiles imported by PT Timor in violation of Article X:3(a) of GATT 1994

9.4 In June 1996, Indonesia authorized PT Timor to import automobiles duty free in accordance with the provisions of Presidential Decree No. 42, although the counter-purchase requirement, which is clearly set out in the Decree of the Minister of Trade and Industry No. 142/MPP/Kep/6/1996[611] ,was obviously not met. The Indonesian trade statistics show that it is quite unlikely that TPN and Kia have met the 25% counter-purchase requirement, which is clearly set forth in the governmental decree.[612] Following this authorization, almost 40,000 automobiles were imported duty free, and sales of those automobiles were also exempted from the luxury tax as discussed. These facts constitute violations of Article X:3(a) of GATT 1994, for the following reasons.

9.5 First, Presidential Decree No.42/1996[613] and the Decree of the Minister of Trade and Industry No.142/MPP/Kep/6/1996 fall within the scope of Article X:1 of GATT 1994, since they are obviously regulations pertaining "to rates of duty, taxes or other charges".

9.6 Second, Indonesia granted authorization to PT Timor, resulting in exemptions from duties and the luxury tax, clearly in violation of the Presidential Decree No. 42 and the Decree of the Minister of Trade and Industry No.142/MPP/Kep/6/1996. In other words, Indonesia administered its regulations in a partial and unreasonable manner.

9.7 Therefore, Indonesia granted benefits to automobiles imported by PT Timor in violation of Article X:3(a) of GATT 1994.

2. Response of Indonesia

9.8 **Indonesia** argues that Japan's contention that the provision of "Pioneer Status" to TPN violated Article X:3(a) of GATT 1994 Is Incorrect. The following are **Indonesia's** arguments in this regard.

(a) Japan's contention that the provision of "Pioneer Status" to TPN violated Article X:3(a) of GATT 1994 is incorrect

9.9 Japan erroneously claims that Indonesia has acted inconsistently with the obligations of Article X:3(a) of the General Agreement to administer laws, regulations, decisions and rulings in a uniform, impartial and reasonable manner. Indonesia has not violated Article X:3(a).

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[610] Report of the Appellate Body on EC - Bananas III, para. 200.

[611] Decree of the Minister of Trade and Industry No.142/MPP/Kep/1996 (Japan Exhibit 43).

[612] During the period from January 1996-December 1996, the total amount of automotive parts and components exported from Indonesia to Korea was $5,777,843, which includes not only parts and components for "Sedan/S515-1500cc", but also for other models produced by Kia Motors and for vehicles produced by other Korean companies (see Japan Exhibit 50). On the other hand, the value of the National Cars imported from Kia Motors during the period from June 1996 through December 1996 was $131,242,800 (see Japan Exhibits 30 and 31). Accordingly, it is quite obvious that, as far as the period from June 1996 through December 1996 is concerned, the value of the counter-purchase by Kia could never amount to 25 per cent of the import value of the National Cars (i.e. $32,810,700).

[613] Presidential Decree No.42/1996 (Japan Exhibit 9).

9.10 First, as discussed in the context of GATT Article I (See Section VII.D), the June 1996 programme expired, as scheduled, on June 30 1997, and will not be renewed. Since the programme and the authority under which it was granted have terminated, there is no basis for an affirmative determination by the Panel.

9.11 Second, TPN was designated to build and produce a national car in Decision of the State Minister for the Mobilization of Investment Funds No. 02/SK/1996 (5 March 1996).[614] The decision was based on:

- TPN's request to be selected to build a car (TPN Letter No. 071/PD/TPN/II/96 (28 February 1996))[615];

- TPN's obtaining domestic investment approval (No. 607/I/PMDN/1995 (9 November 1995))[616] ; and

- TPN's fulfillment of all the criteria and requirements to be designated to build a national car as set out in Decree of the State Minister for Mobilization of Investment Funds No. 1/SK/1996 (27 February 1996))[617] ,which in turn implements Instruction of the President No. 2/1996 (19 February 1996).[618]

9.12 Like Kia, any Japanese company could have sought to participate in the National Car Programme. None have done so. If they had, they would have been judged by the same criteria applied to TPN (those of Instruction of the President No. 2/1996 and the regulations and decrees implementing the Instruction). The programme would have been administered in a uniform, impartial and reasonable manner. Accordingly, no basis exists for Japan's contention that Indonesia acted inconsistently with the obligations of Article X:3(a) of the General Agreement.

(b) Indonesia has complied fully with the letter and the spirit of Article X, which, in any case, does not establish substantive obligations

9.13 Indonesia has administered the laws, decrees, regulations and decisions regarding the National Car Programme in a uniform, impartial manner, in accordance with Article X:3 of GATT 1994. Japan nonetheless insists that its manufacturers still do not understand the subsidies and Indonesia's administration of them. Extraordinary. Japan’s producers understand them well enough to have increased their combined share of all of Indonesia’s passenger car markets, including the market in which the Timor competes, by over 40 per cent. Such growth is unprecedented. Moreover, Japan’s car makers accomplished this by outcompeting the European Communities and United States manufacturers whose market share they acquired, and who, presumably, do understand the subsidies, insofar as neither the United States nor the European Communities has seen fit to pretend ignorance.

9.14 Finally, Japan’s rebuttal is nothing more than a description of the housekeeping related to a terminated measure. The description demonstrates nothing partial, not uniform or unreasonable. The Government cannot understand why Japan insists on continuing to advance an obviously flawed claim under Article X.

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[614] See Indonesia Exhibit 5.
[615] See Indonesia Exhibit 14.
[616] See Indonesia Exhibit 15.
[617] See Indonesia Exhibit 4.
[618] See Indonesia Exhibit 1.

(c) The Government of Indonesia did not establish the National Car Programme for the sole benefit of TPN

9.15 Much of Japan's Article X claim is based on its erroneous and unsupported assertion that the National Car Programme was created solely for the benefit of TPN. As the Government already has demonstrated, this is assertion is false. The programme was created to benefit Indonesia and was made available to any qualifying company. TPN was chosen on the basis of the strength of its proposal. In particular, it was found that TPN's proposal to produce the "Timor" S515 car using technology from Kia Motors of South Korea met the requirements set forth in Decree of the Minister of Industry and Trade No. 31/1996.

(d) The Government of Indonesia is addressing properly the issue of whether TPN has complied with the relevant decrees; in any case, this is a matter of internal enforcement of Indonesian law, not of compliance with Article X of GATT 1994

9.16 Japan also purposefully conflates the terms and relationships among the Decrees with their enforcement, in a vain attempt to further distort Indonesia's conduct. In this regard, Indonesia noted in its Second Submission that it was examining whether TPN had complied with the decrees, and that if the Government found that TPN had not complied, it would take appropriate action as provided for in the decrees.[619] Indonesia subsequently submitted a letter containing the results of this examination, which indicated that TPN had not fulfilled the requirements of the decrees. Accordingly, the Minister of Finance would instruct the Director-General of Customs to demand payment by TPN of the import duties and luxury sales tax due by virtue of TPN's failure to satisfy the criteria of the National Car programme for the first year.

3. Rebuttal Arguments made by Japan

9.17 The following are **Japan's** rebuttal arguments to Indonesia's responses to the claims raised under Article X:3(a) of GATT 1994:

9.18 The Government of Indonesia, in granting benefits under the National Car Programme to a company that does not meet its own regulatory requirements, violates GATT Article X:3(a). Japan has specifically stated that Indonesian trade data indicates that the 25 per cent counter-purchase requirement was not satisfied.

9.19 Indonesia did not make any meaningful response to Japan's arguments. Instead, it stated irrelevantly that "[PT Timor] was designated to build and produce a national car in Decision of the State Minister for the Mobilization of Investment Funds No.02/SK/1996" and that "[l]ike Kia, any Japanese company could have sought to participate in the National Car Programme." It is obvious that neither of these points addresses in any way the Article X:3 violations established by the Government of Japan.

9.20 Indonesia only tries to evade the real issue, alleging, for example, that "Japan ... purposefully conflates the ... Decrees with their enforcement". However, the obligation of GATT Article X:3(a) specifically concerns the administration or enforcement of regulations. Japan cannot fathom why Indonesia would believe that the manner in which it enforces the National Car Programme is not an issue for GATT Article X:3(a).

9.21 Moreover, Indonesia has acknowledged that "preliminary data suggests" that Japan is correct in arguing that PT Timor did not meet the National Car Programme's requirements. Indonesia also

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[619] See Indonesia Exhibit 43 at p. 3.

acknowledged that nonetheless it failed to complete a compliance audit, although the June 1996 Programme allegedly expired more than five months ago. Nor has Indonesia asked PT Timor to return the benefits or presented a schedule on when the audit will be completed. The Government of Japan thus concludes that the delay in auditing is another clear indication of the Government of Indonesia's unreasonable administration of the National Car Programme, and also itself constitutes a violation of GATT Article X:3(a). [620]

9.22 Indonesia essentially admitted that it granted benefits to TPN without considering its own regulations. To be eligible for benefits under the June 1996 Programme, Presidential Decree No. 42 requires that National Cars from Korea must be made by Indonesian workers and must fulfil the 25% counter-purchase requirement. However, Indonesia states in its answers to Japan's questions, with regard to the first requirement, that the "Government currently is verifying the data". And more strikingly, with regard to the second requirement, the Indonesian Government informed Japan just one day before the Second Panel Meeting of its own verification on 9 January 1998 which confirmed that TPN has not met that requirement. Therefore, it is clear that Indonesia granted authorization to TPN without reviewing its compliance, or even the plausibility of compliance, with the requirements.

9.23 Finally, the Government of Japan notes that it requires a considerable stretch of the imagination to regard 40,000 automobiles as being produced "by Indonesian workers" when allegedly only 100 Indonesian nationals have been sent to Korea and they were sent as "trainees" at that. Furthermore, the press reported that a member of the Indonesian Parliament, who visited Korea in August 1996, found only three Indonesian workers at Kia.[621]

B. Claims under Article X:1 of GATT 1994

1. Claims Raised by Japan

9.24 **Japan** claims that the extended National Car Programme also violates Article X:1 of GATT 1994, which requires publication of trade regulations. The following are **Japan's** argument in support of this claim:

9.25 Article X:1 of GATT 1994 establishes that:

> Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining ... to rates of duty, taxes or other charges ... shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. ...

9.26 Indonesia has never clearly set out the requirements for the Imported National Cars, and also administered the relevant regulations partially and unreasonably. The lack of clarity is most striking with respect to Decree of the Minister of Industry and Trade No.31/MPP/SK/2/1996, issued in February 1996, including the requirement that National Cars be "domestically produced" and local content requirements [622], and also with respect to the meaning of "by Indonesian personnel" under Presidential Decree No.42/1996.[623] Indonesia not only failed to make the requirements clear in the

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[620] As indicated above and in Section X, **Indonesia** has submitted to the Panel a letter concerning the results of the audit (Indonesia Exhibit 47).

[621] Jakarta Post, "Kia Motors lacks Indonesian staff: House member" (30 January 1997) (Japan Exhibit 73), Jakarta Post, "Timor sends only 100 supervisors to Kia plant: Tunky" (31 January 1997) (Japan Exhibit 74), Far Eastern Economic Review, "The Timor Gap" (27 February 1997) (Japan Exhibit 75).

[622] Decree of the Minister of Industry and Trade No.31/MPP/SK/2/1996 (Japan Exhibit 28).

[623] Presidential Decree No.42/1996 (Japan Exhibit 9).

published regulations, but even failed to clearly explain the requirements during the consultations with Japan.

9.27 In particular, Indonesia has made clear that the conditions stipulated in the Decree of the Minister of Industry and Trade No. 31/1996 also must be also met, in addition to the conditions of Decree 42/1996.[624] However, Imported National Cars obviously can never meet the conditions set out in Decree 31/1996, in particular paragraph a of Article 1, which requires them to be "domestically produced by using facilities owned by national industrial companies or Indonesian statutory bodies with total shares belonging to Indonesian citizens." (Emphasis added.)

9.28 Second, regarding "the local content requirements as stipulated by the Minister of Industry and Trade" in Article 1 of Presidential Decree No.42/1996, the Government of Indonesia has stated[625] that they correspond to those stipulated in Article 3 of the Decree of the Ministry of Industry and Trade No.31/MPP/SK/2/1996 (i.e., "at the end of the first year, they shall reach the local content rate of more than 20 per cent"). However, the Government of Indonesia further stated that "satisfaction of the 25 per cent counter-purchase requirement [as set out in the Decree of the Minister of Trade and Industry No.142/MPP/Kep/6/1996] will be treated as equivalent to achieving 20 per cent local content," and PT Timor "should export and Kia Motors should purchase automotive parts and components amounting to 25 per cent of the C&F value of imported cars in the one-year period."[626] Accordingly, the Government of Indonesia seems to indicate that imported automobiles are treated as satisfying "local content requirements," as long as the 25 per cent counter-purchase requirement is met by its producer, even if the producer does not use any of such parts and components, imported from Indonesia, to assemble the automobiles for export to Indonesia, without regard to Presidential Decree No.42/1996.

9.29 Third, Article 1 of Presidential Decree No.42/1996 requires that the National Cars be produced "by Indonesian personnel," but the Government of Indonesia has not provided any explanation about what extent of participation by Indonesian workers is necessary to meet the requirement.[627] In this connection, the Government of Indonesia has stated only that PT Timor "reported that, through the end of October 1996, 100 workers had been dispatched to Korea. The workers participate in production as trainees."[628]

9.30 As explained above, Presidential Decree No.42/1996 and its implementing regulations fall within the scope of Article X:1. Accordingly, it should be concluded that Indonesia has not published all the regulations necessary to make the requirements sufficiently clear, or that it has at least not published its regulations "in such a manner as to enable governments and traders to become acquainted with them," either of which constitutes a violation of Article X:1 of GATT 1994.

9.31 In addition, Indonesia also has ignored its obligation to publish trade regulations "promptly". Most of the regulations related to the National Car Programme, including Presidential Instruction

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[624] Japanese Questionnaire regarding the Indonesian National Car Programme (Japan Exhibit 44), Question No.9; Indonesia's Answer to Questions Submitted by Japan (Japan Exhibit 45), Answer No.9. See also Additional Questions from the Government of Japan concerning Indonesian Automobile Programme (Japan Exhibit 46), Questions Nos.IV.3 and IV.4; Answer of the Republic of Indonesia to Additional Questions submitted by the Government of Japan (Japan Exhibit 47) Answers Nos.IV.3. and IV.4.

[625] Id., at Question and Answer No.12 between Japan and Indonesia (Japan Exhibits 44 and 45).

[626] Id., at Questions and Answers No.13, 22 and 23 between Japan and Indonesia (Japan Exhibits 44 and 45).

[627] Question and Answer No.9. between Japan and Indonesia (Japan Exhibits 44 and 45); see also additional question and answer No.IV.5. between Japan and Indonesia (Japan Exhibits 46 and 47).

[628] Question and Answer No.4. between Japan and Indonesia (Japan Exhibits 44 and 45); see also additional Question and Answer No.IV.2. between Japan and Indonesia (Japan Exhibits 46 and 47).

No.2/1996[629] and Presidential Decree No. 42/1996[630] ,are enforced as of the date of issuance, and there was no prior public notification regarding the new regulations before the date of issuance. However, these regulations deeply affect exporters and investors, and it was necessary for the companies to get the relevant information well in advance in order to adapt to the new regulations, for example, in order to get benefits after meeting stipulated requirements. This reinforces the conclusion that Indonesia violated its obligations under GATT Article X:1.

2. Indonesia's Response to the Claim under Article X:1

9.32 In response to the claim raised under Article X:1, Indonesia argues that Japan's contention that Indonesian regulations were not published promptly as required by Article X:1 of GATT 1994 is erroneous. The following are Indonesia's arguments in this regard:

9.33 Japan erroneously contends that Indoneais did not clearly set out the requirements for the June 1996 programme and that this violates the publication requirement of GATT Article X:1. Contrary to Japan's assertion, Decree of the Minister of Industry and Trade No. 31/MPP/SK/2/1996, dated 19 February 1996[631] ,and all other decrees relevant to the June 1996 programme set out fully the requirements and conditions of that programme.

9.34 Even if that were not the case, though, there would be no violation of Article X:1. By its terms, the objectives of this Article are limited to (1) prompt publication, (2) "in such a manner as to enable governments and traders to become acquainted with them." As required by Indonesian law, all regulations and decrees are published in the State Gazette promptly after their promulgation. This official, readily accessible publication fully satisfies the procedural requirement of enabling governments and traders to become acquainted with regulations and decrees. Article X:1 is a transparency requirement, not a substantive obligation to meet one country's subjective, substantive standard as to whether another country's regulation is "clear".

9.35 Japan also erroneously claims that Article X:1 requires publication of official documents prior to their effective date. There is no such requirement. Indeed, the words "shall be promptly published" clearly envision publication after entry into force.

9.36 For these reasons there is no basis for Japan's contention that Indonesia did not act in conformity with Article X:1 of the General Agreement.

9.37 Responding to Japan's arguments and questions, Indonesia stated that Decree No. 31 is irrelevant to the June 1996 Programme.[632]

3. Rebuttal Arguments made by Japan

9.38 **Japan** makes the following rebuttals arguments to Indonesia's responses to the claim raised under Article X:1:

9.39 The Government of Indonesia, in not publishing its measures promptly and "in such a manner as to enable governments and traders to become acquainted with them", violates GATT Article X:1. As demonstrated, the Government of Japan, as well as Japanese traders, still cannot know several

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[629] Presidential Instruction No.2/1996 (Japan Exhibit 8).
[630] Presidential Decree No.42/1996 (Japan Exhibit 9).
[631] See Indonesia Exhibit 2.
[632] See Indonesia Exhibit 43, question 1.

important requirements under the June 1996 Programme, for example, what the term "produced by Indonesian workers" exactly means.

9.40 Indonesia's First Submission does not make any meaningful argument in response. Rather, it simply argues that:

(i) GATT "Article X:1 is a transparency requirement, not a substantive obligation to meet one country's subjective, substantive standard as to whether another country's regulation is 'clear' "; and

(ii) "all regulations and decrees are published in the State Gazette promptly after their promulgation".

9.41 Indonesia's defences cannot prevail, however, because they are inconsistent with the text of Article X:1. Several important measures by Indonesian government pertaining to require merits on imports were not published "in such a manner as to enable governments and traders to become acquainted with them".

9.42 Japan has identified the specific points that need clarification or further elaboration so as "to enable governments and traders to become acquainted with" the National Car Programme, but Indonesia has not addressed these issues. Thus, critical aspects of the National Car Programme remain unknowable. It must be stressed, however, that belated clarification at this stage would not be "prompt" any more and thus could not cure the insufficiency of the publication at an earlier stage.

9.43 In particular, Indonesia confirmed that it still cannot explain the meaning of the requirement of Presidential Decree No. 42 that National Cars imported from Korea must be "made ... by Indonesian workers". Japan asked whether this means that imported National Cars must be made exclusively by Indonesian workers or, if not, what percentage of participation is required. Even at this very late stage, however, Indonesia could not answer such a basic question.

9.44 Furthermore, the discussion at the first Panel meeting revealed some additional facts which constitute another violation of GATT Article X:1. At the first Panel meeting, the European Communities asked: (i) where is the decision of the Minister of Industry and Trade granting Pioneer status to PT Timor, and (ii) where is the decision granting National Car status to the Timor S-515? The Government of Indonesia: (i) in responding to the first question, circulated Decree of the Director General for Metal, Machinery and Chemical Industries No.002/SK/DJ-ILMK/II/1996 of 27 February 1996, and (ii) as to the second question, responded that there existed a letter (No. 1039/DJ-ILMK/X/1997 of 21 October 1997) and indicated that it would submit an English translation. However, the Government of Japan had never seen these documents in any publication accessible before the meeting in December 1997. In other words, these regulations were not published promptly in such a manner as to enable the Government of Japan to become acquainted with them.

9.45 Therefore, the Government of Japan submits, in addition to its argument that the Government of Indonesia did not comply with GATT Article X:1 with respect to the June 1996 Programme, that it also violated Article X:1 in connection with the February 1996 Programme.

X. ADDITIONAL ARGUMENTS REGARDING WHETHER THE JUNE 1996 PROGRAMME IS AN EXPIRED MEASURE, AND THE IMPLICATIONS IF SO

A. Arguments of Indonesia

10.1 **Indonesia** argues, in responding to all of the claims pertaining to the June 1996 programme that this programme has expired, and therefore is not relevant to the work of the Panel. Indonesia further argues that TPN will be required by law to repay all benefits received under the programme, because the counterpurchase requirements of the programme were not met. In support of this argument, Indonesia submitted a letter containing the results of an audit of TPN's compliance with these requirements. **Indonesia's** arguments in this regard are as follows:

10.2 The exemptions once granted are now being removed. The benefits conferred by the subsidy (duties and luxury taxes) having been removed, the subsidy no longer exists and all arguments relating to the June 1996 measures should be ignored by the Panel.

10.3 Also, with respect to claims under Article I of the General Agreement, complainants argued that the June 1996 measures were still in effect because the luxury tax would not be foregone on the unsold cars until they were sold. This is not correct. The tax is due when the duties are due and then the consumer reimburses the company at the time of sale (TPN, of course, was exempt from this requirement). Secondly, TPN failed the Sucofindo audit and, thus, none of the remaining cars will receive the luxury tax exemption. So, even accepting Complainants' position, the June 1996 measures have terminated. Thus, the Panel should reject Complainants' Article I arguments.

10.4 **Indonesia** further argued, in response to a question from the panel, as follows:

1. Enforcement Procedures

10.5 The results of the audit performed by Sucofindo have been provided to the Minister of Industry and Trade. He will review the report, then will notify the Minister of Finance of TPN's failure.

10.6 The Minister of Finance will then instruct the Director-General of Customs to take appropriate action. This instruction will be forwarded to the District Office of the port of entry through which the Timor's were imported, and that Office will issue a letter to TPN demanding payment of the customs import duties and luxury sales tax due by virtue of TPN's failure to satisfy the criteria of the National Car Programme for the first year.

10.7 TPN will have 30 days to respond to this demand. Within that period it may either pay the amount due or file a protest with the Director-General of Customs. If it does not respond within 30 days, the District Office will send a second letter demanding payment within 14 days. If TPN does not respond, action will be taken to collect the amount demanded.

10.8 If TPN files a protest with the Director-General, he will render a decision whether to uphold, reject or modify the decision of the District Office within 60 days.

10.9 If the Director-General upholds the District Office, TPN must pay the amount due within 60 days or petition for review by the Tax Dispute Settlement Body. The decision of this independent review authority is binding. TPN would be required to pay the duties and luxury tax amounts determined to be due before it would be eligible to appeal to the Body. The payment is required to be in cash.

10.10 As required by Article 38 of the Customs Law, payment by TPN must, in addition to the principal due, include interest at the statutory rate of 2 per cent per month beginning with the date of the letter from the District Office demanding payment. (This is a severe penalty. As noted by the US at paragraph 91 of its First Submission and in the Ford/GM letter (US Exhibit 38), the historical Indonesian CPI increase is 8 to 10 per cent per year. (This, rather than temporary, aberrational short-term interest rates caused by a short-term currency depreciation, should be the benchmark.)

2. Effect of Non-Fulfilment of Conditions for the First Year of the Programme

10.11 Decree of the Minister of Finance No. 82/KMK.01/1996 provides:

> If the obligation to fulfil the local content levels for national automotive industrial companies as determined by the Minister of Industry and Trade at a certain stage is not met, the national automotive industrial enterprise concerned shall pay the import levies owing at the relevant stage before being allowed to continue enjoying the facilities referred to in paragraph (2).

10.12 As provided in this Decree, the benefits of exemption from customs duties and luxury sales tax will be suspended once it is "determined" that TPN has not met the requirements of the National Car Programme for the first year. This will occur 30 days after the District Office demands TPN to pay the customs import duties and luxury sales tax. From that time until such time as TPN pays the duties and luxury sales tax determined to be due, it will not be entitled to release CKD's or parts from customs control unless it pays the duties and taxes normally owing in cash. Once it pays this amount, it will resume entitlement to the exemption.

B. Arguments of the United States

10.13 The **United States** presents a rebuttal to the argument that the measure has expired and therefore is not relevant to the Panel's work in the context of its claims under Article I:1 of GATT 1994. (See Section VII.E.3) In addition, with respect to the implications, if any of an eventual repayment by TPN of the benefits under the programme, the **United States** makes the following arguments:

10.14 As a factual matter it simply is not established that the tariff and tax benefits conferred on TPN under Decree No. 42/96 ever will be reimbursed. As the discussion during the question and answer period at the 13 January session made clear, it will take some time before it is established that TPN is even required to reimburse the Government of Indonesia (GOI). First, the relevant GOI authorities must issue a bill to TPN, an action which apparently has yet to be done and for which there apparently is no set deadline. According to Indonesia, this will not happen until the audit report is first reviewed by the Minister of Industry and Trade, who then refers the matter to the Minister of Finance.

10.15 The issuance of a bill then triggers a 30-day period in which TPN can file an administrative appeal with the Director General of Customs. Once this is done, the Director General then has 60 days in which to rule on the appeal. Thereafter, assuming the Director General denies TPN's appeal, TPN has 60 days within which to initiate proceedings before the Indonesian Tax Dispute Settlement Office. Indonesia did not answer the US question regarding the typical duration of this last process, although Indonesia did aver that there are no further appeals permitted from decisions of the Tax Dispute Settlement Office.

10.16 Moreover, a wholly separate question is whether, at the end of what appears to be a lengthy process, the money owed actually will be reimbursed to the GOI. Bear in mind that as of the time this Panel got underway, the amount owed in import duties alone was in excess of **US$736 million,** and

this does not include the amounts owed in unpaid luxury taxes. It also does not include interest, which, according to the Indonesia consists of 2 per cent a month, notwithstanding that Indonesia appears to have entered into a period of hyperinflation. TPN already has taken out a $690 million loan (although only a portion of the loan has been drawn down) that it was able to obtain only due to the direct intervention of GOI officials at the highest level. How is TPN going to repay such sums? If TPN cannot repay these amounts, will the GOI waive repayment? At the second meeting of the Panel, Indonesia confirmed that the GOI, like most governments, has the authority to waive repayment of duties and taxes owed. Moreover, putting aside any statutory or regulatory waiver authority, one must assume that because the subsidies were granted pursuant to Presidential Decree, their repayment also can be waived pursuant to Presidential Decree.

10.17 The fact of the matter is that it may take years before this issue is sorted out, and it would be unfair to the United States to defer the Panel's issuance of its report before the issue is resolved. At this point, the United States believes that the proper approach is to treat the subsidies as if they are not subject to repayment. TPN has had the benefit of the subsidies since Decree No. 42/96 became operational, it still has the subsidies, and it has priced the Timor Kia Sephia and caused serious prejudice to the interests of the United States by means of those subsidies. If TPN ultimately has to repay the subsidies, then Indonesia will be in the convenient position of having complied with what we hope will be the Panel's recommendation that Indonesia withdraw this particular subsidy. If TPN does not repay the subsidies, then that is something that can be dealt with at the implementation stage of this dispute. It would be truly perverse, however, to allow the subsidies bestowed under Decree No. 42/96 to escape scrutiny due to the conveniently timed announcement (the day before the second meeting of the Panel) of the results of an audit, an audit that apparently only triggers, rather than ends, a lengthy domestic internal process.

XI. CLAIMS RAISED UNDER THE TRIPS AGREEMENT

A. Claims raised by the United States

11.1 The **United States** claims that the grant of "National Motor Vehicle" benefits only to motor vehicles bearing a unique Indonesian trademark owned by Indonesian nationals discriminates against foreign-owned trademarks and their owners and is inconsistent with Articles 3, 20 and 65 of the TRIPS Agreement. The following are the **United States'** arguments in support of these claims:

11.2 A distinguishing feature of the National Motor Vehicle programme is the requirement that, in order to receive the benefits of that programme, the "national motor vehicle" must bear a unique Indonesian trademark owned by Indonesian nationals. Presidential Instruction No. 2/1996, in referring to the "national automobile industry," sets forth as one of the criteria for that industry the "us[e] of trade marks created by relevant industrial companies". In establishing the requirements for a "national motor vehicle," Decree No. 31/1996 mandates the "use [of] trade marks created by relevant industrial companies themselves and not yet registered by other parties in Indonesia, and owned by Indonesian companies/citizens ...". This requirement discriminates against foreign-owned trademarks and their owners, and is inconsistent with Articles 3, 20 and 65 of the TRIPS Agreement.

11.3 Article 3 of the TRIPS Agreement requires national treatment in the protection of intellectual property rights, including trademarks.[633] In pertinent part, Article 3.1 provides the following:

[633] Article 3 refers to "intellectual property," which is defined in Article 1.2 of the TRIPS Agreement as "all categories of intellectual property that are the subject of Sections 1 through 7 of Part II." Section 2 of the TRIPS Agreement is entitled "Trademarks."

> 1. Each Member shall accord to the nationals of other Members treatment no less favourable than it accords to its own nationals with regard to the protection of intellectual property ... . (footnote omitted).

11.4 Footnote 3 to Article 3.1 provides as follows:

> For the purposes of Articles 3 and 4, "protection" shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in this Agreement. (emphasis added).

11.5 In addition, Article 20, which deals specifically with trademarks, prohibits the imposition of special requirements on the use of a trademark. In pertinent part, Article 20 provides the following:

> The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings...

11.6 The grant of significant benefits under the National Motor Vehicle programme to producers of a "national motor vehicle" bearing a unique, Indonesian trademark is inconsistent with both Article 3 and Article 20. First, these benefits result in a significant commercial disadvantage to companies that do business under an established or foreign-owned trademark, and the only way for such companies to "level the playing field" is to cease the use of their own mark and attempt to acquire an Indonesian trademark consistent with the requirements of the National Motor Vehicle programme. As a result, foreign nationals are provided with treatment less favorable than that provided Indonesian nationals, contrary to Article 3 of the TRIPS Agreement.

11.7 Second, the ineligibility for benefits under the National Motor Vehicle programme of firms using an established or foreign-owned trademark constitutes a special requirement on the use of a trademark in the course of trade that is prohibited by Article 20 of the TRIPS Agreement.

11.8 Moreover, these measures are inconsistent with the transitional arrangements of Article 65 of the TRIPS Agreement. Article 65.2 provides as follows:

> A developing country Member is entitled to delay for a further period of four years the date of application, as defined in paragraph 1, of the provisions of this Agreement <u>other than Articles 3</u>, 4 and 5. (emphasis added).

11.9 Under Article 65.2, Indonesia is currently subject to the requirements of Article 3. Therefore, its violation of Article 3 is not protected by the four-year transition period of Article 65.2.

11.10 In addition, Article 65.5 of the TRIPS Agreement provides as follows:

> A Member availing itself of a transitional period under paragraphs 1, 2, 3 or 4 shall ensure that any changes in its laws, regulations and practices made during that period do not result in a lesser degree of consistency with the provisions of this Agreement.

Because the restrictions of the National Motor Vehicle programme regarding trademarks came into force after 1 January 1995 (the date of entry into force of the WTO Agreement), they are inconsistent with the standstill provisions of Article 65.5. Because they are inconsistent with Article 65.5, Indonesia's violation of Article 20 is not protected by Article 65.2.

B. Response by Indonesia to the claims raised

11.11 **Indonesia** argues that the trademark usage provision of the National Car Programme is consistent with Articles 3, 20 and 65 of the TRIPS agreement, in responding to the claims raised under that Agreement. The following are **Indonesia's** arguments in this regard:

11.12 Presidential Instruction No. 2 of 1996 sets forth requirements for achieving "pioneer" status designation. One of the requirements is that the company receiving the designation use "a brand name of its own". In other words, to receive the subsidies available under the policy, a national car company must sell that car using a "new" brand name; the brand name cannot be one previously or concurrently registered in another country and used to sell cars.

11.13 Complainant United States asserts that the brand name requirement violates Indonesia's obligations under Articles 3, 20 and 65 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). As demonstrated below, this assertion is incorrect.

1. The brand name requirement is consistent with the national treatment obligation of Article 3 of the TRIPS Agreement

11.14 Article 3 of the TRIPS Agreement establishes a national treatment obligation covering intellectual property. According to Article 3:

> Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property .... (Footnote omitted.)

11.15 Indonesia has complied with this directive. The brand name requirement applies in exactly the same fashion to Indonesian and non-Indonesian companies. Neither may use a pre-existing, pre-registered brand name for a national car. Indonesian and non-Indonesian companies must meet the same requirement—they must establish a new brand name for a national car.

11.16 Thus, the fact that an Indonesian national car cannot be called a "Ford Mustang" or a "Chrysler LeBaron" or a "Chevrolet Camaro" or a "Cadillac Coupe DeVille" is irrelevant. It does not indicate that Article 3 has been violated because the brand-name requirement applies to all parties in precisely the same fashion. No matter what companies make a national car, the cars must be sold under new, Indonesian-registered brand names.

2. The brand name requirement is consistent with the obligations of Article 20 of the TRIPS Agreement

11.17 Article 20 of the TRIPS Agreement sets forth specific "other requirements" concerning trademarks. As demonstrated below, however, none of these requirements is germane to the brand-name requirement. According to Article 20, "[t]he use of a trademark ... shall not be unjustifiably encumbered by special requirements" such as "use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings". In an official, legally mandated communication to its Congress,

the United States Government declared that the purpose of Article 20 is to safeguard the role of a trademark as an indication of the source of the trademarked product.[634]

11.18 Thus, Article 20 is not relevant to the brand-name requirement. Requiring a new trademark in order to receive the subsidies under the national car programme does not serve to deceive or confuse people regarding the source of the trademarked product. It does not encumber an existing trademark with specified "special requirements".

11.19 Moreover, even if Article 20 were not limited to unjustified encumbrances on existing trademarks, it still would not apply to the required use of a new trademark. The United States characterizes the brand name requirement as precluding the use of US trademarks, a very substantial infringement were it true. Had the negotiators meant Article 20 to cover an infringement as substantial as that alleged by complainant United States, they would have specified so in the text of the Article. However, they did not. Article 20 deals with the encumbering of trademark usage through ties to other trademarks or requirements that reduce brand-name recognition. But, these important issues are not raised by the brand name requirement at issue here.

11.20 Moreover, as discussed below, under the provisions of Article 65.2, Indonesia currently is exempt from Article 20.

3. Article 65 exempts Indonesia from certain provisions of the TRIPS Agreement

11.21 Article 65 establishes the schedule for when Member countries must comply with the TRIPS Agreement. All Members are given a one-year grace period (generally calculated from 1 January 1995 (the date of entry into force of the WTO Agreement)) before they must comply with the TRIPS Agreement.[635] Developing country Members receive an additional four-year grace period before they must comply with the TRIPS Agreement (apart from certain, specified articles).[636]

11.22 Thus, under Article 65, Indonesia has until 1 January 2000 before it must comply with the vast majority of the TRIPS Agreement. Because Article 3 is one of the specified exceptions, Indonesia is not exempt from complying with the national treatment obligation. However, the Article 65.2 exemption does apply to Article 20. Therefore, in addition to the reasons demonstrated above, due to the Article 65.2 grace period, Indonesia cannot now be found to have violated Article 20 of the TRIPS Agreement.

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[634] In the "Statement of Administrative Action," which the United States Government was required by law to submit to its Congress as part of the US process for implementing the WTO agreements, the United States describes the purpose of Article 20 of the TRIPs Agreement as follows:

> Article 20 safeguards the role of a trademark as an indication of the source of the trademarked product or service by prohibiting imposition of special requirements, such as use with another trademark, that could impair this role. Member countries may, however, require the firm or person producing the goods or services to include its trademark along with, but not limited to, the trademark distinguishing the goods or services at issue.

Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statement of Administration Action and Required Supporting Statements, House Document 103-316, Vol.I at 984, 103d Cong., 2d Sess. (27 September 1994) (emphasis added).

[635] See TRIPS Agreement, Article 65.1.

[636] See TRIPS Agreement, Article 65.2. A review of Article 65.5 demonstrates that the length of this period is not shortened by Article 65.5 as the United States asserts. Even if it were, as established above, the brand name requirement does not violate the provisions of the TRIPS Agreement and, thus, Article 65.5 is not implicated.

4. A US car company would not have been precluded from being a National Car producer

11.23 As demonstrated before, the United States TRIPS complaint reduces to the argument that a United States company cannot be a national car producer. Had a United States company made an acceptable offer to TPN, that company's mark would not have been infringed or derogated because the US company would have remained free to sell its cars in Indonesia, under the US brand, at the same time it participated with TPN. The cars would, in any case, not be identical. The US car, manufactured by a US entity, would occupy a much different (higher) slot in the Indonesian market than would the National Car built by an Indonesian company. Also, as with the Sephia versus the Timor, the cars' specifications likely would differ significantly.

C. Rebuttal arguments made by the United States

11.24 The following are the **United States'** rebuttal arguments to Indonesia's response to the claims raised on the basis of provisions of the TRIPS Agreement:

11.25 With respect to the TRIPS Agreement, Indonesia claims that there is no violation of Article 3 because the brand name requirement of the National Car Programme applies in the same manner to Indonesian and foreign companies. This is simply false, because according to the relevant implementing measures, only Indonesian companies are eligible for the National Car Programme, and only Indonesian companies may obtain a “national car” trademark. This is blatant discrimination against foreign nationals.

11.26 Moreover, in its discussion of Article 3, Indonesia conveniently omits footnote 3 to that article, which states that “protection” for purposes of Articles 3 and 4 includes “those matters affecting the use of intellectual property rights specifically addressed in this Agreement”. (Emphasis added).

11.27 In the context of that footnote, Indonesia's practices in respect of national car trademarks discriminate against foreign nationals and the protection accorded their rights in several respects. First, Indonesia discriminates in respect of the acquisition of a national car trademark. Indonesia admits that any trademark that could apply to a national car must be acquired by an Indonesian company, be that company a joint venture or a wholly-owned Indonesian company. This is a clear violation of national treatment.

11.28 Second, the requirement to use a "new" Indonesian trademark on a national car discriminates against owners of existing marks in respect of the maintenance of the mark. It is unlikely that the owner of the mark normally used (global mark) on the vehicle marketed as a "national car" in Indonesia will be able to use that mark without creating confusion *(i.e.,* confusion resulting from using different marks on the same car). Consequently, it is more likely that the global mark will be subject to cancellation for non-use in Indonesia. Finally, Indonesia discriminates in respect of the protection accorded global marks, because such a mark cannot be used on a national car.

11.29 Because the definition of "protection" as applied in TRIPS Article 3 applies the national treatment obligation in respect of use of intellectual property rights to matters specifically addressed in the TRIPs Agreement, use of a trademark is specifically addressed in the Agreement in Article 20. Although Article 3 and its footnote do not require that a practice violate both the national treatment obligation and the provision specifically addressing the particular use of the right, that is the situation in this case. Indonesia's practice violates both TRIPS Article 3 and Article 20.

11.30 The United States believes that Indonesia's practices violate Article 20 of the TRIPS Agreement, because they constitute a special requirement that unjustifiably encumbers use of the trademark in trade. One cannot use an existing trademark on a national car even though it tells the

consumer more about the actual source of the car than the new mark that must be obtained to qualify as a national car. Moreover, the benefits accruing from being a national car are such that marketing other cars (which carry a pre-existing trademark) is made difficult. This tactic is unjustifiable in that it is akin to saying that the Indonesian Government wants to develop a brand name, i.e., a trademark, and will do so by eliminating other brands of cars from the market.

11.31 Further regarding Article 20, Indonesia again engages in a convenient omission by deleting, in its quotation of Article 20, the phrase “in the course of trade”. That phrase, however, is very important. If use of a previously or concurrently registered trademark precludes access to the benefits of the National Car Programme, that certainly discourages the use of the mark in the course of trade, thereby encumbering its use within the meaning of Article 20. At a minimum, there is de facto discrimination against foreign nationals and their trademarks, because Indonesian holders of a trademark satisfying the national car requirements are treated better than foreign holders of international marks. Put differently, the encumbrance imposed by the trademark requirement of the National Car Programme on previously or concurrently registered trademarks constitutes a ban - the ultimate encumbrance - on the use of such trademarks on certain products.

11.32 In addition, a requirement that a trademark owner use a different trademark from that which it uses in the rest of the world to obtain a special advantage in Indonesia could put the regular mark at risk of cancellation for non-use in Indonesia. Because the trademark owner would be choosing to use the unique Indonesian mark, it would not be able to argue that its non-use arose independently of its will.

11.33 In short, Indonesia’s limited interpretation of the purpose of Article 20 is not borne out by the text. Moreover, Indonesia’s citation to the US Statement of Administrative Action (“SAA”) does not prove anything, because the SAA merely referred to one set of practices that could be dealt with under Article 20. It was not the purpose of this document to catalogue all the possible ways in which Article 20 could be violated, nor would it have been feasible to do so. In particular, the drafters of that document could not have foreseen the particular method used by Indonesia to violate Article 20.

11.34 Indonesia asserts that the Indonesian firms seeking National Car producer status "would have jumped at the chance to have an arrangement" with a US auto manufacturer. In other words, Chrysler, for example, could have stood in the shoes of Kia Motors, and could have been the supplier of the "Timor Chrysler Neon", even if it would not have been the recipient of the subsidies under the National Car Programme.

11.35 However, consider the price that Chrysler would have had to pay to be a supplier of the "Timor Chrysler Neon." It could have supplied TPN (or some other Indonesian company) with finished Neons or Neon kits, but, under the National Car Programme, it could do so only if it agreed to have the Neons rebadged as "Timors". If it agreed to such a deal, Chrysler would have had to forego all of the benefits that go along with selling a product, and establishing a product in a market, under its own trademark. Indonesian purchasers of our hypothetical "Neon National Car" would become familiar with, and develop a loyalty to, the Timor trademark, not the Chrysler trademark.

11.36 In short, the special trademark requirement of the National Car Programme constitutes an unjustifiable encumbrance on the use of a trademark in the course of trade. A foreign company with its own trademark that seeks to participate in the National Car Programme must relinquish its trademark rights. If it choose not to relinquish its trademark rights, it must face unfair competition in the market place.

11.37 It may well be true that Kia, given all of its problems, was willing to relinquish the rights guaranteed it by the TRIPS Agreement. However, the fact that Kia was willing to forego its rights

does not mean that it is acceptable, or consistent with the TRIPS Agreement, to impose such encumbrances on the rights of nationals of other Members.

11.38 Nor would a requirement that two trademarks be used on a product be legitimate under Article 20 of the TRIPS Agreement. The TRIPS negotiators intended to stop this type of practice, and, in particular, discussed a prior practice of India that required such linkages. Specific examples of linked trademarks that were discussed were "Lahil-Pepsi" and "Modi-Xerox."

11.39 Indeed, the express language of Article 20 condemns such a practice, by stating as follows: "The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark ...". (Emphasis added). Thus, even if the Indonesian authorities could allow a national car to bear two marks, including a mark owned by a foreign company (and the language of the relevant measures would seem to preclude this), such a practice would violate Article 20.

11.40 Article 20 of the TRIPS Agreement prohibits unjustifiable encumbrances, imposed through special requirements, on the use of a trademark in the course of trade. An illustrative list of such encumbrances follows. Prohibited encumbrances clearly must encompass measures that affect such a fundamental issue as the right or ability to use the trademark. If an existing trademark cannot be used on a National Car, even if that mark accurately reflects the source of the car or its arts, use of that mark clearly has been encumbered and, in the view of the United States, without justification other than a desire to limit access to the benefits of the National Car programme.

11.41 The United States believes that the focus under Article 20 should not be on the precise “special requirement”, but on the effect of the requirement; i.e., does it unjustifiably encumber use of the trademark. The fact that the text of Article 20 includes “use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings” as one example of a special requirement clearly indicates that other special requirements can act as encumbrances on use of a mark in trade. While eliminating encumbrances that unjustifiably affect the ability of a trademark to distinguish the goods or services of one undertaking from another is a key objective of Article 20, it is not the sole objective. The right to register a trademark, even in its preferred form, without the right or ability to use it in trade in that form is meaningless.

11.42 Thus, the prohibition on use of an established or foreign-owned trademark on a National Car constitutes an unjustifiable encumbrance on the use of the trademark in the course of trade. The special requirement used to implement this unjustified encumbrance is essentially that a new mark, owned by an Indonesian national, be registered and used on the car. In the view of the United States, this is the ultimate encumbrance—it is a ban on use of the trademark on certain products.

11.43 Finally, with respect to the transitional rules in Article 65, Indonesia simply ignores the plain text of Article 65.5. That provision states that a Member availing itself of a transitional period, such as Indonesia here, shall ensure that “any changes in its laws, regulations and practices made during a [transitional period] do not result in a lesser degree of consistency with the provisions of this Agreement.” Because the National Car Programme post-dates the entry into force of the WTO Agreement and violates Article 20, it is inconsistent with Article 65.5, and Indonesia must return to the pre-violation *status quo ante*.

XII. THIRD PARTY ARGUMENTS

A. India

12.1 **India** made the following arguments as a third party to the panel proceedings:

12.2 Relating to the alleged violation of the TRIMs Agreement by Indonesia, it is a matter of record that Indonesia had notified the measures already taken by it to the TRIMs Committee in May 1995. However, in October 1996 Indonesia on reexamination of their measures felt that they could not be termed as TRIMs and consequently they withdrew their above notification.

12.3 There are two procedural issues relating to this matter which the complainants have raised in this case on which we would like to comment before coming to the substantive issue. Firstly, it has been *implied* that a Member cannot withdraw a notification, once submitted to the WTO. This is an averment that we cannot accept. We strongly feel that Members have the right to both amend or to even withdraw any of their notifications, provided there are sufficient grounds justifying such action. Consequently, we feel that Indonesia was fully within its legal rights to withdraw the notification it had made to the TRIMs committee.

12.4 The second procedural issue, the mention of which we find in the complainants first submission, relates to the alleged ineligibility of Indonesia to benefit from certain transitional provisions simply because its notification was not submitted on time. We note that Indonesia's measures, as we will elaborate a little later, are not TRIMs. However, we would like to strongly state our position that delay in notifying a measure, no matter under which provision, cannot in any way be construed as diminishing the benefits that any Member may have by virtue of it being in a special category, such as a developing country. While we agree that delay in notifying measures should ideally not occur, it must at the same time also be realized that small delegations often have constraints of resources which at times leads to an unintended delay in the notification of their measures. It is for this reason that we believe that any such procedural delays should not mitigate the benefits which any member may otherwise be eligible for, under a covered agreement.

12.5 Coming to the substance of the legal issue relating to the TRIMs Agreement, the complainants have stated that the measures taken by Indonesia are violative of Article 2 of the TRIMs Agreement. As we are all aware, Article 2.1 of the TRIMs Agreement states that "no member shall apply any TRIM that is inconsistent with the provision of Article III of GATT 1994". The emphasis here is no doubt on the application by Members of a measure which can be said to be a trade-related investment measure. It is therefore evident that we need to ab initio be clear whether the said measures taken by Indonesia come within the ambit of being trade related investment measures or not.

12.6 Going back to the drafting of the TRIMs Agreement, the Agreement is basically designed to govern and to provide a level playing field for foreign investment in third countries. It is evident that any measure taken by a country relating to its internal taxes or subsidies, as Indonesia has done, cannot therefore be construed to be a trade-related investment measure. This is particularly important when we view the fine print in the TRIMs Agreement which in fact does not add any new obligations to Members, since it merely states that a measure which is a trade-related investment measure should not be violative of Article III or Xl of GATT 1994. This interpretation has been upheld in the recent report of the panel on the European Communities regime for the importation, sale and distribution of bananas in which it has been stated that "the TRIMs Agreement essentially interprets and clarifies the provisions of Article III (and also Article Xl) where trade-related investment measures are concerned. Thus, the TRIMs Agreement does not add to or subtract from those GATT obligations".

12.7 Indonesia has pointed out in its submission that its measures are in the nature of subsidies specifically provided to the automobile industry and therefore come within the purview of the

Subsidies Agreement and not the TRIMs Agreement. We have carefully gone through the first submissions made by the complainants as well as the Republic of Indonesia. We would like to bring on record that we agree with what Indonesia has stated that the measures taken by it are entirely in the form of subsidies and their legality or otherwise therefore needs to be examined in the light of provisions of the Agreement on Subsidies and Countervailing Measures, and not the TRIMs Agreement. India strongly feels and has stated its position in earlier fora also, that subsidies should be governed solely by the Subsidies Agreement. There has been consistency in our stand and in the interpretation in various fora, that just as investment measures cannot be presumed to be a form of subsidization, subsidies too cannot be presumed to be trade related investment measures.

12.8 With regard to the interpretation of certain provisions of the Subsidies Agreement, we would like to wholeheartedly endorse what has been stated by Indonesia in its written submission. In particular, we would like to state that we entirely agree with Indonesia that (a) Article 27.3 of the Subsidies Agreement does not preclude the introduction or expansion of domestic content subsidies; (b) the domestic content subsidy is not within the scope of Article 27.4 of the Subsidies Agreement since it is not an export subsidy and since Indonesia is a developing country; and (c) the domestic content subsidy is not within the scope of Article 28.2 because it is not inconsistent with the Subsidies Agreement.

12.9 Coming to the second issue on which we would like to state our position, viz, that relating to Article I of GATT i.e., the provision for MFN treatment. It has been argued that, under the measures taken by Indonesia, the Kia car being produced in Korea has been granted special and differential treatment, as compared to cars being produced elsewhere, and is therefore violative of the MFN principle. We have carefully perused the regulations and decrees issued by the Republic of Indonesia in 1996. In none of these decrees do we find mention of any specific country, including Korea. It is therefore evident that while the presidential decree and other notifications refer to national motor vehicles, they do not in any way mandate preferential treatment of automobiles or their components or parts from any country. Purely from a legal view point, it is therefore clear, that the above referred regulations have not violated the MFN principle since they have not conferred any special privileges to cars or their parts being manufactured in a particular country.

12.10 In this context, we do not agree with the argument put forth by some of the complainants that even if a particular regulation does not mention a country by name, but its effect is to benefit a particular producer or a country, then it is violative of the MFN principle. We find no legal strength in this argument, since it is clear that any automobile manufacturer based in any country could have, and in fact can, avail of the specific benefits and subsidization programme introduced by Indonesia, provided they fulfil the conditions specified in the said regulation. The fact that no other country has so far approached the Republic of Indonesia in this regard cannot therefore be construed as an indication that the said provision has violated the MFN principle.

12.11 Before concluding, we would like to refer some of the arguments put forth by Indonesia regarding the steps taken by Indonesia to diversify production and to deregulate international trade so that the country could continue in its commitment towards economic reform. What is significant is that these steps were taken even though Indonesia's total external debt had reached US$108 billion in 1995 and that the deficit in Indonesia's current account had more than doubled in one year to US$6.8 billion in the same year. Although we agree that these statistics have no direct bearing on the issues for consideration before the Panel, we would like to highlight the fact that developing countries often need to take stops to bolster their economy and to overcome problems of imbalances in regional development. We would suggest that the multilateral trading system examines the initiatives taken by these countries in the overall pursuit of economic development in their context.

12.12 We all stand to gain from the WTO system if we develop reasonable and coherent interpretations detached from short-term economic and commercial interest. This would assist panels

in their search for the right interpretations, particularly in evolving areas such as the TRIMs Agreement and the Agreement on Subsidies and Countervailing Measures.

B. Korea

12.13 **Korea** made the following arguments as a third party to the panel proceedings:

1. Preliminary jurisdictional issue

12.14 One of the basic tenets of the DSU is to allow the complaining party with trade grievances to state perspicuously the alleged offending measures which it seeks to challenge and has declared inconsistent with WTO obligations. The obvious intent of this requirement is to provide the member state with an opportunity to effectively examine and respond to charges that the law or practice is a transgression to the WTO Agreements and, if necessary, take corrective measures to remedy the situation. This was confirmed in the Appellate Body ruling on the European Communities-Regime for the Importation, Sale and Distribution of Bananas which states that "claims ... must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending party and any third parties to know the legal basis of the complaint". The Drafters of the DSU, cognizant of the importance of identifying the measures to be challenged, inserted Article 6.2 which reads:

> The request for the establishment of a panel shall ... identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

12.15 The United States discusses in detail how the US$690 million loan made to Timor Putra Nasional contravenes Article III:4 of GATT l994 and Article 2 of TRIMs Agreement. The United States further argues that the loan constitutes a specific subsidy which causes serious prejudice.

12.16 The loan to which the United States alludes, however, is not a part of the terms of reference because it was never specifically identified as a measure at issue in the 12 June 1997 request of the United States for the establishment of a panel. The most recent Appellate Body ruling in the Bananas case sheds light on the DSU Article 6.2 requirement. The Appellate Body states:

> We do not agree with the Panel that "even if there was some uncertainty whether the panel request had met the requirements of Article 6.2, the first written submissions of the Complainants 'cured' that uncertainty because their submissions were sufficiently detailed to present all the factual and legal issues clearly" ... If a claim is not specified in the request for the establishment of a panel, then a faulty request cannot be subsequently 'cured' by a complaining party's argumentation in its first written submission to the panel or in any other submission or statement made later in the panel proceeding.

12.17 It is also noteworthy that the loan was provided after the creation of the panel. In the United States - Measures Affecting Alcoholic and Malt Beverages case, Canada endeavoured to reserve the right to invoke new measures which may arise during the panel deliberation. The panel concluded that its "terms of reference do not permit it to examine any new measure which may come into effect during the Panel's deliberations".

12.18 As the terms of reference do not identify the loan and the defect cannot subsequently be cured by a first submission, the panel should avoid ruling on any claims made by the United States in connection with the August 1997 loan.

2. Substantive Issues

12.19 First, as was rightly pointed out in the submissions of the parties to the dispute, nothing in the legislation by Indonesia establishing either the February 1996 or the June 1996 programme explicitly mandates preferential treatment of products from any specific country. A national car producer has the freedom to choose the origin of technology and of the component and parts used in the production.

12.20 Kia Motor Corporation has become a beneficiary of such preferential treatment by having simply been chosen by PT Timor Putra Nasional as a partner for a joint venture. The term 'joint venture' is used in a general descriptive sense and not as a legal characterization of the arrangement as provided for in the relevant laws of Indonesia.

12.21 Second, in its first submission, the Government of Indonesia argues that the exemptions and reductions of import duties and luxury tax for the producers of a national car is not inconsistent with the provisions of Subsidies and Countervailing Measures Agreement ("SCM"), because, under Article 27.3 of SCM, Indonesia is not subject to the provisions of Article 3.1(b) of SCM as a developing country for a period of five years.

12.22 If such an argument is accepted by the panel, Korea is of the view that Indonesia's import duties and luxury tax subsidies should not be regulated by Article I or III of GATT 1994, because, in the event of conflict between SCM and GATT 1994, the provisions of SCM shall prevail to the extent of the conflict as provided for in General Interpretative Note to multilateral agreements on trade in goods. A reference to Articles I and III of GATT 1994 and the SCM Agreement reflects a preliminary view of the Korean Government without prejudicing the positions on this particular issue of the parties directly involved.

12.23 Finally, as was accurately stated by Indonesia, the Sportage is not and will not become eligible for the National Car Programme. Therefore, complaints pertaining to Kia Sportage are irrelevant to the present case.

XIII. INTERIM REVIEW[637]

13.1 On 6 April 1998, Indonesia requested the Panel to review, in accordance with Article 15.2 of the DSU, certain aspects of the interim report that had been transmitted to the parties on 24 March 1998. On 7 April 1998, the European Communities, Japan and the United States also requested the Panel to review the interim report. None of the parties requested the Panel to hold an additional meeting.

13.2 We have reviewed the arguments and drafting suggestions presented by the four parties, and finalized our report, taking into account those comments by the parties which we considered justified. In this context we have clarified the wording of certain paragraphs addressing some factual aspects of the various pieces of legislation under examination and revised paragraphs 2.1, 2.3, 2.28, 2.37, 2.44, 3.1, 2.44, 3.1, 3.4(a), 5.126, 6.100, 7.87 to 7.91, 7.161, 7.163, 8.13, 8.160, 8.199, 8.332, 8.393, 8.418, 8.443, 8.444, and 10.4 to 10.12 of the descriptive part and paragraphs 14.10, 14.86, 14.92, 14.107 and 14.115 of the findings accordingly. Some parties have also raised arguments with regard to the description of their claims. We have carefully reviewed the claims of the complainants, as identified in the originals of their requests for establishment of panels, and revised paragraphs 14.15, 14.18, 14.20, 14.21, 14.94, 14.124, 14.125 and 14.148 accordingly. We have also revised paragraphs 14.210 to 14.213 of the findings to more accurately characterize the arguments of the European Communities. Further, we have decided in light of comments from the European Communities to delete paragraphs 14.198 and 14.199 and to modify paragraph 14.247. In addition, we have made other minor modifications including those to paragraphs 14.9, 14.38, 14.68, 14.73, 14.76, 14.77, 14.94, 14.95, 14.133, 14.134, 14.149, 14.152, 14.176 and 15.1(a).

13.3 Finally, we would like to address the issue of the confidentiality of the interim report. When, on 24 March 1998, we transmitted our interim report to the parties, we clearly indicated that such report was confidential. Indeed all panel proceedings remain confidential until the panel report is circulated to WTO Members. According to paragraph (h) of Appendix 1 of the Council Decision on Procedures for the Circulation and Derestriction of WTO Documents[638] it is possible to maintain the restricted nature of any such panel report for 10 days after circulation to Members. We had also explicitly emphasized at our first meeting with the parties that the panel proceedings were confidential and that we expected all delegations to treat the present proceedings with utmost circumspection and discretion. This was accepted by the parties. We are seriously concerned to find out that parties (leaks from Japan and the United States have been brought to our attention) have not respected this obligation and have disclosed aspects of the interim report. We consider that this lack of respect of a specific requirement imposed by the Panel affects the rights of the parties and the integrity of the dispute settlement process, and should not remain unmentioned.

[637]Pursuant to Article 15.3 of the DSU, the findings of the panel report shall include a discussion of the arguments made at the interim review stage. Consequently the following section entitled Interim Review is part of the Findings of this Panel Report.

[638] Decision adopted by the General Council on 18 May 1996, WT/L/160/Rev.1.

XIV. FINDINGS[639]

A. Preliminary Rulings

1. Presence of private lawyers as representatives of a party to the dispute

14.1 As further detailed in paragraphs 4.1 to 4.35 of the Descriptive Part, in connection with the first substantive meeting of the Panel with the parties, Indonesia announced that two private lawyers were members of its delegation. Following a request by the United States to exclude those lawyers from the meeting, the Panel heard the arguments of the parties on this issue. On 3 December 1997, the Chairman announced the following ruling on behalf of the Panel:

> "I wish to inform the parties that having carefully reviewed the letters received in the preliminary matter before us, and having heard the arguments of the parties, the Panel does not agree with the United States' request to exclude from meetings of the Panel certain persons nominated by the Government of Indonesia as members of its delegation. We conclude that it is for the Government of Indonesia to nominate the members of its delegation to meetings of this Panel, and we find no provision in the WTO Agreement or the DSU, including the standard rules of procedure included therein, which prevents a WTO Member from determining the composition of its delegation to WTO panel meetings. Nor does past practice in GATT and WTO dispute settlement point us to a different conclusion in this case. In particular, we note that unlike in this present case, the working procedures of the Bananas III Panel contained a specific provision requiring the presence only of government officials.
>
> We would like to emphasize that all members of parties' delegations -- whether or not they are government employees -- are present as representatives of their governments, and as such are subject to the provisions of the DSU and of the standard working procedures, including Articles 18.1 and 18.2 of the DSU and paragraphs 2 and 3 of those procedures. In particular, parties are required to treat as confidential all submissions to the Panel and all information so designated by other Members; and, in addition, the Panel meets in closed session. Accordingly, we expect that all delegations will fully respect those obligations and will treat these proceedings with the utmost circumspection and discretion. I would ask the four Heads of Delegation to confirm that all members of their delegations are present as representatives of their governments, and as such will abide by all of the applicable provisions; and therefore that the governments are responsible for the actions of their representatives."[640]

14.2 The parties accepted these prescriptions by the Panel and the four Heads of Delegation confirmed that all members of their delegations were present as representatives of their governments, and as such would abide by all of the applicable provisions.

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[639] Throughout this report, we have based our analysis on the ordinary meaning to be given to the terms of the provisions under examination in their context and in the light of their object and purpose. In our analysis of the scope and purpose of these provisions we have also taken into account past GATT and WTO panel reports and Appellate Body reports when we considered them relevant and applicable to the present dispute. We are aware, however, that they are not binding, except with respect to resolving the particular dispute between the parties to that dispute. Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, WT/DS8, 10, 11, adopted on 1 November 1996, p. 14, hereafter called *Alcoholic Beverages (1996).*

[640] The Panel in referring to *Bananas III*, referred to the Appellate and Panel Reports on *EC - Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27, adopted on 25 September 1997.

2. The alleged loan to PT TPN as a measure covered by the terms of reference of this panel

14.3 At the first meeting of the Panel with the parties, on 3 December 1997, Indonesia raised a preliminary objection to the United States' claim with respect to a $US 690 million loan to PT TPN, on the basis that this loan was not within the Panel's terms of reference. The arguments of the parties can be found in paragraphs 4.36 to 4.50 of the Descriptive Part of this report. After hearing the arguments of the parties, the Chairman announced the following ruling on behalf of the Panel:

> "In its first submission, the United States alleges that the Government of Indonesia directed certain government-owned and private banks to provide PT TPN with a $690 million loan as a component of the National Motor Vehicle Programme. The United States claims that this government-directed loan is inconsistent with Article III:4 of GATT 1994 and Article 2 of the TRIMs Agreement, and that it is a specific subsidy which causes or threatens to cause serious prejudice to the interests of the United States. Indonesia in its first submission alleges that the loan is not within the Panel's terms of reference and asks us to so rule. At its first meeting, we invited the parties to address this issue.
>
> We note that this Panel has standard terms of reference. Therefore, in determining whether a measure is before us, we must examine the United States' request for establishment of a panel, which is found in document WT/DS59/6. Consistent with the findings of the Appellate Body in Bananas III, we have carefully examined that request to ensure its compliance with both the letter and spirit of Article 6.2 of the Dispute Settlement Understanding. We conclude that the $690 million loan was not "identified as a specific measure" in that document as required by Article 6.2 of the DSU. Indeed the United States states that the loan was not identified in the U.S. request, because it had not yet been made. Rather, the United States suggests that the loan is properly before the Panel because it is one aspect of the National Car Programme, which the United States considers to be the subject of its request. In our view, however, the United States in its request has clearly identified the measures to be considered by the Panel, and those measures do not include this loan. Accordingly, we conclude that the loan in question is not within the terms of reference of this Panel."

14.4 Consequently, we do not address any claims related to the said $690 million loan in our findings.

3. Business proprietary information

14.5 At three points in its first submission, the United States indicated that it had further information relevant to its serious prejudice claims but that this information was "business proprietary" and that the United States was reluctant to provide it to the Panel in the absence of "adequate procedures" to protect such information.

14.6 At the first meeting of the Panel, Indonesia expressed concern that the United States would submit this information only in its second submission, thereby denying Indonesia an opportunity to respond in its second submission. Accordingly, Indonesia requested the Panel to require the United States to submit its confidential data immediately. Indonesia further stated that it must be given an opportunity to review and respond fully to the data and to any additional argumentation based thereon. The arguments of the parties can be found in paragraphs 4.51 to 4.60 of the Descriptive Part of this panel report.

14.7 The Panel considered the request by Indonesia and on 3 December 1997 the Chairman announced the following ruling on behalf of the Panel:

> "We encourage all parties to submit relevant data to the Panel as early as possible. However, we have concluded that it would not be appropriate for us to require the United States to submit the information in question in the context of this meeting. It is a matter for each party to decide when and if to submit information and argumentation within the schedule set forth by the Panel. In this respect, we note that there is no rule in the DSU or our working procedures that requires parties to submit all factual information in their first submissions. In fact, factual information is often provided in second submissions or in response to questions from a panel as the issues in the case come into sharper focus. We see no reason to deviate from that approach in this case.
>
> This does not mean that we do not take seriously Indonesia's concern that it be allowed an opportunity to review and respond to any new data and to any additional argumentation based thereon. We note that, at the second meeting of the Panel, parties will be able to address any new data and related argumentation presented in each others' second submissions. If, however, any party considers at the time of that meeting that it has not had an adequate opportunity to address any such data and argumentation, the party should so inform us at that time. I can assure you that the Panel will take all reasonable steps to insure that all parties have had a full opportunity to respond to the factual information and argumentation submitted to the Panel.
>
> Finally, we would like to remind all parties that Article 18.2 of the DSU does allow parties to designate information as confidential. Such designation will be respected by this Panel, the WTO Secretariat and the other parties to the dispute. Accordingly, we encourage all parties to submit to the Panel such information as they consider may be helpful to the resolution of this dispute. In this respect, we note that the parties agree that the complainants alleging serious prejudice must demonstrate its existence by positive evidence. If the United States considers that the information in question is necessary in order to meet that burden, and if it believes that Article 18.2 is inadequate, the United States may propose to the Panel in writing, at the earliest possible moment, a procedure that it considers sufficient to protect the information in question."

14.8 The United States did not propose or request the Panel to adopt any such procedure.

4. Whether the National Car programme has expired and should therefore not be examined by this panel

14.9 On 25 February 1998, Indonesia sent to the Chairman of the Subsidies Committee a letter in which it indicated that on 21 January 1998 the National Car programme was terminated and that regulations and decrees thereunder had been revoked. For Indonesia, the Presidential Instruction establishing the National Car programme was therefore "obsolete". A copy of that letter was officially notified to the Chairman of this Panel. Upon request of the Panel, all parties have commented on this notification by Indonesia.[641] We note that this communication from Indonesia came after the deadline of 30 January 1998 set by the Panel for submitting information and arguments in this case. Further, the complainants challenge whether the National Car programme has effectively

[641] See paragraphs 4.61 to 4.110 of the Descriptive Part.

been terminated and have requested the Panel to rule on all claims before it. In any event, taking into account our terms of reference, and noting that any revocation of a challenged measure could be relevant to the implementation stage of the dispute settlement process, we consider that it is appropriate for us to make findings in respect of the National Car programme. In this connection, we note that in previous GATT/WTO cases, where a measure included in the terms of reference was otherwise terminated or amended after the commencement of the panel proceedings, panels have nevertheless made findings in respect of such a measure.[642] We shall therefore proceed to examine all of the claims of the complainants.

B. Claims

1. Claims of the complainants

14.10 The various Indonesian measures at issue in this dispute are described in paragraphs 2.3 to 2.43 of the Descriptive Part of this report. For the purpose of these findings, we shall generally categorize and refer to the measures as those adopted pursuant to the 1993 car programme,[643] the February 1996 car programme[644] and the June 1996 car programme[645]. When we refer to the "Indonesian car programmes", especially in the discussion on the general relationship between the provisions of the SCM Agreement and Article III of GATT, we include all the measures adopted pursuant to all three car programmes. When we refer to the National Car programme we refer to the measures adopted pursuant to the February and June 1996 car programmes. Our use of these general references is not intended to preclude discussion of the WTO compatibility of more specific aspects of the various car programmes. We note, however, that Japan considers that most of Government Regulation No.20/1996 and Government Regulation No. 36/1996 are not related to the National Car Programme. We also note that Government Regulation No. 36/1996 has affected the level of benefits under the 1993 car programme.

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[642] See, e.g. Panel Report on *United States - Measures Affecting Imports of Wool Shirts and Blouses from India*, WT/DS33, adopted on 23 May 1997, (hereafter called "*Shirts and Blouses*"), the US restriction was withdrawn shortly before the issuance of the panel report; Panel Report on *EEC - Restrictions on Imports of Dessert Apples, Complaint by Chile*, adopted on 22 June 1989, BISD 36S/93; Panel Report on *EEC-Restrictions on Imports of Apples, Complaint by the United States*, adopted on 22 June 1989, BISD 36S/135; Panel Report on *United States - Prohibition of Imports of Tuna and Tuna Products from Canada*, adopted on 22 February 1982, BISD 29S/91; Panel Report on *EEC - Restrictions on Imports of Apples from Chile*, adopted on 10 November 1980, BISD 27S/98; and Panel Report on *EEC - Measures on Animal Feed Proteins*, adopted on 14 March 1978, BISD 25S/49. In the Panel Report on *United States - Section 337 of the Tariff Act of 1930*, BISD 36S/345, adopted on 7 November 1989 (hereafter called "*Section 337*"), the challenged measure was amended during the panel process but the panel refused to take into account such amendment. We note that this is also the line taken by the Appellate Body in *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparels and Other Items*, WT/DS56, adopted on 22 April 1998, para. 64.

[643] Including the Decree of the Minister of Industry No. 114/M/S/6/1993, dated 9 June 1993 and its amendments; Decree of Minister of Finance No. 645/KMK.01/1993, dated 10 June 1993; Decree of Minister of Finance No. 647/KMK.04/1993, dated 10 June 1993; Decree of Minister of Finance No. 223/KMK.01/1995, dated 23 May 1995.

[644] Including the Presidential Instruction No. 2 and all of the implementing regulations and decrees (e.g. Government Regulation No. 20/1996, Decree of the Minister of Industry and Trade No. 31/MAP/S/2/1996, Decree of the Minister of Finance No. 82/KMK.01/1996), Decree of the State Minister for Mobilisation of Investment Funds/Chairman of the Investment Coordinating Board No.01/SK/1996, 27 February 1996, Decision of the State Minister For the Mobilization of Investment Funds/Chairman of the Capital Investment Co-Ordinating Board, Number 02/SK/1996, 5 March 1996.

[645] Including the Presidential Decree No.42, 4 June 1996, Government Regulation No. 36/1996, Decree of the Minister of Industry and Trade No. 142/MAP/KEP/6/1996 and Decree of the Minister of Finance No. 404/KMK.01/1996.

14.11 We understand from the requests for establishment of the panel that the claims of the complainants are as follows:

(i) Local-content requirements

14.12 The European Communities and the United States claim that the local content requirements of the 1993 car programme (to which are linked tax benefits for finished motor vehicles incorporating a certain percentage value of domestic products and customs duty benefits for imported parts and components used in motor vehicles incorporating a certain percentage value of domestic products) violate the provisions of Article III:4 of the General Agreement on Tariff and Trade of 1994 (hereafter, "GATT")[646] and Article 2 of the Agreement on Trade-Related-Investment Measures (hereafter "TRIMs Agreement").

14.13 Japan, the European Communities and the United States claim that the local content requirements of the February 1996 car programme (to which are linked tax benefits for National Cars incorporating a certain percentage value of domestic products and customs duty benefits for imported parts and components used in National Cars) violate the provisions of Article III:4 of GATT and Article 2 of the TRIMs Agreement.

(ii) Tax discrimination

14.14 The European Communities and the United States claim that the tax benefits of the 1993 car programme in favour of certain domestic cars violate the provisions of Article III:2 of GATT.

14.15 The European Communities, Japan and the United States claim that the tax benefits of the February 1996 car programme in favour of National Cars violate the provisions of Article III:2 of GATT. The European Communities and the United States claim that the tax benefits of the June 1996 car programme in favour of National Cars violate the provisions of Article III:2 of GATT.

14.16 The European Communities claim that the tax benefits on finished motor vehicles of the 1993 and the February and June 1996 car programmes, because of the local content requirements, also provide an indirect tax benefit on parts and components of the finished motor vehicles, in violation of Article III:2 of GATT.

(iii) MFN discrimination

14.17 Japan, the European Communities and the United States claim that the tax benefits accorded to National Cars produced in Korea, under the June 1996 car programme, violate Article I of GATT.

14.18 Japan, the European Communities and the United States claim that the customs duty benefits accorded to National Cars produced in Korea under the June 1996 car programme violate Article I:1 of GATT.

14.19 Japan and the European Communities claim that the customs duty benefits accorded on certain parts and components used for the production in Indonesia of National Cars under the February 1996 car programme violate Article I of GATT.

[646] Throughout this draft, "GATT" will be used when referring to GATT 1994. When references are made to GATT 1947, the Panel will be referring to the General Agreement on Tariff and Trade of 1947 which was terminated on 31 December 1995 by the Decision of 8 December 1994 adopted by the Preparatory Committee for the WTO and the CONTRACTING PARTIES TO GATT 1947, PC/12-L/7583. In discussions involving the comparison between provisions of GATT 1947 and parallel provisions in the WTO Agreement (including GATT 1994), we may use the expression GATT 1994 and GATT 1947.

14.20 The European Communities claim as well that the customs duty benefits on certain parts and components used for the production of finished motor vehicles in Indonesia under the 1993 car programme, violate Article I of GATT. We note, however, that the European Communities have not further argued this claim.

(iv) Absence of notification and partial administration

14.21 Japan claims that the National Car programme violates Article X:1 of GATT, because it was not published promptly in such a manner as to enable governments and traders to become acquainted with it, and Article X:3(a) of GATT, because it has not been administered in a uniform, impartial and reasonable manner.

(v) Serious prejudice

14.22 The European Communities and the United States claim that the February and June 1996 car programmes constitute specific subsidies which cause serious prejudice to their interests within the meaning of Article 6 of the SCM Agreement.

(vi) Extension of the scope of existing subsidies

14.23 The United States claims that the introduction of the National Car programme and certain modifications to the 1993 car programme represent an extension of the scope of existing subsidy programmes in violation of Article 28 of the SCM Agreement.

(vii) National treatment violation with respect to the acquisition and maintenance of trademarks, and the use of trademarks

14.24 The United States claims that the provisions of the National Car programme discriminate against nationals of other WTO Members with respect to the acquisition and maintenance of trademarks, and the use of trademarks as specifically addressed in Article 20, in violation of Article 3 of the TRIPS Agreement.

(viii) Introduction of special requirements in respect of the use of trademarks

14.25 The United States claims that the provisions of the National Car programme which were introduced by Indonesia during its transition period under the TRIPS Agreement put special requirements on nationals of other WTO Members in respect of the use of their trademarks inconsistent with Article 20 of the TRIPS Agreement and are thus in violation of Indonesia's obligations under Article 65.5 of that Agreement.

2. Indonesia's general defence

14.26 The general defense of Indonesia to these claims is that the SCM Agreement is *lex specialis* to this dispute. For Indonesia this principle means that because the measures at issues are subsidies, they are governed exclusively by Article XVI of GATT and the SCM Agreement.

14.27 More specifically, we understand Indonesia's argument to be two-fold. First, in support of its defense that the only law applicable to this dispute is the SCM Agreement, Indonesia submits that:

1. There is a general conflict[647] between Article III of GATT and the SCM Agreement (i.e. there is a conflict between the entirety of the SCM Agreement and the entirety of Article III). Indonesia in its second submission expands this argument to include claims under Article I of GATT as well;

2. The application to this dispute of Article III of GATT would reduce the SCM Agreement to "inutility"[648];

3. General rules of treaty interpretation require rethinking the scope of Article III:8(b);

4. Since Article III is not applicable, the TRIMs Agreement is not applicable.

Second, we understand that Indonesia argues that should Article III and/or the TRIMs Agreement be considered to apply to this dispute, there are specific conflicts between some of the provisions of the SCM Agreement, on the one hand, and some provisions of Article III on which the complainants base their claims, on the other hand. For Indonesia, any and all conflicts should be resolved in favour of the SCM Agreement which, according to Indonesia, permits the car programmes under examination. We shall first address Indonesia's argument that the only law applicable to this dispute is the SCM Agreement.

C. Is the SCM Agreement the only "Applicable Law" to this Dispute?

1. General considerations

14.28 In considering Indonesia's defence that there is a general conflict between the provisions of the SCM Agreement and those of Article III of GATT, and consequently that the SCM Agreement is the only applicable law, we recall first that in public international law there is a presumption against conflict.[649] This presumption is especially relevant in the WTO context[650] since all WTO agreements,

[647] In these findings, when we refer to general conflict we mean a conflict that is alleged to exist between the entirety of the SCM Agreement and the entirety of Article III, Article I or the TRIMs Agreement, as discussed in Section C of this report. We consider whether there is a specific conflict between any specific provision of the SCM Agreement and Article III:2 of GATT in Section E hereafter.

[648] The Appellate Body Report on *United States - Standards for Reformulated and Conventional Gasoline* (hereafter called *Gasoline*) stated at page 23: "An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.", WT/DS2/AB/R, adopted on 20 May 1996.

[649] In international law for a conflict to exist between two treaties, three conditions have to be satisfied. First, the treaties concerned must have the same parties. Second, the treaties must cover the same substantive subject matter. Were it otherwise, there would be no possibility for conflict. Third, the provisions must conflict, in the sense that the provisions must impose mutually exclusive obligations. "... [T]echnically speaking, there is a conflict when two (or more) treaty instruments contain obligations which cannot be complied with simultaneously. ... Not every such divergence constitute a conflict, however. ... Incompatibility of contents is an essential condition of conflict". (7 Encyclopedia of Public International Law (North-Holland 1984), page 468). The *lex specialis derogat legi generali* principle "which [is] inseparably linked with the question of conflict"(Idem., page 469) between two treaties or between two provisions (one arguably being more specific than the other), does not apply if the two treaties ".. deal with the same subject from different point of view or [is] applicable in different circumstances, or one provision is more far-reaching than but not inconsistent with, those of the other" (Wilfred Jenks, "The Conflict of Law-Making Treaties", The British Yearbook of International Law (BYIL) 1953, at 425 *et seq.*). For in such a case it is possible for a state which is a signatory of both treaties to comply with both treaties at the same time. The presumption against conflict is especially reinforced in cases where separate agreements are concluded between the same parties, since it can be presumed that they are meant to be consistent with themselves, failing any evidence to the contrary. See also E.W. Vierdag, "The Time of the "Conclusion" of a Multilateral Treaty: Article 30 of the Vienna Convention on the

including GATT 1994 which was modified by Understandings when judged necessary, were negotiated at the same time, by the same Members and in the same forum. In this context we recall the principle of effective interpretation[651] pursuant to which all provisions of a treaty (and in the WTO system all agreements) must be given meaning, using the ordinary meaning of words. Second, we note that Article III, which does not require the existence of any trade effect for it to be violated, occupies a particularly important place in the rules governing the multilateral trading system as it serves, *inter alia*, as a guarantee of the effectiveness of negotiated tariffs. The Appellate Body in its report on *Japan -Taxes on Alcoholic Beverages* stated:

> "The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the WTO Agreement".[652]

We also note that Article III and Article XVI have co-existed since the inception of the GATT system of rules. In light of the above, we will approach allegations of conflicts with caution.

2. Is there a general conflict between the SCM Agreement and Article III of GATT?

14.29 As noted, Indonesia in part bases its argument that the SCM Agreement is the only applicable law in this dispute on an assertion that the SCM Agreement in its entirety conflicts with Article III in its entirety. In considering Indonesia's arguments, we recall that for a conflict to exist between two agreements or two provisions thereof, they must cover the same substantive matter. Otherwise there is no conflict since the two provisions have different purposes.[653] We recall also that Article III, which prohibits discrimination between imported and domestic products, and Article XVI, which regulates subsidies to producers, have been part of GATT 1947 since its inception. This implies that the drafters of GATT 1947 intended these two sets of provisions to be complementary. Indeed, this is confirmed by an examination of the respective coverage of the two provisions.

14.30 Article III has always been a provision that is concerned with (and prohibits) discrimination between imported and domestic products. By contrast, the provisions of Article XVI of GATT 1947 have dealt generally with the regulation of subsidies to producers. Article XVI of GATT 1947 did not address the issue of discrimination between imported and domestic products that may occur when using such subsidies. When such discrimination arose, it was prohibited by the relevant provisions of Article III. Subsidies which discriminated in favour of domestic products fell within the prohibition of the provisions of Article III by virtue of such discrimination. In this sense we agree with the 1992

Law of Treaties and Related Provisions ", BYIL, 1988, at 100; Sir Robert Jennings/Sir Arthur Watts (ed.), Oppenheim's International Law, Vol. I., Parts 2 to 4, 1992, at 1280; Sir Gerald Fitzmaurice, "The Law and procedure of the International court of Justice", BYIL , 1957, at 237; Sir Ian Sinclair, The Vienna Convention on the Law of Treaties, 1984, at 97.

[650] In this context we note that the WTO Agreement contains a specific rule on conflicts which is however limited to conflicts between a specific provision of GATT 1994 and a provision of another agreement of Annex 1A. We do not consider this interpretative note in this section of the report because we are dealing with Indonesia's argument that there is a general conflict between Article III and the SCM Agreement, while the note is concerned with specific conflicts between a provision of GATT 1994 and a specific provision of another agreement of Annex 1A.

[651] This would correspond to the ruling of the Appellate Body when it stated that a treaty may not be interpreted so as to reduce whole clauses to "inutility". See footnote 12 *supra*.

[652] *Alcoholic Beverages(1996),* Appellate Body Report, p.16.

[653] We recall our discussion in footnote 13 above on the conditions for a conflict to exist.

Malt Beverages[654] panel which discussed the relationship between the GATT rules on Article III and XVI and the related purpose of Article III:8(b):

> "5.8 The Panel noted that in contrast to Article III:8(a), where it is stated that "this Article shall not apply to ... [government procurement]", the underlined words are not repeated in Article III:8(b). The ordinary meaning of the text of Article III:8(b), especially the use of the words "shall not prevent", *therefore suggests that Article III does apply to subsidies*, and that Article III:8(b) only clarifies that the product-related rules in paragraphs 1 through 7 of Article III "shall not prevent the payment of subsidies exclusively to domestic producers (emphasis added)".

14.31 Has this situation changed with the expansion of rules regulating subsidies now contained in the SCM Agreement? Indonesia argues that the SCM Agreement now provides for an all encompassing definition and system of remedies for subsidies that would consequently exclude the relevance and application of the national treatment provisions of Article III.

14.32 While it is true that the obligations in Section A of Article XVI of GATT 1947 in respect of subsidies were limited compared to those provided in the new SCM Agreement, Article XVI of GATT 1947 did provide for a comprehensive framework regulating the provision of subsidies and so does the SCM Agreement today. Section A of Article XVI of GATT 1947 applied to "subsidies in general"; whereas Section B provided additional remedies for export subsidies. The mere fact that in the SCM Agreement the remedies against subsidies have been strengthened is not a sufficient reason to conclude that in the WTO Agreement the structural relationship between the rules on national treatment on products and the rules on subsidies to producers have been altered. Moreover, the fact that the SCM Agreement, unlike Article XVI of GATT 1947, contains a definition of subsidies does not suggest a different conclusion. The absence of a definition of "subsidy" in GATT 1947 did not make Article XVI of GATT 1947 inapplicable.

14.33 As was the case under GATT 1947, we think that Article III of GATT 1994 and the WTO rules on subsidies remain focused on different problems. Article III continues to prohibit discrimination between domestic and imported products in respect of internal taxes and other domestic regulations, including local content requirements. It does not "proscribe" nor does it "prohibit" the provision of any subsidy *per se*. By contrast, the SCM Agreement prohibits subsidies which are conditional on export performance and on meeting local content requirements, provides remedies with respect to certain subsidies where they cause adverse effects to the interests of another Member and exempts certain subsidies from actionability under the SCM Agreement. In short, Article III prohibits discrimination between domestic and imported products while the SCM Agreement regulates the provision of subsidies to enterprises.

14.34 Contrary to what Indonesia claims, the fact that a government gives a subsidy to a firm does not imply that the subsidy itself will necessarily discriminate between imported and domestic products in contravention of Article III of GATT. Article III:8(b) of GATT makes clear that a government may use the proceeds of taxes collected equally on all imported and domestic products in order to provide a subsidy to domestic producers (to the exclusion of producers abroad).[655]

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[654] Panel Report on *United States - Measures Affecting Alcoholic Malt Beverages*, BISD 39S/206, adopted on 19 June 1992, hereafter called *Malt Beverages* .

[655] See in support of this *Malt Beverages*, op. cit.:"5.10 ... Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due."

14.35 Finally, the fact that, as a result of the Uruguay Round, the SCM Agreement to some extent covers subject matters that were already covered by other GATT disciplines is not unique. This situation is similar to the relationship between GATT 1994 and GATS. In *Periodicals*[656] and in *Bananas III*[657], the defending parties argued that since a set of rules on services exists now in GATS, the provisions of Article III:4 of GATT on distribution and transportation have ceased to apply. Twice the Appellate Body has ruled that the scope of Article III:4 was not reduced by the fact that rules on trade in services are found in GATS: "The entry into force of the GATS, as Annex 1B of the WTO Agreement, does not diminish the scope of application of the GATT 1994."[658]

14.36 Accordingly, we consider that Article III and the SCM Agreement have, generally, different coverage and do not impose the same type of obligations.[659] Thus there is no general conflict between these two sets of provisions.

3. Would the application of Article III of GATT to this dispute reduce the SCM Agreement to "inutility"?

14.37 Indonesia argues that general rules of treaty interpretation preclude finding that a subsidy permissible under the SCM Agreement is proscribed by Article III because, if Article III were applicable to this dispute, the entire SCM Agreement would be reduced to "inutility". We note initially that in most cases the subsidies regulated under the SCM Agreement will not be covered by the provisions of Article III:2 or III:4. For instance, Article III:2 would not cover direct transfers of funds, e.g., loans and grants to firms, as this Article is concerned only with the application of indirect taxes on products. Subsidies in these forms may be contrary to Article III:4 to the extent that they are linked to measures which affect the internal sale, purchase, use, etc. of domestic goods. The provision of raw materials by a government at a subsidised price would not be contrary to either Article III:2 or Article III:4, unless it also contained a condition that affected as such the internal sale, offering for sale, etc. of goods.

14.38 The same distinction is applicable to tax measures. When subsidies to producers result from exemptions or reductions of indirect taxes on products, Article III:2 of GATT is relevant. In contrast, subsidies granted in respect of direct taxes are generally not covered by Article III:2, but may infringe Article III:4 to the extent that they are linked to other conditions which favour the use, purchase, etc. of domestic products.

14.39 This is to say that the only subsidies that would be affected by the provisions of Article III are those that would involve discrimination between domestic and imported products. While Article III of GATT and the SCM Agreement may appear to overlap in respect of certain measures, the two sets of provisions have different purposes and different coverage. Indeed, they also offer different remedies, different dispute settlement time limits and different implementation requirements. Thus,

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[656] Panel and Appellate Body Reports on *Canada - Certain Measures Concerning Periodicals*, WT/DS31, adopted on 30 July 1997, hereafter called *Periodicals*.

[657] Panel and Appellate Body Reports on *EC - Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27, adopted on 25 September 1997, hereafter called *Bananas III*.

[658] *Periodicals*, op.cit., Appellate Body Report, p.19.

[659] This conclusion is confirmed, amongst other provisions, by the footnote to Article 32.1 of the SCM Agreement which recognizes that actions against subsidies remain possible under GATT 1994. Article 32.1 of the SCM Agreement reads as follows: "No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement". The footnote 56 to this Article reads as follows: "This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate".

we reject Indonesia's argument that the application of Article III to subsidies would reduce the SCM Agreement to "inutility".

14.40 We note further that Indonesia's argument would imply that every time a measure involves tax discrimination in respect of products, that measure should be considered a subsidy governed exclusively by the SCM Agreement to the exclusion of Article III:2. It appears to us that this line of argument would reduce Article III:2 to "inutility", since the very explicit (and arguably only) purpose of Article III:2 is to deal with tax discrimination in respect of products.

4. Article III:8(b) of GATT

14.41 In line with its two previous arguments, Indonesia maintains the view that "the payment of subsidies" in Article III:8(b) of GATT must refer to all subsidies identified in Article 1 of the SCM Agreement, not merely to the subset of "direct" subsidies. Under this approach, any measure which constitutes a subsidy within the meaning of the SCM Agreement would not be subject to Article III of GATT. In Indonesia's view, only this interpretation avoids rendering the SCM Agreement meaningless.

14.42 Article III:8(b) of GATT provides as follows:

> "The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products."

14.43 We consider that the purpose of Article III:8(b) is to confirm that subsidies to producers do not violate Article III, so long as they do not have any component that introduces discrimination between imported and domestic products. In our view the wording "payment of subsidies exclusively to domestic producers" exists so as to ensure that only subsidies provided to producers, and not tax or other forms of discrimination on products, be considered subsidies for the purpose of Article III:8(b) of GATT. This is in line with previous GATT panels[660] and WTO Appellate Body[661] reports.

14.44 We recall also that the type of interpretation sought by Indonesia was explicitly excluded by the drafters of Article III:8(b) when they rejected a proposal by Cuba at the Havana Conference to amend the Article so as to read:

> "The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article [XVI]".[662]

14.45 The arguments submitted by Indonesia that its measures are only governed by the SCM Agreement clearly do not find any support in the wording of Article III:8(b) of GATT. On the contrary, Article III:8(b) confirms that the obligations of Article III and those of Article XVI (and the SCM Agreement) are different and complementary: subsidies to producers are subject to the national treatment provisions of Article III when they discriminate between imported and domestic products.

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[660] Panel Report on EEC - Payments and Subsidies Paid to Processors and Producers of Oil Seeds and Related Animal-feed Proteins, BISD 37S/86, adopted on 25 January 1990; Panel Report on Italian Discrimination Against Agriculture Machinery, BISD 7S/6, adopted on 23 October 1958; and Malt Beverages, op.cit..

[661] *Periodicals*, op.cit..

[662] E/CONF.2/C.3/6, page 17; E/CONF.2/C.3/A/W.32, page 2.

14.46 We find, therefore, that Article III of GATT is generally applicable to the measures at issue in the present dispute.

5. Is the TRIMS Agreement applicable to this dispute?

14.47 Indonesia argues that the TRIMs Agreement is not applicable to this dispute. For Indonesia, since Article III does not apply to the measures under examination, being in conflict with the SCM Agreement, the TRIMs Agreement does not apply either. Indonesia also argues that its car programmes are subsidies and therefore cannot be trade-related investment measures.

14.48 We note that we have found above that the provisions of Article III are generally relevant and applicable to the present dispute. We therefore reject Indonesia's argument that the TRIMS Agreement is not applicable to the measures under examination because Article III does not apply to those measures. We must now proceed to examine whether the Indonesian car programmes under examination can be covered at the same time by the provisions of the TRIMs Agreement and those of the SCM Agreement.

14.49 In considering this issue of whether a measure covered by the SCM Agreement can also be subject to the obligations contained in the TRIMs Agreement, we need to examine whether there is a general conflict between the SCM Agreement and the TRIMs Agreement. We note first that the interpretive note to Annex IA of the WTO Agreement is not applicable to the relationship between the SCM Agreement and the TRIMs Agreement. The issue of whether there might be a general conflict between the SCM Agreement and the TRIMs Agreement would therefore need to be examined in the light of the general international law presumption against conflicts and the fact that under public international law a conflict exists in the narrow situation of mutually exclusive obligations for provisions that cover the same type of subject matter.

14.50 In this context the fact that the drafters included an express provision governing conflicts between GATT and the other Annex 1A Agreements, but did not include any such provision regarding the relationship between the other Annex 1A Agreements, at a minimum reinforces the presumption in public international law against conflicts. With respect to the nature of obligations, we consider that, with regard to local content requirements, the SCM Agreement and the TRIMs Agreement are concerned with different types of obligations and cover different subject matters. In the case of the SCM Agreement, what is prohibited is the grant of a subsidy contingent on use of domestic goods, not the requirement to use domestic goods as such. In the case of the TRIMs Agreement, what is prohibited are TRIMs in the form of local content requirements, not the grant of an advantage, such as a subsidy.

14.51 A finding of inconsistency with Article 3.1(b) of the SCM Agreement can be remedied by removal of the subsidy, even if the local content requirement remains applicable. By contrast, a finding of inconsistency with the TRIMs Agreement can be remedied by a removal of the TRIM that is a local content requirement even if the subsidy continues to be granted. Conversely, for instance, if a Member were to apply a TRIM (in the form of local content requirement), as a condition for the receipt of a subsidy, the measure would continue to be a violation of the TRIMs Agreement if the subsidy element were replaced with some other form of incentive. By contrast, if the local content requirements were dropped, the subsidy would continue to be subject to the SCM Agreement, although the nature of the relevant discipline under the SCM Agreement might be affected. Clearly, the two agreements prohibit different measures. We note also that under the TRIMs Agreement, the advantage made conditional on meeting a local content requirement may include a wide variety of incentives and advantages, other than subsidies. There is no provision contained in the SCM Agreement that obliges a Member to violate the TRIMs Agreement, or vice versa.

14.52 We consider that the SCM and TRIMs Agreements cannot be in conflict, as they cover different subject matters and do not impose mutually exclusive obligations. The TRIMs Agreement and the SCM Agreement may have overlapping coverage in that they may both apply to a single legislative act, but they have different foci, and they impose different types of obligations.

14.53 In support of this finding, we agree with the principles developed in the *Periodicals*[663] and *Bananas III*[664] cases concerning the relationship between two WTO agreements at the same level within the structure of WTO agreements. It was made clear that, while the same measure could be scrutinized both under GATT and under GATS, the specific aspects of that measure to be examined under each agreement would be different. In the present case, there are in fact two different, albeit linked, aspects of the car programmes for which the complainants have raised claims. Some claims relate to the existence of local content requirements, alleged to be in violation of the TRIMs Agreement, and the other claims relate to the existence of subsidies, alleged to cause serious prejudice within the meaning of the SCM Agreement.

14.54 To respond to an argument raised by Indonesia in the context of its discussion of the relationship between Article III of GATT and the SCM Agreement, we do not consider that the application of the TRIMs Agreement to this dispute would reduce the SCM Agreement, and Article 27.3 thereof, to "inutility". On the contrary, with Article 27.3 of the SCM Agreement, those subsidy measures of developing countries that are contingent on compliance with TRIMs (in the form of local content requirement) and that are permitted during the transition period provided under Article 5 of the TRIMs Agreement, are not prohibited by Article 3.1(b) of the SCM Agreement, for the transition period specified in Article 27.3 of the SCM Agreement.

14.55 We find that there is no general conflict between the SCM Agreement and the TRIMs Agreement. Therefore, to the extent that the Indonesian car programmes are TRIMs and subsidies, both the TRIMs Agreement and the SCM Agreement are applicable to this dispute.

6. Conclusion

14.56 In view of the above findings, we reject Indonesia's general defense that the only applicable law to this dispute is the SCM Agreement. We consider rather that the obligations contained in the WTO Agreement are generally cumulative, can be complied with simultaneously and that different aspects and sometimes the same aspects of a legislative act can be subject to various provisions of the WTO Agreement.

14.57 We now turn to the claims of the complainants.

D. Claims of Local Content Requirements

14.58 The European Communities and the United States claim that the 1993 car programme, by providing for local content requirements linked to tax benefits for finished cars incorporating a certain

[663] In *Periodicals*, op. cit., the Appellate Body stated at page 19: "The entry into force of the GATS, as Annex 1B of the WTO Agreement, does not diminish the scope of application of the GATT 1994".

[664] In *Bananas III*, the Appellate Body stated in paragraph 221: "The second issue is whether the GATS and the GATT are mutually exclusive agreements. (...) Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods. certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. (...) [W]hile the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different".

percentage value of domestic products, and to customs duty benefits for imported parts and components used in cars incorporating a certain percentage value of domestic products, violates the provisions of Article 2 of the TRIMs Agreement, and Article III:4 of the GATT.

14.59 Japan, the European Communities and the United States also claim that the 1996 car programme, by providing for local content requirements linked to tax benefits for National Cars (which by definition incorporate a certain percentage value of domestic products), and to customs duty benefits for imported parts and components used in National Cars, violates the provisions of Article 2 of the TRIMs Agreement and Article III:4 of the GATT.

1. The relationship between the TRIMS Agreement and Article III of GATT

14.60 Since the complainants have raised claims that the local content requirements of the car programmes violate both the provisions of Article III:4 of GATT and Article 2 of the TRIMs Agreement, we must consider which claims to examine first. For Indonesia, this issue does not arise because it argues that the TRIMs Agreement does not add anything to Article III; it merely interprets Article III, elaborates the principles developed in the *FIRA*[665] panel report and applies them to trade-related investment measures. In deciding which claims to examine first, we must, initially, address the relationship between Article III of GATT and the TRIMs Agreement.

14.61 In this regard, we note first that on its face the TRIMs Agreement is a fully fledged agreement in the WTO system. The TRIMs Agreement is not an "Understanding to GATT 1994", unlike the six Understandings which form part of the GATT 1994.[666] The TRIMs Agreement and Article III:4 prohibit local content requirements that are TRIMs and therefore can be said to cover the same subject matter. But when the TRIMs Agreement refers to "the provisions of Article III", it refers to the substantive aspects of Article III; that is to say, conceptually, it is the ten paragraphs of Article III that are referred to in Article 2.1 of the TRIMs Agreement, and not the application of Article III in the WTO context as such. Thus if Article III is not applicable for any reason not related to the disciplines of Article III itself, the provisions of Article III remain applicable for the purpose of the TRIMs Agreement. This view is reinforced by the fact that Article 3 of the TRIMs Agreement contains a distinct and explicit reference to the general exceptions to GATT. If the purpose of the TRIMs Agreement were to refer to Article III as applied in the light of other (non Article III) GATT rules, there would be no need to refer to such general exceptions.[667]

14.62 Moreover, it has to be recognized that the TRIMs Agreement, in addition to interpreting and clarifying the provisions of Article III where trade-related investment measures are concerned, has introduced special transitional provisions including notification requirements.[668] This reinforces the

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[665] Panel Report on *Canada: Administration of the Foreign Investment Review Act*, BISD 30S/140, adopted on 7 February 1984, hereafter called *FIRA*.

[666] The General Agreement on Tariffs and Trade 1994 ("GATT") is defined as to consist of: (a) the provisions in the General Agreement on Custom duties and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (excluding the Protocol of Provisional Application), as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement; (b) the provisions of a series of the legal instruments (protocols and decisions) set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement; (c) six Understandings on the interpretation of provisions of GATT 1994; and (d) the Marrakesh Protocol to GATT 1994.

[667] We note that a similar drafting technique was used with the TRIPS Agreement which cross-refers to provisions of other international treaties.

[668] We note that Indonesia has put emphasis on a particular statement of the *Bananas III* panel concerning the relationship between Article III of GATT and the TRIMs Agreement. We consider that that

conclusion that the TRIMs Agreement has an autonomous legal existence, independent from that of Article III. Consequently, since the TRIMs Agreement and Article III remain two legally distinct and independent sets of provisions of the WTO Agreement, we find that even if either of the two sets of provisions were not applicable the other one would remain applicable. And to the extent that complainants have raised separate and distinct claims under Article III:4 of GATT and the TRIMs Agreement, each claim must be addressed separately.

14.63 As to which claims, those under Article III:4 of GATT or Article 2 of the TRIMs Agreement, to examine first, we consider that we should first examine the claims under the TRIMs Agreement since the TRIMs Agreement is more specific than Article III:4 as far as the claims under consideration are concerned. A similar issue was presented in *Bananas III*, where the Appellate Body discussed the relationship between Article X of GATT and Article 1.3 of the Licensing Agreement and concluded that the Licensing Agreement being more specific it should have been applied first.[669] This is also in line with the approach of the panel and the Appellate Body in the *Hormones*[670] dispute, where the measure at issue was examined first under the SPS Agreement since the measure was alleged to be an SPS measure.

2. The application of the TRIMS Agreement

14.64 Article 2.1 of the TRIMs Agreement provides that

> " ... no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994."

By its terms, Article 2.1 requires two elements to be shown to establish a violation thereof: first, the existence of a TRIM; second, that TRIM is inconsistent with Article III or Article XI of GATT. No claims have been raised with reference to a violation of Article XI of GATT.

14.65 Article 2.1 of the TRIMs Agreement refers to Article III generally. It is our view that the complainants have limited their TRIMs inconsistency claims to the aspects of the Indonesian car programmes that would violate the provisions of the TRIMs Agreement which prohibit any advantage conditional on meeting local content requirements. In other words, while the complainants have claimed that some other aspects of the same car programmes also violate the provisions of Article III:2 of GATT, they have not claimed that the tax discrimination aspects of the measures *per se* violate the TRIMs Agreement. Therefore, we will examine under the TRIMs Agreement, only the consistency of the local content requirements made effective through the custom duty and tax benefits of these car programmes. Later, we shall examine the consistency of the tax discrimination aspects *per se* of these car programmes with the provisions of Article III:2 of GATT.

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statement has to be understood in the particular context of that dispute between two developed countries (no transition period was therefore applicable) where the panel had already reached a conclusion that the measure at issue violated Article III:4 of GATT. Therefore there was no need to further discuss the TRIMs Agreement since any action to remedy the inconsistency found under Article III:4 of GATT would necessarily remedy inconsistencies under the TRIMs Agreement. In the present case, we have to address the legal relationship between these two agreements.

[669] The Appellate Body in *Bananas III* stated in paragraph 204:"Although Article X:3(a) of the GATT 1994 and Article 1.3 of the *Licensing Agreement* both apply, the Panel, in our view, should have applied the *Licensing Agreement* first, since this agreement deals specifically, and in detail, with the administration of import licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3(a) of the GATT 1994."

[670] Panel and Appellate Body reports on *EC - Measures Concerning Meat and Meat Products (Hormones) Complaints by the United States and Canada*, WT/DS26 and DS48, adopted on 13 February 1998, hereafter called *Hormones*.

14.66 We note also that Article 2.2 of the TRIMs Agreement provides:

> "2.2 An Illustrative List of TRIMs that are inconsistent with the obligations of national treatment provided for in paragraph 4 of Article III of GATT 1994 ... is contained in the Annex to this Agreement.

14.67 The United States and the European Communities claim that any measure that falls within the description of Item 1(a) of the Illustrative List of the TRIMs Agreement constitutes *per se* a TRIM inconsistent with Article 2 of the TRIMs Agreement. For the United States, if any Member, in whatever context, requires the purchase by an enterprise of a domestic product in order to obtain an advantage, that requirement by definition has investment consequences for such an enterprise, bringing the measure within the coverage of the TRIMs Agreement and confirming its violation thereof. The United States adds that, even if the identification of a relationship to investment were necessary to prove an inconsistency with the TRIMs Agreement, the Indonesian measures under examination fulfil such a condition, because the measures necessitate an investment in Indonesia (as a producer of motor vehicles or motor vehicle parts and components) to qualify for the various tax and customs duty incentives.

14.68 Japan rather argues that two elements must be shown to establish a violation of Article 2 of the TRIMs Agreement: first, there must be a TRIM; second, the measure in question must be inconsistent with Article III of GATT (or with Article XI of GATT).

14.69 The European Communities and Japan submit as well that the central aspect of the various measures included in the Indonesian car programmes is to develop domestic manufacturing capability of automobiles and automotive parts and components, and that they thereby qualify as "investment" measures. For these complainants, the Indonesian car programmes are "trade related" because they encourage the use of domestic over imported parts and thereby affect trade.

14.70 Indonesia argues that, while its subsidies may at times indirectly affect investment decisions of the recipient of the subsidy or other parties, these decisions are not the object, but rather the unintended result, of the subsidy. Indonesia adds that many subsidies will result indirectly in increased investment. Indonesia adds that these subsidies have not been adopted as investment regulations. Therefore, for Indonesia, the measures under examination are not trade-related investment measures. Indonesia also supports the argument put forward by India, a third party, that the TRIMs Agreement is basically designed to govern and provide a level playing field for foreign investment, and that therefore measures relating to internal taxes or subsidies cannot be construed to be trade-related investment measures.

14.71 We note that the arguments presented by the parties reflect different views on whether any requirement by an enterprise to purchase or use a domestic product in order to obtain an advantage, by definition falls within the Illustrative List or whether the TRIMs Agreement requires a separate analysis of the nature of a measure as a trade-related investment measure before proceeding to an examination of whether the measure is covered by the Illustrative List. However, if we were to consider that the measures in dispute in this case are in any event trade-related investment measures, it would not be necessary to decide this basic issue of interpretation. We note in this regard that the United States and the European Communities have also argued in the alternative that, even if it is necessary to show a relationship of a measure to investment, any such requirement would be satisfied in the case under consideration.

14.72 Therefore, we will first determine whether the Indonesian measures are TRIMs. To this end, we address initially the issue of whether the measures at issue are "investment measures". Next, we

consider whether they are "trade-related". Finally, we shall examine whether any measure found to be a TRIM is inconsistent with the provisions of Article III and thus violates the TRIMs Agreement.

(a) Are the Indonesian measures "investment measures"?

14.73 We note that the use of the broad term "investment measures" indicates that the TRIMs Agreement is not limited to measures taken specifically in regard to *foreign* investment. Contrary to India's argument, we find that nothing in the TRIMs Agreement suggests that the nationality of the ownership of enterprises subject to a particular measure is an element in deciding whether that measure is covered by the Agreement. We therefore find without textual support in the TRIMs Agreement the argument that since the TRIMs Agreement is basically designed to govern and provide a level playing field for foreign investment, measures relating to internal taxes or subsides cannot be construed to be a trade-related investment measure. We recall in this context that internal tax advantages or subsidies are only one of many types of advantages which may be tied to a local content requirement which is a principal focus of the TRIMs Agreement. The TRIMs Agreement is not concerned with subsidies and internal taxes as such but rather with local content requirements, compliance with which may be encouraged through providing any type of advantage. Nor, in any case, do we see why an internal measure would necessarily not govern the treatment of foreign investment.

14.74 We next consider whether the Indonesian measures are investment measures. In this regard, we consider the following extracts (emphases added) from the official Indonesian legislation relevant and instructive.

14.75 With regard to the 1993 car programme, we note:

- The "considerations section" of the Decree of the Ministry of Industry announcing the 1993 car programme states:

> "a. that within the framework of supporting and promoting the development of the automotive industry and/or the component industry in the future, it is deemed necessary to regulate the local content levels of domestically produced motor vehicles or components in connection with the grant of incentives in the imposition of import duty rates;
>
> b. that in order to further strengthen domestic industrial development by taking into account the trend of technological advance and the increase of the capability and mastering of industrial design and engineering, it is necessary to improve the relevant existing regulations already laid down;"[671]

- The "considerations section" of the 1995 amendment to the 1993 car programme states:

> "That in the framework of further promoting of the development of the motor vehicles industry and /or domestically produced components, it is considered necessary to amend..."[672]

[671] Decree of the Ministry of Industry No 114/M/S/6/1993, 9 June 1993.

[672] Decree of the Minister of Industry no 108/M/S/5/1995, on the amendment of the attachment I to Decree of the Minister of Industry Number 114/M/S/6/1993, 23 May 1995.

14.76 With regard to the February 1996 car programme, we note the following:

- The title of the Presidential Instruction for the National Car programme (No.2) is "The Development of the National Automobile Industry".[673]

- Paragraph a) of the "Considering" section of the Government Regulation No.20 states:

> "that in the effort to promote the growth of the domestic automotive industry, it is deemed necessary to enact regulations concerning the Sales Tax on Luxury Goods upon the delivery of domestically produced motor vehicles".[674]

- In addition, the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board issued a decree entitled "Investment Regulations within the Framework of the Realisation of the Establishment of the National Automobile Industry"[675] which emphasized that the new measures were intended to promote investment, stating in its fifth considering:

> "5. that it is therefore necessary to issue a decree for the regulation of investment in the national automobile industry."

- Article 2 of that same Investment Regulation by the Minister of State for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board provides:

> "In order to realise the development of the national automobile industry as meant in Article 1:
>
> 1. ...
> 2. In the endeavour to realise the development of such national car industry, the investment approval will be issued to the automobile industry sector with tax facilities in accordance with legal provisions enacted specifically for such purpose."

- The Decision relating to the investment facilities regarding the Determination of PT. Timor Putra National to Establish and Produce a National Car, entitled "Decision of the State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board" states:

> "1. That in implementing a national car industry it is deemed necessary to determine investment approval for a car industry which will build and produce a national car.
>
> 2. That in the framework of investment for the car industry, PT.Timor Putra National has submitted an application and working program to build a national car industry and has obtained domestic

[673] Instruction of the President of the Republic of Indonesia No.2 of 1996, 19 February 1996.
[674] Government Regulation No. 20 of 1996, 19 February 1996.
[675] Decree of the State Minister for Mobilisation of Investment Funds/Chairman of the Investment Coordinating Board No.01/SK/1996, 27 February 1996.

> investment approval (PMDN) NO.607/PMDN/1995, dated 9 November 1995".[676]

14.77 With regard to the June 1996 car programme, we note that the "Considering" section of the Decree of the President of the Republic No. 4267[677] on the Extension (June) to the February 1996 car programme provides:

> "a. that the development of the national car is aimed at improving the nation's self-reliance ... and to achieve this solid preparations and continuous support are necessary;
> b. that the preparation for domestic production of national cars require the availability of huge financing and therefore will be carried out in stages;
> c. that in connection with the preparations, it is considered necessary to establish a policy on the implementation stage of the production of national cars."

- The "Considering" section of the Government Regulation No. 3667[678] states:

> "That within the framework of promoting the development of the automotive industry in the increased use of domestically produced automotive components, it is deemed necessary to grant Sales Tax on Luxury Goods facilities to the group of luxury goods upon delivery of certain motor vehicles"

- The Elucidation to the Government Regulation No. 36 states:

> "Within the framework of speeding up the realisation of production of national motor vehicles using domestically made automotive components, it is necessary to promote the domestic automotive industry in order to further its growth particularly in the face of global competition. One of the endeavours which can be exerted is the provision of a tax incentive in the form of exemption from the assessment of Sales Tax on Luxury Goods on the delivery of certain motor vehicles which have achieved certain levels of local content."

14.78 We note also that Indonesia indicates[679] that the objectives of the National Car programme include the following:

- To improve the competitiveness of local companies and strengthen overall industrial development;
- To develop the capacity of multiple-source auto parts and components;
- To encourage the development of the automotive industry and the automotive component industry;
- To bring about major structural changes in the Indonesian automobile industry;

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[676] Decision of the State Minister For the Mobilization of Investment Funds/Chairman of the Capital Investment Co-Ordinating Board; Number 02/SK/1996, 5 March 1996.

[677] Presidential Decree No.42 Concerning the Production of National Automobiles, 4 June 1996.

[678] Government Regulation No. 36/1996: The Amendment of Government Regulation No.50 of 1994 Regarding the Implementation of Law No.8 of 1993 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as amended by Law No.11 of 1994, as Lastly Amended by Government Regulation No. 20 of 1996, 4 June 1996.

[679] See paragraph 6.51 of the Descriptive Part.

- To encourage the transfer of technology and contribute to large-scale job creation;
- To encourage car companies to increase their local content, resulting in a rapid growth of investment in the automobile industry.

14.79 Indonesia has also stated that PT TPN is a "domestic capital investment company".[680]

14.80 On the basis of our reading of these measures applied by Indonesia under the 1993 and the 1996 car programmes, which have investment objectives and investment features and which refer to investment programmes, we find that these measures are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components in Indonesia. Inherent to this objective is that these measures necessarily have a significant impact on investment in these sectors. For this reason, we consider that these measures fall within any reasonable interpretation of the term "investment measures". We do not intend to provide an overall definition of what constitutes an investment measure. We emphasize that our characterization of the measures as "investment measures" is based on an examination of the manner in which the measures at issue in this case relate to investment. There may be other measures which qualify as investment measures within the meaning of the TRIMs Agreement because they relate to investment in a different manner.

14.81 With respect to the arguments of Indonesia that the measures at issue are not investment measures because the Indonesian Government does not regard the programmes as investment programmes and because the measures have not been adopted by the authorities responsible for investment policy, we believe that there is nothing in the text of the TRIMs Agreement to suggest that a measure is not an investment measure simply on the grounds that a Member does not characterize the measure as such, or on the grounds that the measure is not explicitly adopted as an investment regulation. In any event, we note that some of the regulations and decisions adopted pursuant to these car programmes were adopted by investment bodies.

(b) Are the Indonesian measures "trade-related"?

14.82 We now have to determine whether these investment measures are "trade-related". We consider that, if these measures are local content requirements, they would necessarily be "trade-related" because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade.

(c) Illustrative List of the TRIMs Agreement

14.83 An examination of whether these measures are covered by Item (1) of the Illustrative List of TRIMs annexed to the TRIMs Agreement, which refers amongst other situations to measures with local content requirements, will not only indicate whether they are trade-related but also whether they are inconsistent with Article III:4 and thus in violation of Article 2.1 of the TRIMs Agreement.

14.84 The Annex to the TRIMs Agreement reads as follows:

[680] See paragraph 6.50 of the Descriptive Part.

"ANNEX
ILLUSTRATIVE LIST

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of 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;"

14.85 We note that all the various decrees and regulations implementing the Indonesian car programmes operate in the same manner. They provide for tax advantages on finished motor vehicles using a certain percentage value of local content and additional customs duty advantages on imports of parts and components to be used in finished motor vehicles using a certain percentage value of local content. We also note that under the June 1996 car programme, the local content envisaged in the February 1996 car programme could be performed through an undertaking by the foreign producer of National Cars to counter-purchase Indonesian parts and components.

14.86 For instance, the Decision to issue the Decree of the Minister of Industry Concerning The Determination of Local Content Levels of Domestically Made Motor Vehicles or Components attached to the Decree of the Ministry of Industry announcing the 1993[681] car programme states in its Article 2:

"(1) The Automotive Industry and/or the Components Industry may obtain certain Incentives within the framework of importing needed Components, Sub-Components, basic materials and semi-Finished Goods, originating in one source as well as various sources (multi sourcing), if the production has reached/can achieve certain Local Content levels. (...)
(3) The Local Content levels of domestically made Motor Vehicles and/or Components which are eligible for Incentives including their Incentive rates shall be those listed in Attachment I to this decree." (emphasis added)

The Instruction of the President of the Republic of Indonesia No.2 of 1996 of the National Car programme (dated 19 February 1998) states in its "INSTRUCT ... SECONDLY:

"WITHIN the framework of establishment of the National Car Industry:

1. The Minister of Industry and Trade will foster, guide and grant facilities in accordance with provisions of laws in effect such that the national car industry:

a. uses a brand name of its own;
b. uses components produced domestically as much as possible;
c. is able to export its products." (emphasis added)

More specifically Regulation No. 20/1996 established the following sales tax structure where passenger cars of more than 1600cc and jeeps with local content of less than 60% would pay 35% tax;

[681] Decree of the Ministry of Industry No. 114/M/S/6/1993, 9 June 1993.

passenger cars of less than 1600cc, jeeps with local content of more than 60%, and light commercial vehicles (other than jeeps using gas) would pay 20% tax; and National Cars would pay 0% tax.[682] We recall that one of the requirements for designation as a "National Car" is that the local content rate must be 20% at the end of the first year, 40% at the end of the second year and 60% at the end of the third year.[683]

14.87 We also note with reference to the June 1996 car programme, that the Decree of the President of the Republic of Indonesia Number 42 of 1996[684] on the production of National Cars provides in Article 1:

> "National Cars which are made overseas by Indonesian workers and fulfil the local content stipulated by the Minister of Industry and Trade will be treated equally to those made in Indonesia."

The Decree of the Minister of Industry and Trade adopted pursuant to this Presidential Decree 42 states in Articles 1, 2 and 3:

> "Article 1
> Within the framework of preparations, the production of national cars can be carried out overseas for a one-time maximum period of 1 (one) year on the condition that Indonesian made parts and components are used.
> Article 2
> The procurement of Indonesian made parts and components shall be performed through a system of counter purchase of parts and components of motor vehicles by the overseas company carrying out the production and reexporting of national cars to Indonesia.
> Article 3
> The value of the Counter purchase referred to in Article 2 shall be fixed at the minimum of 25% (twenty-five percent) of the import value of the national cars assembled abroad (C&F value)".

14.88 We believe that under these measures compliance with the provisions for the purchase and use of particular products of domestic origin is necessary to obtain the tax and customs duty benefits on these car programmes, as referred to in Item 1(a) of the Illustrative List of TRIMs.

14.89 We need now to decide whether these tax and customs duty benefits are "advantages" in the meaning of the chapeau of paragraph 1 of that Illustrative List. In the context of the claims under Article III:4 of GATT, Indonesia has argued that the reduced customs duties are not internal regulations and as such cannot be covered by the wording of Article III:4. We do not consider that the matter before us in connection with Indonesia's obligations under the TRIMs Agreement is the customs duty relief as such but rather the internal regulations, i.e. the provisions on purchase and use of domestic products, compliance with which is necessary to obtain an advantage, which advantage here is the customs duty relief. The lower duty rates are clearly "advantages" in the meaning of the chapeau of the Illustrative List to the TRIMs Agreement and as such, we find that the Indonesian measures fall within the scope of the Item 1 of the Illustrative List of TRIMs.

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[682] See paragraphs 2.28 *et seq*. of the Descriptive Part. Regulation No. 36/1996 increased the tax incentive available by providing that passenger cars and light commercial vehicles with a local content in excess of 60% would pay 0% tax. See paragraphs 2.36 *et seq*. of the Descriptive Part.

[683] See paragraphs 2.24 *et seq*. of the Descriptive Part.

[684] The Decree of the Minister of Industry and Trade Number: 142/MPP/Kep/6/1996 Regarding the Production of the National Car, 5 June 1996.

14.90 Indonesia also argues that the local content requirements of its car programmes do not constitute classic local content requirements within the meaning of the *FIRA* panel (which involved a binding contract between the investor and the Government of Canada) because they leave companies free to decide from which source to purchase parts and components. We note that the Indonesian producers or assemblers of motor vehicles (or motor vehicle parts) must satisfy the local content targets of the relevant measures in order to take advantage of the customs duty and tax benefits offered by the Government. The wording of the Illustrative List of the TRIMs Agreement makes it clear that a simple advantage conditional on the use of domestic goods is considered to be a violation of Article 2 of the TRIMs Agreement even if the local content requirement is not binding as such. We note in addition that this argument has also been rejected in the Panel Report on *Parts and Components*.[685]

14.91 We thus find that the tax and tariff benefits contingent on meeting local requirements under these car programmes constitute "advantages". Given this and our earlier analysis of whether these local content requirements are TRIMs and covered by the Illustrative List annexed to the TRIMs Agreement, we further find that they are in violation of Article 2.1 of the TRIMs Agreement.

14.92 We note that a violation of Article 2.1 of the TRIMs Agreement may be justified under Articles 3, 4 or 5 of the TRIMs Agreement.[686] However, Indonesia has not invoked any of the general exceptions of GATT as referred to in Article 3 of the TRIMs Agreement, nor the provisions available to developing countries referred to in Article 4. In addition, Indonesia does not claim that the measures in dispute benefit from the transitional period under Article 5 of the TRIMs Agreement.[687]

3. Article III:4 of GATT

14.93 The complainants have claimed that the local content requirements under examination, and which we find are inconsistent with the TRIMs Agreement, also violate the provisions of Article III:4 of GATT. Under the principle of judicial economy[688], a panel only has to address the claims that must be addressed to resolve a dispute or which may help a losing party in bringing its measures into conformity with the WTO Agreement. The local content requirement aspects of the measures at issue have been addressed pursuant to the claims of the complainants under the TRIMs Agreement. We consider therefore that action to remedy the inconsistencies that we have found with Indonesia's

[685] In *Parts and Components*, the panel recognized that requirements that an enterprise voluntarily accepts to gain government-provided advantages are nonetheless "requirements" (italics in original): "5.21 The Panel noted that Article III:4 refers to "all laws, regulations or requirements affecting (the) internal sale, offering for sale, purchase, transportation, distribution or use." The Panel considered that the comprehensive coverage of "*all* laws, regulations or requirements *affecting*" the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, . . . but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute "requirements" within the meaning of that provision ... ." Panel Report on *EEC - Regulation on Imports of Parts and Components*, BISD 37S/132, adopted on 16 May 1990.

[686] We recall our view that Article III:8(b) of GATT does not constitute a defense to any measure providing discrimination between imported and domestic products, including local content requirements. See paragraph 14.43 *supra*.

[687] Article 5 of the TRIMs Agreement offers a transitional period to developing countries that allows them to maintain any notified TRIM, existing 180 days prior to 1 January 1995. Such TRIMs are to be phased out by 1 January 2000. Notifications under Article 5 were required to be made by 31 March 1995. We note that on 23 May 1995, Indonesia made a notification with respect to its 1993 Incentive System to the TRIMs Committee under Article 5 of the TRIMs Agreement. On 28 October 1996, Indonesia notified the TRIMs Committee that it was withdrawing its notification related to automobiles because it considered that this programme was not a TRIM.

[688] As defined by the Appellate Body in *Shirts and Blouses*, op. cit., pp. 17-20.

obligations under the TRIMs Agreement would necessarily remedy any inconsistency that we might find with the provisions of Article III:4 of GATT. We recall our conclusion that non applicability of Article III would not affect as such the application of the TRIMs Agreement. We consider therefore that we do not have to address the claims under Article III:4, nor any claim of conflict between Article III:4 of GATT and the provisions of the SCM Agreement.

E. Claims of Tax Discrimination

14.94 The three complainants claim that the sales tax benefits under the February 1996 car programmes are in violation of Article III:2 of GATT. The United States and the European Communities also claim that the sales tax benefits of the 1993 and of the June 1996 car programmes are inconsistent with Article III:2. Finally the European Communities claim that since the 1993 and the 1996 programmes provide for a level of tax applicable on a finished product which is a function of its local content level, imported parts and components are, as a result, subject "indirectly" to a tax which is in excess of that indirectly applied on domestic like parts and components.

14.95 We note that Indonesia has not submitted much evidence or argument against the claims of the complainants that the car programmes tax, directly or indirectly, imported like or directly competitive products in violation of the national treatment obligation of Article III:2. Indonesia did state that most (but not all) parts and components were tailor-made and that imported cars were not like domestic cars. However, Indonesia did not argue that these imported products were not or could not be directly competitive or substitutable to domestically produced products.

14.96 Rather, Indonesia's main defense to these claims under Article III:2 would appear to be that there is a conflict between Article III:2 of GATT and the SCM Agreement and that to apply Article III:2 to subsidies would reduce the SCM Agreement to "inutility". We shall first examine this defense by Indonesia.

1. Is there a conflict between the provisions of the SCM Agreement and Article III:2 of GATT?

14.97 Indonesia argues that there is a conflict between Article III:2 and the SCM Agreement in that the obligations contained in Article III:2 of GATT and the SCM Agreement are mutually exclusive.[689] For Indonesia, the obligations under both agreements cannot be complied with at the same time without the need to renounce explicit rights or authorizations contained in the SCM Agreement to maintain the subsidies at issue absent serious prejudice to like products. Indonesia refers to the interpretative note to Annex 1A of GATT and the *Bananas III* test. All parties have entered into lengthy argumentation on the relevance, application and consequences of these provisions.

14.98 In examining this issue, we need not decide whether the test suggested by the *Bananas III* panel report with regard to the interpretative note to Annex 1 A is the correct one in the WTO context. Indonesia argues that there is a conflict because the SCM Agreement "explicitly authorizes" Members to provide subsidies that are prohibited by Article III:2 of GATT. Assuming that such "explicit authorization" is the correct conflict test in the WTO context, we find that, whether or not the SCM Agreement is considered generally to "authorize" Members to provide actionable subsidies so long as they do not cause adverse effects to the interests of another member, the SCM Agreement clearly does not authorize Members to impose discriminatory product taxes. Nor does a focus on Article 27.3 suggest a different approach. Whether or not Article 27.3 of the SCM Agreement can be reasonably interpreted to "authorize", explicitly or implicitly, the provision of subsidies contingent on the use of domestic over imported goods (an issue we do not here decide), Article 27.3 is unrelated to, and cannot reasonably be considered to "authorize", the imposition of discriminatory product taxes.

[689] See paragraphs 5.145 to 5.204 of the Descriptive Part.

14.99 We also recall that the obligations of the SCM Agreement and Article III:2 are not mutually exclusive. It is possible for Indonesia to respect its obligations under the SCM Agreement without violating Article III:2 since Article III:2 is concerned with discriminatory product taxation, rather than the provision of subsidies as such. Similarly, it is possible for Indonesia to respect the obligations of Article III:2 without violating its obligations under the SCM Agreement since the SCM Agreement does not deal with taxes on products as such but rather with subsidies to enterprises. At most, the SCM Agreement and Article III:2 are each concerned with different aspects of the same piece of legislation.[690]

14.100 We find, therefore, that Article III:2 is applicable to the present dispute.

14.101 We shall now examine the validity of the complainants' claims under Article III:2 of GATT.

2. Article III:2 of GATT

14.102 Article III:1 and III:2 of GATT provide as follows:

> " *National Treatment on Internal Taxation and Regulation*
>
> 1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.*
>
> 2. 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. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*"

The Note Ad to Article III:2 provides:

> *"Paragraph 2*
>
> A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed."

14.103 It has been established[691] that Article III:2 contains two standards, depending on whether the imported and domestic goods are considered to be "like products" subject to the requirements of the first sentence of Article III:2, or whether the imported and domestic goods are rather considered as being "directly competitive or substitutable goods" subject to the requirements of the second sentence of Article III:2. If a complainant raises a claim under the first sentence of Article III:2, it must establish that the imported products are taxed "in excess" of any domestic like products. If a

[690] We refer to our discussion on this matter in Section C above, paragraphs 14.28 ff *supra*.
[691] *Alcoholic Beverages(1996)*, op. cit., Appellate Body Report, p. 17.

complainant raises a claim under the second sentence of Article III:2, it must establish that the imported products are "not similarly taxed" to the domestic "directly competitive or substitutable goods" and that the dissimilar taxation is "applied ... so as to afford protection to domestic production".

(a) Article III:2, first sentence

14.104 The European Communities submit a series of categories of goods which, it argues should be considered "like products" for the purposes of applying Article III:2, first sentence, in the present case.[692] The European Communities argue that the tax exemptions provided by the various car programmes under examination are not based on any factor which in itself affects the properties, nature or quality of the products concerned or their end uses. Rather the exemptions are based on the country of manufacture of the products; or on their level of local content; or on whether a motor vehicle is a National Car and has complied with certain local content requirements or has incorporated a certain percentage of "counter-purchased" parts and components exported from Indonesia; or on the characteristics of the car manufacturers.

14.105 Japan claims that the tax benefits of the 1996 car programmes violate Article III:2, first sentence but limits its claim of like products to National Cars and like imported automobiles. The United States claims that National Cars and other Indonesian cars with more than 60 per cent local content are like imported motor vehicles. Both Japan and the United States argue that such imported products are taxed in excess of domestic like products.

14.106 Indonesia does not specifically argue that the complainants have not demonstrated the elements necessary to establish a violation of Article III:2 (i.e. like products and differential taxation)[693] ,but rather argues that Article III:2 of GATT is inapplicable because it prohibits what the SCM Agreement permits. We have already rejected this argument from Indonesia.

14.107 To establish a violation of Article III:2, first sentence, complainants must prove that imported products are taxed "in excess" of domestic like products. In examining the claims of the complainants, we note that Indonesia does not dispute that pursuant to the 1993 and 1996 car programmes imported motor vehicles are taxed in excess of the domestic products at issue. For instance, more specifically, under the 1996 car programmes, National Cars are completely exempted from sales tax, and under the 1993 car programme (as modified by Regulation No. 36/1996) domestic passenger cars below 1600cc with greater than 60% local content are exempted from sales tax while imported sedans or domestic sedans with 60% or less local content are subject to a sales tax of 35%.

14.108 Turning to the "like product" issue, in applying this test, we note that the term "like product" is not defined in GATT. Past panels have recognized that the term has different meanings in different GATT provisions, depending on the context and the object and purpose of those provisions.[694] In this

[692] See paragraph 5.16 of the Descriptive Part.

[693] We recall, on the issue of burden of proof, that the complainant parties bear the burden of proof in that they must establish a *prima facie* case of inconsistency with a provision before the burden of showing consistency with that provision is taken on by the defendant party. But, as noted by the Appellate Body in the *Hormones* report: "It is also well to remember that 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". Appellate Body Report on *Hormones*, op.cit., para. 104.

[694] Panel Report on *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, adopted on 10 November 1987, BISD 34S/83, para. 5.6, hereafter called *Alcoholic Beverages* (1987).

connection, it is useful to recall the Appellate Body's discussion of Article III in *Alcoholic Beverages(1996)*[695]:

> "The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures ÿnot be applied to imported or domestic products so as to afford protection to domestic production'".[696] ...
> Moreover, it is irrelevant that "the trade effects" of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products[697]".

14.109 In *Alcoholic Beverages(1996)*[698] and *Periodicals*[699], the Appellate Body endorsed the basic approach set out in the 1970 Report of the Working Party on Border Tax Adjustment:

> "... the interpretation of the term [like product] should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a similar product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end uses in a given market; consumers' tastes and habits, which change from country to country; the products properties, nature and quality".[700]

14.110 Applying these criteria to the case at hand, we note that Japan specifically claims that, for purposes of Article III:2, four models of Japanese cars that have been sold in the Indonesian market are like the National Car (i.e. the Timor, which is based on the Kia Sephia[701]). Those cars are the Toyota Corolla, the Mitsubishi Lancer, the Honda Civic and the Suzuki Baleno. In support thereof, it notes the similar engine sizes: 1500cc for the Timor, 1600cc for the others. We note that the evidence before us demonstrates that these cars are categorized similarly in market segmentation studies, with the Baleno in Segment B (Supermini Segment), the Corolla and Civic in Segment C1 (lower end of the Lower Medium Segment) and the Lancer in Segment C2 (upper end of the Lower Medium Segment).[702] In particular, at least as to the imported models in Segment C1, it appears to us

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[695] *Alcoholic Beverages(1996)*, op. cit., Appellate Body Report, p.16.

[696] Panel Report on *Section 337*, op. cit., para. 5.10.

[697] Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9, hereafter called *Superfund*.

[698] Appellate Body Report on *Alcoholic Beverages(1996)*, op. cit., p.20.

[699] Appellate Body Report on *Periodicals*, op. cit., p.21.

[700] Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para 18. In *Alcoholic Beverages(1996)*, the Appellate Body noted that "We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of 'likeness' is meant to be narrowly squeezed". Appellate Body Report on *Alcoholic Beverages (1996)*, op.cit., p.21.

[701] The DRI's Global Automotive Group, a company whose clients appear to include all major auto manufacturers, including KIA, PT TPN's National Car partner, identifies models sold in the Indonesian market by the more common model names used in other markets. However, it is clear from the data provided by DRI that the "Sephias" referred to in the Asian Forecast are in fact Timors imported from Korea or assembled in Indonesia. Thus under the DRI's classification the Timor falls within Segment C1 (lower end of the Lower Medium Segment).

[702] This market segmentation is based on the analysis made by the DRI's Global Automotive Group. As further developed in paragraphs 14.177 *et seq.* hereafter we have relied on this DRI study as an important element of our analysis for the purpose of determining the likeness of products pursuant to the claims under the SCM Agreement. We find that in this case the criteria used by DRI in arriving at its market segmentation are appropriate to the determination of like products under Article III:2, first sentence.

that these models of cars have the same end uses and the same basic properties, nature and quality. Given that these models are in the same market segments, there would not appear to be any relevant differences in respect of consumers' tastes and habits sufficient to render these products unlike. We note, however, that both the Corolla and the Civic are imported into Indonesia in CKD (completely knocked down) form. In our analysis of determining the likeness of products pursuant to complainants' claims under the SCM Agreement, we have examined whether a CKD kit can be "like" a finished car. We consider that, in the present case, the same analysis is appropriate to the determination of like products under Article III:2, first sentence. From the evidence submitted, it is not clear whether the Civics sold in Indonesia can be considered to be imports of like products from Japan, as data provided by Indonesia in the Annex V (SCM) context indicate that the Honda models sold in Indonesia received benefits under the 1993 car programme, implying that these models have more than 20% local content. However, we need not decide whether the Civic is or is not an imported like product, since we find that there is at least one model in market Segment C1, the Corolla, that does appear not to have received any such benefit, indicating that its percentage of Indonesian local content, if any, is minimal. In our view, this evidence is sufficient to establish a presumption[703] of likeness between the Timor and Corolla for purposes of Article III:2. Since Indonesia has submitted no evidence or argument to rebut the presumption of likeness for the purposes of Article III:2, we find that imported products like the National Car exist for purposes of Article III:2.

14.111 While the European Communities and the United States did not identify specific car models that they alleged to be like products to the National Car or other Indonesian cars for Article III:2 purposes, we note that they did so for purposes of their claims under the SCM Agreement. In connection therewith[704], we found after a detailed examination that several models in Segment C1 (Ford Escort, Peugeot 306 and Opel Optima) were like the Timor. We believe that in the present case the same facts which support a finding of likeness for the purpose of the SCM Agreement also support a finding of likeness for the purpose of the first sentence of Article III:2 of GATT.

14.112 More importantly, we note that because of the structure of the tax regime under examination, any imported like products would necessarily be taxed in excess of domestic like products. In considering the broader arguments put forward by the complainants that the tax measures in dispute violate Article III:2 because they discriminate not on the basis of factors affecting the properties, nature, qualities or end use of the products, but on origin-related criteria, we recall that the Appellate Body decisions in *Alcoholic Beverages(1996)* and *Periodicals* suggest that the term "like products" as used in Article III:2 should be interpreted narrowly.[705] We note, however, that in this case the "like products" issue is not the same as the "like products" issue in the *Alcoholic Beverages(1996)* case. There, the internal tax imposed on domestic shochu was the same as that imposed on imported shochu; the higher tax imposed on imported vodka was also imposed on domestic vodka. Identical products (not considering brand differences) were taxed identically. The issue was whether the differences between the two products shochu and vodka, as defined for tax purposes, were so minor that shochu and vodka should be considered to be like products and therefore subject to the requirement of Article III:2, first sentence, that one should not be taxed in excess of the other. Here, the situation is quite different. The distinction between the products, which results in different levels of taxation, is not based on the products *per se*, but rather on such factors as the nationality of the producer or the origin of the parts and components contained in the product. As such, an imported product identical in all respects to a domestic product, except for its origin or the origin of its parts and components or other factors not related to the product itself, would be subject to a different level of taxation.

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[703] *Shirts and Blouses*, op. cit., Appellate Body Report, p.14.
[704] See paragraphs 14.193 *infra*.
[705] *Alcoholic Beverages(1996)*, op. cit., Appellate Body Report, pp.19-20; *Periodicals*, op. cit., Appellate Body Report, p.22.

14.113 In *Periodicals*, the Appellate Body recognized the possibility of using hypothetical imports to determine whether a measure violates Article III:2, although in that case the Appellate Body rejected the hypothetical example used by the Panel.[706] But this case is different. Under the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product. Appropriate hypotheticals are therefore easily constructed. An imported motor vehicle alike in all aspects relevant to a likeness determination would be taxed at higher rate simply because of its origin or lack of sufficient local content.[707] Such vehicles certainly can exist (and, as demonstrated above, do in fact exist). In our view, such an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2, without the need to demonstrate the existence of actually traded like products.[708] This is directly in accord with the broad purposes of Article III:2, as outlined by the Appellate Body in paragraph 14.108, *infra*.

14.114 Thus, by providing for the imposition of taxes on imported products in excess of taxes imposed on domestic like products, the tax provisions of the Indonesian car programmes violate the provisions of the first sentence of Article III:2 of GATT.

(b) Article III:2, second sentence

14.115 In light of the foregoing finding under Article III:2, first sentence, we consider that it would not be necessary to examine the same programmes under Article III:2, second sentence. We note, however, that any imported motor vehicle that would be directly competitive or substitutable to a domestic product at issue, would not be taxed similarly to a National Car or to a finished motor vehicle that meets a certain local content value. Indeed the large tax differential (for instance under the 1996 car programmes, National Cars are completely exempted from sales tax and under the 1993 car programme - as modified by Regulation No. 36/1996 - domestic sedans below 1600cc and with greater than 60% local content are exempted from sales tax while imported sedans or domestic sedans with 60% or less local content are subject to a sales tax of 35%) is clear evidence that the relevant products are not similarly taxed. Finally, the nature of the discrimination, which is to promote a national industry by giving it advantages vis-à-vis imported products, is clearly designed so as to afford protection to domestic production, contrary to the second sentence of Article III:2 of GATT.

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[706] *Periodicals*, op. cit., Appellate Body Report, pp. 20-21.

[707] Thus, although there is no evidence in the record of such actual imports, it can be found that any imported motorcycles of 250 cc or less, which are like Indonesian made motorcycles of 250 cc or less, would be taxed in excess of the latter; any imported combines, minibuses, vans and pick-ups, which are like Indonesian made combines, minibuses, vans and pick ups, including those with a local content of 60 % or more, would be taxed in excess of the latter; any imported buses, which are like Indonesian made buses, would be taxed in excess of the latter; any imported sedans and stations wagons of less than 1,600 cc, which are like Indonesian made sedans and station wagons of less than 1,600 cc, including those with a local content of 60 % or more, would be taxed in excess of the latter.

[708] This finding is in accord with a number of previous panel reports concluding that differences in producers' characteristics, which do not affect the products' characteristics, cannot justify a different tax treatment of the products involved. See, e.g., *Malt Beverages*, at para 5.19 ("beer produced by large breweries is not unlike beer produced by small breweries"); *Gasoline*, at para. 6.11 ("Article III:4 of the General Agreement deals with the treatment to be accorded to like products; its wording does not allow less favourable treatment dependent on the characteristics of the producer."); Panel Report on *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, adopted 4 October 1994, DS44/R, para. 97 ("The Panel thus considered that the system for calculation of the BDA on imported tobacco itself, not just the manner in which it was currently applied, was inconsistent with Article III:2 because it carried with it the risk of discriminatory treatment of imports in respect of internal taxes.")

14.116 We find therefore that the various measures adopted pursuant to the Indonesian car programmes under examination, are inconsistent with Article III:2 first and second sentences, in that the structure of the tax scheme is such that imported products are taxed in excess of domestic like products and imported products which are directly competitive or substitutable to domestic products are also necessarily not similarly taxed so as to afford protection to the domestic production of such products.

14.117 In the light of the foregoing finding, we consider it unnecessary to address the European Communities' claim that imported parts and components are subject "indirectly" to a tax which is in excess of that indirectly applied on domestic like parts and components since the sales tax applicable on a finished product varies according to its local content level.

3. Article III:8(b) of GATT

14.118 Although it does not do so explicitly, Indonesia could be viewed as claiming that should Article III:2 be applicable, those of its measures which are subsidies should be exempted from Article III through the application of Article III:8(b).[709]

14.119 In our view, with regard to subsidies to producers, Article III:8(b) should be interpreted to mean that:

1) if the subsidy benefit to producers derives from indirect taxes, there must be a prior collection on a non-discriminatory basis of such taxes;

2) the subsidies must have been provided directly to the producers, that is to say that Article III:8(b) does not cover a financial advantage that benefits producers indirectly (for example subsidies paid to consumers of products, produced by domestic producers).

14.120 In this sense, we agree with the statement of the Appellate Body in the recent *Periodicals* case where it approved the reasoning of the *Malt Beverages* case on Article III:8(b).

"We [the Appellate Body] agree with the panel in *United States - Malt Beverages* that:

> 5.10 Article III:8(b) limits, therefore, the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced."[710] (emphasis added)

[709] We have already discussed the scope and purpose of Article III:8(b) in Section C of this report. We consider that one of the purposes of Article III:8(b) is to confirm the respective scopes of Article III and Article XVI (and now the SCM Agreement).

[710] *Periodicals*, op. cit., Appellate Body Report, p. 34.

We also agree with the following passage of *Malt Beverages*:

> "5.9 ... Any fiscal burden imposed by discriminatory internal taxes on imported goods is likely to entail a trade-distorting advantage for import-competing domestic producers, the prohibition of discriminatory internal taxes in Article III:2 would be ineffective if discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8(b)."

14.121 We find therefore that subsidies that result from product-tax discrimination are subject to the prohibitions of Article III:2 of GATT. This is to say that the Indonesian measures involving tax exemptions and reductions, here on finished motor vehicles including National Cars, are fully subject to the prohibition against product-tax discrimination of Article III:2.

14.122 Thus, Article III:8(b) of GATT does not provide Indonesia with a defense to the claims that its car programmes violate the provisions of Article III:2 of GATT.

F. Claims of MFN Discrimination

14.123 The three complainants claim that the sales tax exemptions of the June 1996 car programme violate Article I:1 of GATT because they confer advantages of the type covered by Article I:1 which are conditional (25% counter-purchase requirement) and available *de facto* only to imports of motor vehicles from Korea but not to imports of like products from other WTO Members.

14.124 Japan, the European Communities and the United States also claim that the customs duties exemptions of the June 1996 car programme violate Article I:1 of GATT because they confer advantages of the type covered by Article I:1 which are conditional (25% counter-purchase requirement) and available *de facto* only to imports of motor vehicles from Korea but not to imports of like products from other WTO Members.

14.125 Japan and the European Communities claim that the customs duty exemptions on parts and components of the February 1996 car programme violate Article I:1 of GATT because they confer advantages of the type covered by Article I:1 which are conditional (only if used in National Cars) and available *de facto* only to imports of parts and components from Korea since the only National Car assembled in Indonesia is a replica of the Kia Sephia from Korea, and this, to the detriment of imports of "like" parts and components from other Members.

14.126 The European Communities also argue that the sales tax exemption provided to National Cars assembled in Indonesia under the February 1996 car programme violates Article I:1 of GATT because it provides an "indirect advantage" to parts and components assembled in National Cars; therefore this indirect advantage (covered by Article I of GATT) benefits mainly, if not exclusively, imports of parts and components originating in Korea since the only National Car assembled in Indonesia is a replica of the Kia model Sephia from Korea, and this is to the detriment of imports of "like" parts and components from other Members.[711]

[711] However the European Communities does not appear to have made such a claim (for what they label measure (d)) in their request for a panel. We note also that in their request for establishment of a panel the European Communities claimed that the import duty relief (what they label measure (a)) of the 1993 car programme violate the provisions of Article I:1 of GATT. However the European Communities did not further argue such latter claims in their submissions and oral presentations to the Panel.

14.127 Indonesia argues that its measures are subsidies governed exclusively by the SCM Agreement and therefore are not subject to Article I of GATT for the same reasons as it argued that Article III of GATT is not applicable to this dispute.

14.128 Indonesia also notes that in all past cases where panels found *de facto* discrimination violations, a particular result was mandated by government action. In none of them was the choice of supplier made by the private-party recipient of the subsidy found to constitute government-mandated *de facto* discrimination. For Indonesia, the essential fact remains that a private-sector choice, not government direction, was the reason why there were imports from Korea. Such a private choice is not within the scope of Article I.

14.129 Indonesia also adds that the June 1996 car programme has expired and will not be renewed. For Indonesia all claims related to this June 1996 car programme are therefore moot. The complainants respond that the government of Indonesia does not forego its sales tax until a car is sold and that since there are still some 20,000 cars not yet sold and/or imported, the Panel should examine the measure. In response to additional questions from the Panel after the second meeting, Indonesia argued that PT TPN, the only company entitled to benefits under the June 1996 car programme, failed the "SUCOFINDO audit"[712] and, thus, none of the remaining cars will receive the customs duty or tax exemption.

14.130 Indonesia also argues that the National Car and components and parts imported for it, are not "like" any passenger vehicles, components or parts imported from the territories of complainants as the parts and component are tailor-made for the Indonesian National Cars.

1. General defences of Indonesia

(a) Is the SCM Agreement the only agreement applicable to this dispute at the exclusion of Article I of GATT?

14.131 We have already discussed in Section C above why we consider that the SCM Agreement is not generally the only relevant and applicable agreement to the measures under examination. We found that the obligations contained in the WTO Agreement are generally cumulative and can be complied with simultaneously. We shall, therefore, now proceed to the examination of the claims of the complainants that aspects of the Indonesian car programmes violate the MFN obligations of Article I of GATT.

14.132 Before we do this, we must address the argument put forward by Indonesia that the Panel cannot or should not address the claims regarding the June 1996 car programme because that programme has expired and because in any case PT TPN has lost all its rights to any future benefits under that car programme.

(b) Are the Claims Related to the June 1996 Car Programme Moot?

14.133 In its various submissions Indonesia claims that the special one year permission granted to PT Timor under the June 1996 car programme was terminated and that any claims related thereto should be ignored by the Panel.

14.134 In paragraph 14.9 above, we found that generally panels have examined measures which were amended or terminated during the panel process and, notwithstanding Indonesia's allegation that the National Car programme was terminated, we decided to issue our report. In this context we note that

[712] See paragraphs 10.1 to 10.12 of the Descriptive Part.

when the present panel proceedings commenced Presidential Decree 42/96, Decree 142/1996 of the Ministry of Industry and Governmental Regulation 36/1996 had not been repealed.

14.135 We also note that in the recent *Wool Shirts* case, the panel faced a similar situation in that the United States withdrew its import restriction a few days after the interim review meeting. The panel concluded:

> "in the absence of an agreement between the parties to terminate the proceedings, we think that it is appropriate to issue our final report regarding the matter set out in the terms of reference of this Panel in order to comply with our mandate [....] notwithstanding the withdrawal of the US restraint".[713]

14.136 Under the circumstances, taking into account the terms of reference of this Panel, we consider that it is appropriate for us to address the measures under the June 1996 car programme. We shall proceed therefore to examine the claims of the complainants and the defense of Indonesia.

2. Criteria for an Article I of GATT violation

14.137 Article I of GATT requires that any privileges granted to imports of any country be accorded immediately and unconditionally to the like products originating in or destined for the territories of all other Members.

> "1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."

14.138 The Appellate Body, in *Bananas III*, confirmed that to establish a violation of Article I, there must be an advantage, of the type covered by Article I and which is not accorded unconditionally to all "like products" of all WTO Members. Following this analysis, we shall first examine whether the tax and customs duty benefits are advantages of the types covered by Article I. Second, we shall decide whether the advantages are offered (i) to all like products and (ii) unconditionally.

(a) Are the tax and customs duty benefits of the February and June 1996 car programmes advantages of the types covered by Article I?

14.139 The customs duty benefits of the various Indonesian car programmes are explicitly covered by the wording of Article I. As to the tax benefits of these programmes, we note that Article I:1 refers explicitly to "all matters referred to in paragraphs 2 and 4 of Article III". We have already decided that the tax discrimination aspects of the National Car programme were matters covered by Article III:2 of GATT. Therefore, the customs duty and tax advantages of the February and June 1996 car programmes are of the type covered by Article I of GATT.

[713] Panel Report on *Shirts and Blouses*, op. cit., para 6.2, affirmed by the Appellate Body.

(b) Are these advantages offered "unconditionally" to all "like products"?

(i) "like products"

14.140 The European Communities, following the same logic it used for the like product definition in its Article III claims, submit that National Cars and their parts and components imported from Korea are to be considered "like" any motor vehicle and parts and components imported from other Members. The European Communities argue that imported parts and components and motor vehicles are all like the relevant domestic products since the definition of "National Cars" and their parts and components is not based on any factor which may affect *per se* the physical characteristics of those cars and parts and components, or their end uses. The United States argues that cars imported in Indonesia are like the Kia Sephia from Korea. Japan argues that parts and components and cars imported from Japan, or any other country, and those imported from Korea constitute "like products".

14.141 We have found in our discussion of like products under Article III:2 that certain imported motor vehicles are like the National Car[714]. The same considerations justify a finding that such imported vehicles can be considered like National Cars imported from Korea for the purpose of Article I. We also consider that parts and components imported from the complainants are like imports from Korea. Indonesia concedes that some parts and components are exactly the same for all cars. As to the parts and components which arguably are specific to the National Car, Indonesia does not contest that they can be produced by the complainants' companies. This fact confirms that the parts and components imported for use in the National Car are not unique. As before, we note in addition that the criteria for benefitting from reduced customs duties and taxes are not based on any factor which may affect *per se* the physical characteristics of those cars and parts and components, or their end uses. In this regard, we note that past panels interpreting Article I have found that a legislation itself may violate that provision if it could lead in principle to less favourable treatment of the same products.[715]

14.142 We find, therefore, that for the purpose of the MFN obligation of Article I of GATT, National Cars and the parts and components thereof imported into Indonesia from Korea are to be considered "like" other similar motor vehicles and parts and components imported from other Members.

(ii) "unconditional advantages"

14.143 We now examine whether the advantages accorded to National Cars and parts and components thereof from Korea are unconditionally accorded to the products of other Members, as required by Article I. The GATT case law is clear to the effect that any such advantage (here tax and customs duty benefits) cannot be made conditional on any criteria that is not related to the imported product itself.

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[714] We refer to our discussions in paragraphs 14.110 and 14.111 where we found that given that the Timor, Escort, 306, Optima and Corolla models are in the same market segments, there would not appear to be any relevant differences in respect of consumers' tastes and habits sufficient to render these products unlike. In our view, this evidence is also sufficient to establish a presumption of likeness between the Timor, Corolla, Escort, 306 and Optima for purposes of Article I of GATT. Since Indonesia has submitted no evidence or argument to rebut the presumption of likeness for purposes of Article I of GATT, we find that at least these imported motor vehicles are like the National Car for purposes of Article I of GATT.

[715] See for instance the Panel Report on *United States - Denial of Most-favoured-nation Treatment as to Non-rubber Footwear from Brazil*, adopted on 19 June 1992, BISD 39S/128, para. 6.12.

14.144 For instance, in the Panel Report on *Belgian Family Allowances*[716], the panel condemned a measure which discriminated against imports depending on the type of family allowances that was in place:

> "3. According to the provisions of paragraph 1 of Article I of the General Agreement, any advantage, favour, privilege or immunity granted by Belgium to any product originating in the territory of any country with respect to all matters referred to in paragraph 2 of Article III shall be granted immediately and unconditionally to the like product originating in the territories of all contracting parties. Belgium has granted exemption from the levy under consideration to products purchased by public bodies when they originate in Luxembourg and the Netherlands, as well as in France, Italy, Sweden and the United Kingdom. If the General Agreement were definitively in force in accordance with Article XXVI, it is clear that that exemption would have to be granted unconditionally to all other contracting parties (including Denmark and Norway). The consistency or otherwise of the system of family allowances in force in the territory of a given contracting party with the requirements of the Belgian law would be irrelevant in this respect, and the Belgian legislation would have to be amended insofar as it introduced a discrimination between countries having a given system of family allowances and those which had a different system or no system at all, and made the granting of the exemption dependent on certain conditions." (emphasis added)

14.145 Indeed, it appears that the design and structure of the June 1996 car programme is such as to allow situations where another Member's like product to a National Car imported by PT PTN from Korea will be subject to much higher duties and sales taxes than those imposed on such National Cars. For example, customs duties as high as 200% can be imposed on finished motor vehicles while an imported National Car benefits from a 0% customs duty. No taxes are imposed on a National Car while an imported like motor vehicle from another Member would be subject to a 35% sales tax. The distinction as to whether one product is subject to 0 % duty and the other one is subject to 200% duty or whether one product is subject to 0% sales tax and the other one is subject to a 35% sales tax, depends on whether or not PT TPN had made a "deal" with that exporting company to produce that National Car, and is covered by the authorization of June 1996 with specifications that correspond to those of the Kia car produced only in Korea. In the GATT/WTO, the right of Members cannot be made dependent upon, conditional on or even affected by, any private contractual obligations in place.[717] The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty benefits accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members "immediately and unconditionally".[718]

14.146 We note also that under the February 1996 car programme the granting of customs duty benefits to parts and components is conditional to their being used in the assembly in Indonesia of a

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[716] BISD 1S/59, adopted on 7 November 1952.

[717] For instance in the *FIRA* case, the Panel rejected Canada's argument that the situation under examination was the consequence of a private contract with an investor: "5.6 The Panel carefully examined the Canadian view that the purchase undertakings should be considered as private contractual obligations of particular foreign investors vis-à-vis the Canadian government. The Panel recognized that investors might have an economic advantage in assuming purchase undertakings, taking into account the other conditions under which the investment was permitted. The Panel felt, however, that even if this were so, private contractual obligations entered into by investors should not adversely affect the rights which contracting parties, including contracting parties not involved in the dispute, possess under Article III:4 of the General Agreement and which they can exercise on behalf of their exporters." See *FIRA*, op. cit, para. 5.6.

[718] See *Working Party Report on the Accession of Hungary*, BISD 20S/34 adopted on 30 July 1973.

National Car. The granting of tax benefits is conditional and limited to the only Pioneer company producing National Cars. And there is also a third condition for these benefits: the meeting of certain local content targets. Indeed under all these car programmes, customs duty and tax benefits are conditional on achieving a certain local content value for the finished car. The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty advantages accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members "immediately and unconditionally".

14.147 For the reasons discussed above, we consider that the June 1996 car programme which introduced discrimination between imports in the allocation of tax and customs duty benefits based on various conditions and other criteria not related to the imports themselves and the February 1996 car programme which also introduce discrimination between imports in the allocation of customs duty benefits based on various conditions and other criteria not related to the imports themselves, are inconsistent with the provisions of Article I of GATT.

14.148 Since the European Communities did not properly claim that the tax benefits of the February 1996 car programme violated Article I[719], we cannot address the related alleged claim that under the same 1996 February car programme imported parts and components from Korea are subject to an indirect tax advantage (covered by Article I).

G. Claims of Inadequate Publication and Partial Administration

14.149 Only Japan has raised claims under Article X of GATT. Japan claims that the National Car programme violates Article X:1 because Indonesia has failed to publish trade regulations "promptly" and "in such a manner as to enable governments and traders to become acquainted with them". Japan further alleges that Indonesia has not set out the requirements for the National Car programme and has also failed to explain the requirements of its National Car programme during the consultations.

14.150 Japan also claims that the June 1996 National Car program was administered in violation of Article X:3(a) which requires uniform, impartial and reasonable administration of regulations, including those pertaining to rates of duty, taxes or other charges. Japan argues that in June 1996 Indonesia authorized PT Timor to import automobiles duty free, although the counter-purchase requirement mentioned in the Decree, was not met. For Japan, these facts constitute violations of Article X:3(a) since Indonesia administered its regulations in a partial and unreasonable manner.

14.151 Indonesia simply responds that Article X does not establish substantive obligations, but rather procedural and administrative obligations. In any case, Indonesia submits that it has published its regulations and decrees in the statute books and State Gazettes promptly after their adoption, and this is in conformity with Article X.

14.152 We have already found that the measures adopted pursuant to the National Car programme violate the provisions of Articles I and/or III of GATT. Therefore, we consider that it is not necessary to examine Japan's claims under Article X of GATT.

H. Claims of Serious Prejudice under Part III of the SCM Agreement

14.153 We next turn to the complainants' serious prejudice claims. The European Communities and the United States contend that the tariff and luxury sales tax exemptions provided by Indonesia

[719] As mentioned before in their request for establishment of panel the European Communities did not claim that the tax benefits under the February 1996 (what the European Communities had labelled the measure (d)) violated Article I. See paragraph (iii) of the EC's request for establishment of panel.

through the National Car programme[720] are specific subsidies which have caused serious prejudice to their interests within the meaning of Article 5(c) of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement").[721] Specifically, the complainants allege that the effect of alleged subsidies for the national car is (a) to displace or impede imports of like products of the European Communities and the United States into the Indonesian market and (b) a significant price undercutting by the subsidized national car as compared with like EC and US products in the Indonesian market. The European Communities further contend, in the alternative, that the alleged subsidies provided by Indonesia through the National Car programme threaten to cause serious prejudice to EC interests.[722] Indonesia argues that the tariff and tax benefits provided through the National Car programme do not cause or threaten to cause serious prejudice to the interests of the European Communities or the United States.

14.154 In addressing the EC and US claims, we will first consider whether the measures in question are specific subsidies within the meaning of the SCM Agreement. Next we will consider whether Indonesia, as a developing country Member, may be subject to claims that subsidies provided by it have caused serious prejudice to the interests of other Members. Finally, we must examine whether the European Communities and the United States have demonstrated by positive evidence that the measures in question have caused serious prejudice or, in the case of the European Communities, have threatened to cause serious prejudice, to their interests within the meaning of Part III of the SCM Agreement, either through displacement and impedance, price undercutting, or both. A threshold question with respect to this final phase of the analysis is to determine which EC and US products, if any, are like products to the National Car (the Timor) within the meaning of the SCM Agreement.

1. Are the measures specific subsidies?

14.155 As with any analysis under the SCM Agreement, the first issue to be resolved is whether the measures in question are subsidies within the meaning of Article 1 that are specific to an enterprise or industry or group of enterprises or industries within the meaning of Article 2. It is to be recalled that the measures in question are: import duty and luxury sales tax exemptions on CBU Timors imported by PT TPN from Korea, import duty exemptions on parts and components used or to be used in the assembly of the Timor in Indonesia, and luxury sales tax exemptions on Timors assembled in Indonesia. In this case, the European Communities, the United States and Indonesia agree that these measures are specific subsidies within the meaning of those articles. Specifically, they concur that the tariff and sales tax exemptions in question represent government revenue forgone within the meaning of Article 1.1(a)(1)(ii) and that the measures confer a benefit on PT TPN within the meaning of Article 1.1(b) of the Agreement. All three parties reiterated this view in response to a written question from the Panel. Further, the European Communities, the United States and Indonesia agree that these subsidies are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b), and that they are therefore deemed to be specific pursuant to Article 2.3 of the

[720] Neither the European Communities nor the United States has made a claim of serious prejudice arising from measures adopted pursuant to the 1993 car programme.

[721] Japan's request for establishment of a panel noted Japan's view that the measures pursuant to the National Car programme cause serious prejudice to Japan's interests, but did not ask this Panel to make a finding on this issue. Rather, Japan reserved the right to request the establishment of a separate panel under Article 7.4 of the SCM Agreement with respect to this issue.

[722] In its first submission, the United States claimed that the National Car programme also threatened to cause serious prejudice with respect to US exports of light trucks to Indonesia. The US threat claim was, however, related to an allegedly government-directed $690 million loan. The United States has informed us that, in light of our preliminary ruling that the loan is not within our terms of reference, the United States is no longer pursuing this claim.

Agreement.[723] In light of the views of the parties, and given that nothing in the record would compel a different conclusion, we find that the measures in question are specific subsidies within the meaning of Articles 1 and 2 of the SCM Agreement.

2. May the complainants bring a serious prejudice claim against Indonesia?

14.156 Article 27 of the SCM Agreement provides significant special and differential treatment for developing country Members of the WTO, including with respect to claims of serious prejudice arising from subsidies provided by developing country Members. Thus, Article 27.9 provides that

> Regarding actionable subsidies granted or maintained by a developing country Member other than those referred to in paragraph 1 of Article 6, action may not be authorized or taken pursuant to Article 7 unless nullification or impairment of tariff concessions or other obligations under GATT 1994 is found to exist as a result of such subsidy, in such a way as to displace or impede imports of a like product into the market of the subsidizing developing country Member or unless injury to a domestic industry in the market of an importing Member occurs.

In other words, Article 27.9 provides that, *in the usual case*, developing country Members may not be subject to a claim that their actionable subsidies have caused serious prejudice to the interests of another Member. Rather, a Member may only bring a claim that benefits under GATT have been nullified or impaired by a developing country Member's subsidies or that subsidized imports into the complaining Member have caused injury to a domestic industry.

14.157 The complainants do not contest that Indonesia is a developing country Member entitled to the special and differential treatment provided by Article 27.9. Rather, they contend that Article 27.9 is not applicable in this case because the subsidies in question fall under the provisions of Article 6.1(a), i.e., that the *ad valorem* subsidization of the Timor exceeds 5 per cent. The European Communities further contend, in the alternative, that the subsidies fall under the provisions of Article 6.1(a) because, pursuant to Annex IV:4 to the Agreement, PT TPN is in a start-up situation and the overall rate of subsidization exceeds 15 per cent of the total funds invested. Accordingly, the complainants consider that they are authorized under Article 27.8 to bring a serious prejudice claim.

14.158 We agree that Article 27.8 allows a WTO Member to bring a serious prejudice claim with respect to subsidies provided by a developing country Member which fall within the scope of Article 6.1. Article 27.8 provides that:

> There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6.

In other words, while a subsidy falling within the terms of Article 6.1 generally is presumed to cause serious prejudice to the interests of another Member, that presumption is not applicable where the subsidizing country is a developing country Member. Instead, while such a subsidy by a developing country Member may be subject to a serious prejudice challenge, a complainant does not benefit from

[723] See Section VIII:A of the Descriptive Part. The European Communities and the United States also consider the subsidies to be specific on the grounds that they are in fact made available to a single enterprise within a single sector.

a presumption of serious prejudice; rather, a complainant must demonstrate the existence of serious prejudice by positive evidence.

14.159 The question remains whether the subsidization challenged in this dispute satisfies the requirements of Article 6.1(a). That provision states that "[s]erious prejudice shall be deemed to exist in the case of . . . the total *ad valorem* subsidization[14] of a product exceeding five per cent . . . ." Footnote 14 states that "[t]he total *ad valorem* subsidization shall be calculated in accordance with the provisions of Annex IV." That Annex, in turn, sets forth a number of principles to be applied in calculating the total *ad valorem* subsidization for purposes of Article 6.1(a). Among the provisions of Annex IV is a special rule that, "[w]here the recipient firm is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidization exceeds 15 per cent of the funds invested."

14.160 In their first submissions, both the European Communities and the United States submitted a number of calculations intended to demonstrate that the terms of Article 6.1(a) were satisfied in this case. Thus, the European Communities provided calculations indicating that the *ad valorem* subsidization of Timors assembled in Indonesia ranged from 40 to 61 per cent, while the *ad valorem* subsidization of Timors imported from Korea ranged from 156 to 460 per cent. In the alternative, the European Communities calculate that, if PT TPN is in a start-up period, Article 6.1(a) applies because the overall rate of subsidization (219-225 per cent) exceeds 15 per cent of the total funds invested. The US calculations, excluding the alleged $690 million loan found to be outside our terms of reference, indicate a rate of subsidization for Timors imported from Korea of between 54 and 166 per cent (depending on whether the import duty exemption on the Timors imported from Korea was expended in the year of receipt or allocated over a number of years), while the rate of subsidization for Timors assembled in Indonesia would be 49.37 per cent in 1998 and 44.65 per cent in 1999. The United States considered that the start-up provisions of Annex IV were not applicable in this case.

14.161 The calculations provided by the European Communities and the United States present a variety of issues under Article 6.1(a) and Annex IV. However, we do not need in this case to calculate the precise level of *ad valorem* subsidization. Rather, we need only determine whether the *ad valorem* rate of subsidization exceeds 5 per cent. This question is not in dispute here, since Indonesia calculates that the *ad valorem* subsidization conferred by the exemption from the luxury sales tax alone is 29.54 per cent for Timors imported from Korea, 26.20 per cent for Timors assembled at the Tambun plant, and 18.68 per cent for Timors to be assembled at the Karawang plant. Thus, the parties concur that the *ad valorem* subsidization exceeds 5 per cent. We do not see any basis to disagree with the parties that the *ad valorem* subsidization is in excess of 5 per cent. To the contrary, given that the luxury sales tax from which Timors are exempted is itself 35 per cent of the cost of the cars sold, it would appear inevitable that the *ad valorem* subsidization resulting from such an exemption would exceed 5 per cent by any reasonable calculation.

14.162 For the foregoing reasons, we find that the complainants are not precluded by Article 27 from seeking to demonstrate, by positive evidence, that Indonesia has caused, through the effects of the subsidies at issue in this case, serious prejudice to their interests.[724]

3. Like product analysis

14.163 As we have seen, both the European Communities and the United States claim that Indonesia has caused, through the subsidies provided under the National Car programme, serious prejudice to their interests. They further allege that this serious prejudice arises both from displacement or

[724] Indonesia has also expressed the view that developing country Member subsidies are subject to a serious prejudice claim by virtue of the fact that they fall within the terms of Article 3.1(b) of the SCM Agreement. In light of the foregoing finding, we do not need to address that issue.

impedance of their exports of passenger cars to Indonesia and through significant price undercutting of their passenger cars by the subsidized Timor in the Indonesian market.

14.164 Article 6.3 provides in relevant parts as follows:

> Serious prejudice in the sense of paragraph (c) may arise in any case where one or several of the following may apply:
>
> (a) the effect of the subsidy is to displace or impede the exports of a *like product* of another Member into the Market of the subsidizing Member;
>
> .....
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a *like product* of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
>
> ..... (emphasis added).

It is clear from the text of Article 6.3 that any analysis of displacement or impedance or of price undercutting must focus on the effects of the subsidy vis à vis the like product to the subsidized product. In this case, the European Communities and the United States have alleged that the subsidies in question are conferred on the Timor. Accordingly, our analysis of the effects of these subsidies must be performed in relation to their effects on products which are "like products" to that passenger car.

(a) Types of Cars

14.165 The first "like product" issue presented by this dispute is which EC and US motor vehicles sold in Indonesia, if any, can properly be considered to be "like products" to the Timor within the meaning of the SCM Agreement. The parties have presented differing views as to how broadly or narrowly the concept of "like product" should be applied in this dispute.

14.166 The European Communities assert that all motor vehicles falling within the category of "passenger cars" constitute a single category of "like product" for the purposes of the SCM Agreement, given that they all share the same basic characteristics and serve an identical end-use. The European Communities contend that there are virtually limitless variations with respect to passenger cars, and that any effort to divide passenger cars into two or more "like products" would inevitably yield arbitrary results because the Panel would be required either to choose among the criteria or to apply several criteria simultaneously. Further, the European Communities point out that there are continua of products with respect to many of these criteria, and drawing lines along those continua would be arbitrary regardless of where the lines were drawn. The European Communities argue in the alternative that, at the very least, the Opel Optima and Peugeot 306 must be considered to be "like" the Timor because, while not identical, they have physical characteristics which closely resemble those of the Timor.

14.167 The US approach to "like product" is narrower than that proposed by the European Communities. The United States contends that four US passenger cars sold or planned to be sold in Indonesia -- the Opel Vectra and Optima, the Ford Escort and the Chrysler Neon -- are "like products"

to the Timor. In support of this conclusion, the United States contends that these products have similar end-uses (to transport passengers) and that, because the physical characteristics of these cars (e.g., size, weight, height, engine size) are similar or virtually identical to those of the Timor, they "closely resemble" that car. In support of its conclusions, the United States cites what it considers to be highly authoritative market segmentation analysis applied by the DRI Global Automotive Group and reflected in a number of DRI publications excerpts of which have been placed before the Panel,[725] under which the Timor, Optima, Escort and Neon are all classified as Segment C (Lower Medium Segment) passenger cars, while the Vectra is classified as Segment D (Upper Medium Segment) passenger cars.

14.168 Indonesia takes issue with both the EC and US approaches to the "like product" question. Indonesia considers that, because an affirmative finding of serious prejudice would deprive Indonesia of a conditional right to provide subsidies, the concept of "like product" must be very narrowly construed, and that the burden of proof on complainants is particularly high. Indonesia argues that the complainants have not met their burden of proving that products are like and of establishing acceptable like product categories. Indonesia does not appear to take issue with the principle that the analysis should be limited to passenger cars. However, it notes that while all passenger cars share certain basic characteristics, they are still highly differentiated on the basis of numerous other physical and non-physical characteristics and thus should not be treated as "like". In this case, Indonesia argues, because the Timor is highly differentiated from US and EC models and is thus non-substitutable, those products cannot be considered to be like products to the Timor. Rather, Indonesia considers that the Timor and the Bimantara Cakra are in a market segment by themselves, "small budget" cars, while even the US and EC cars closest to the Timor are in the "small normal/regular" market segment.

14.169 In assessing the arguments of the parties, we are cognizant that the complainants are required to demonstrate the existence of serious prejudice by positive evidence. Thus, we agree with Indonesia that the complainants bear the burden of presenting argument and evidence with respect to each element of their serious prejudice claims -- including the existence of effects on a "like product". This is consistent with the general principle, stated by the Appellate Body in *Shirts and Blouses*, that complainants must present evidence and argument sufficient to establish a presumption that a defending Member has acted in a manner inconsistent with its WTO obligations.[726] We do not agree, however, that the complainants bear a heavier than usual burden of proof in this dispute or that the concept of "like product" should be interpreted more narrowly than usual because Indonesia is a developing country Member. The special and differential treatment available to Indonesia is spelled out in Article 27 of the SCM Agreement, and it is substantial. But for that special and differential treatment, the subsidies in question would by Indonesia's own admission be prohibited under Article 3.1(b) of the SCM Agreement. Moreover, because Indonesia is a developing country Member, Article 27.8 requires complainants to demonstrate serious prejudice by positive evidence "in accordance with the provisions of paragraphs 3 through 8 of Article 6" rather than taking advantage of the rebuttable presumption of serious prejudice that otherwise would have applied under Article 6.1(a). Article 27 does not, however, impose a higher burden of proof on complainants than that normally applicable under Article 6, nor does it provide that the term "like product" is to be defined differently in the case of subsidization provided by a developing country Member.

[725] *Asian Automotive Industry Forecast Report of June 1997; World Car Industry Forecast Report of February 1997*.

[726] *Shirts and Blouses*, op. cit., Appellate Body Report, p. 13.

14.170 Turning now to an analysis of the issue at hand, we note that the term "like product" is used in a variety of contexts within the WTO Agreement.[727] As it is used in most cases, the term is not defined, and numerous GATT and WTO panels have been required to apply the term to particular factual situations. The SCM Agreement, however, shares with the Agreement on Implementation of Article VI of GATT 1994 (ADP Agreement) a definition of the term "like product" that is not found elsewhere in the WTO Agreement. Note 46 to Article 5.1 of the SCM Agreement provides that:

> Throughout this Agreement the term "like product" (produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

Although this definition appears in Part V of the SCM Agreement (relating to countervailing measures), the use of the clause "throughout this Agreement" makes clear that this definition is equally applicable to the provisions of Part III, including Article 6 relating to adverse effects.

14.171 The definition of "like product" found in the SCM Agreement first appeared in the Kennedy Round Anti-Dumping Agreement[728] and, in spite of proposals for modifications during various negotiations, was carried virtually unchanged into the Tokyo Round Anti-Dumping and Subsidies Codes[729] and hence into the WTO SCM and ADP Agreements. Thus, the definition of "like product" applicable in this dispute has existed for thirty years. In light of this, and in spite of the fact that investigating authorities in anti-dumping and countervailing duty cases have been wrestling with the concept of "like product" for decades, it is surprising that no GATT or WTO panel has yet been required to apply this definition of "like product" to particular facts, or even to provide any detailed discussion regarding the meaning of the term or its clarification. Thus, we are operating in uncharted territory in our consideration of this issue.

14.172 In determining what criteria might be relevant to performing "like product" analysis under the SCM Agreement, our point of departure must of course be the text of the SCM Agreement. In this case, no party has argued that there is an "identical" product that should be treated as the "like product" to the Timor. Rather, the parties have focused on the question of which cars have "characteristics closely resembling" those of the Timor. On its face, this term is quite narrow. It is not enough that the products have characteristics which resemble the Timor; rather they must have characteristics which "closely" resemble the Timor. The parties have identified a wide range of physical characteristics which they consider may be relevant to this analysis. In addition, Indonesia considers certain "non-physical" characteristics, consumer perceptions and preferences to be relevant

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[727] For example, Articles I and III of GATT. Article I:1: " . . . any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." Article III:2: "The products of 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." Article III:4: "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 . . . "

[728] Kennedy Round Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, Article I.A(b).

[729] Tokyo Round Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, Article 2.2; Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, note 18 to Article 6.

to the analysis. Further, there have been references to the uses to which a product may be put, to the substitutability of products, to price and to tariff classification principles.

14.173 In our view, the analysis as to which cars have "characteristics closely resembling" those of the Timor logically must include as an important element the physical characteristics of the cars in question. This is especially the case because many of the other possible criteria identified by the parties are closely related to the physical characteristics of the cars in question. Thus, factors such as brand loyalty, brand image/reputation, status and resale value reflect, at least in part, an assessment by purchasers of the physical characteristics of the cars being purchased. Although it is possible that products that are physically very different can be put to the same uses, differences in uses generally arise out of, and assist in assessing the importance of, different physical characteristics of products. Similarly, the extent to which products are substitutable may also be determined in substantial part by their physical characteristics. Price differences also may (but will not necessarily) reflect physical differences in products. An analysis of tariff classification principles may be useful because it provides guidance as to which physical distinctions between products were considered significant by Customs experts. However, we do not see that the SCM Agreement precludes us from looking at criteria other than physical characteristics, where relevant to the like product analysis. The term "characteristics closely resembling" in its ordinary meaning includes but is not limited to physical characteristics, and we see nothing in the context or object and purpose of the SCM Agreement that would dictate a different conclusion.[730]

14.174 Although we are required in this dispute to interpret the term "like product" in conformity with the specific definition provided in the SCM Agreement, we believe that useful guidance can nevertheless be derived from prior analysis of "like product" issues under other provisions of the WTO Agreement. Thus, we note the statement of the Appellate Body in *Alcoholic Beverages (1996)*[731] that, in this context as in any other, the issue of "like product" must be considered on a case-by-case basis, that in applying relevant criteria panels can only use their best judgement regarding whether in fact products are like, and that this will always involve an unavoidable element of individual, discretionary judgement. With this in mind, we now proceed to consider the application of these general principles to the case at hand.

14.175 Turning first to the argument of the European Communities that all passenger cars should be considered "like products" to the Timor, we consider that such a broad approach is not appropriate in this case. While it is true that all passenger cars "share the same basic physical characteristics and share an identical end-use", we agree with Indonesia that passenger cars are highly differentiated products. Although the European Communities have not provided the Panel with information regarding the range of physical characteristics of passenger cars, all drivers know that passenger cars may differ greatly in terms of size, weight, engine power, technology, and features. The significance of these extensive physical differences, both in terms of the cost of producing the cars and in consumer perceptions regarding them, is manifested in huge differences in price between brands and models. It is evident that the differences, both physical and non-physical, between a Rolls Royce and a Timor are enormous, and that the degree of substitutability between them is very low. Viewed from the perspective of the SCM Agreement, it is almost inconceivable that a subsidy for Timors could displace or impede imports of Rolls Royces, or that any meaningful analysis of price undercutting

[730] This interpretation is confirmed by the negotiating history of this definition. As noted above, this definition of "like product" is virtually unchanged from that which first appeared in the Kennedy Round Anti-Dumping Code. Thus, the penultimate draft of that Code defined the term "like product" to mean a product which "has physical characteristics close to those of the exported product." T.64/NAB/W/16, dated 3 March 1967. In the revised draft of 28 March 1967, the word "physical" had been deleted from the text, which was revised to the formulation ("characteristics closely resembling") that exists today. T.64/NAB/W/17.

[731] Op. cit., pp. 19-23.

could be performed between these two models. In short, we do not consider that a Rolls Royce can reasonably be considered to have "characteristics closely resembling" those of the Timor.

14.176 The European Communities contend that we must consider all passenger cars to be "like" because any effort to differentiate between passenger cars with a multitude of differing characteristics would inevitably result in arbitrary divisions. We are aware that there are innumerable differences among passenger cars and that the identification of appropriate dividing lines between them may not be a simple task. However, this does not in our view justify lumping all such products together where the differences among the products are so dramatic. The parties to this dispute have submitted substantial data regarding a wide range of characteristics of the Timor and of the models that the European Communities and United States consider to be like products to the Timor. We must endeavour to find some reasonable way to assess the relative importance of the various differences in the minds of consumers and to devise some sensible means to categorize passenger cars.

14.177 One reasonable way for this panel to approach the "like product" issue is to look at the manner in which the automotive industry itself has analyzed market segmentation. The United States and the European Communities have submitted information regarding the market segmentation approach taken by DRI's Global Automotive Group, a company whose clients include all major auto manufacturers, including KIA, PT TPN's national car partner. DRI's *Asian Automotive Industry Forecast Report of June 1997* ("*Asian Forecast*") divides passenger cars into five segments: Small Cars Segment (Segment A), Supercompact Segment (Segment B), Lower Medium Segment (Segment C), Upper Medium Segment (Segment D) and Executive Segment (Segment E). Three of those segments (C to E) are divided into subsegments 1 (lower end) and 2 (upper end). While the *Asian Forecast* does not identify the Timor, it does indicate that the Kia Sephia -- Timor's parent car -- falls within the C1 Segment (lower end of Lower Medium Segment).[732] The *Asian Forecast* also places the Optima and the 306 in the C1 Segment, while the Vectra is placed in the D1 (lower end of Upper Medium Segment). The Escort and Neon are not identified in the portion of the *Asian Forecast* (Table 6 relating to sales in Indonesia) before the Panel, presumably because they are not sold in Indonesia. However, market segmentation data from DRI's *World Car Industry Forecast Report of February 1997* ("*World Forecast*"), which appears to follows the same market segmentation approach as the *Asian Forecast*, places the Escort in the C1 Segment, while it places the Neon in the C2 Segment (upper end of Lower Medium Segment).

14.178 The question remains whether the criteria used by DRI in arriving at its market segmentation are appropriate to a "like product" analysis under the SCM Agreement. We consider that they are. The *Asian Forecast* indicates that:

> DRI's segmentation of passenger car demand is designed to identify sets of products which car consumers recognize as falling within competing categories. No single vehicle attribute defines any segment; rather the categorization is subjective, combining judgements on several items of vehicle specifications and purchaser perceptions. In choosing five market segments, we have sought to identify five product types of appeal to different customers.

The *World Forecast* provides some further explanation regarding DRI's market segmentation analysis. It states that:

[732] DRI identifies models sold in the Indonesian market by the more common model names used in other markets. However, it is clear from the sales data provided by DRI that the "Sephias" referred to in the *Asian Forecast* are in fact Timors imported from Korea or assembled in Indonesia.

> This segmentation is effectively a hybrid in product space terms. This can be designed as a vector in vehicle size and price/market position. To identify the vehicle market position a little more clearly we have subdivided the segments C to E into lower end (1) and upper end (2).

Thus, DRI has in its analysis considered the physical characteristics of the cars in question when designing its segmentation. It has used as an initial filter the size of the vehicle, but it has then divided cars of a given size into upper and lower end categories, and has moved luxury cars, regardless of size, from lower segments to the E segment. We consider such an approach, which segments the market based on a combination of size and price/market position, to be a sensible one which is consistent with the criteria relevant to "like product" analysis under the SCM Agreement.

14.179 Indonesia notes that "like product" analysis may depend upon the market in question, and that DRI's segmentation analysis was developed for the European market. Indonesia further argues that the Timor sold in Indonesia is not in fact identical to the Kia Sephia, but is rather an older model of the Sephia with a smaller engine and fewer features than the new Sephia. In support of this proposition, it points to a US exhibit indicating that Sephia models sold in the United States beginning in 1996 had a larger 1.8 litre engine and new features such as an improved suspension and airbags. Indonesia also submitted data showing that the Sephia sold in the United States weighs from 68 to 103 kg. more than the Timor S-515. Indonesia has not presented any evidence regarding the size of the engine for Sephias sold in Europe, so the implications of this evidence for the validity of DRI's market segmentation analysis are unclear.[733] It does not appear, however, that DRI considered these differences sufficiently important to merit classifying the Timor sold in the Indonesian market differently from the Sephia sold in other markets. Further, DRI apparently considers its segmentation analysis to be applicable to the Asian market generally and to the Indonesian market in particular, as it applies that analysis in the *Asian Forecast*.

14.180 Indonesia further objects that the complainants have not submitted the full text of the *Asian Forecast*, and that the Panel should draw adverse inferences from this fact. However, the materials provided by the complainants appear to include that portion of the Asian Report relating to market segmentation, and Indonesia has not given the panel any reason to believe that relevant portions of the *Asian Forecast* have been excluded. Further, because the *Asian Forecast* is not a document to which the complainants can control access, resort to adverse inferences would not appear appropriate. Finally, Indonesia objects that the DRI approach is limited solely to physical dimensions, and fails to consider other physical characteristics much less "actual market forces or competition." As indicated by our discussion, however, Indonesia's argument on this score appears to be factually incorrect.

14.181 In our view, the DRI market segmentation analysis presented by the European Communities and the United States supports the view that all vehicles in the C1 Segment -- including the 306, Optima and Escort -- are "like products" to the Timor within the meaning of the SCM Agreement. By contrast, the DRI analysis places the Vectra and the Neon in different market segments (D1 and C2 respectively), and this in our view weakens the complainants' view that these products should be

[733] The United States placed into the record a number of articles from US publications (the *Washington Post, New York Times* and *Car and Driver* magazine) suggesting that the Neon and the Sephia were competing in the same market segment in the United States, while Indonesia identified a publication (Automotive News) placing the Sephia in a separate class (budget) from that of the Neon and Escort (small). None of these articles provided any explanation for the market segmentation selected. In this context, we take note of evidence submitted by Indonesia regarding differences between the Sephia sold in the United States and the Timor.

considered to be "like" the Timor.[734] The complainants have not provided any explanation as to why the Panel should consider DRI's market segmentation relevant yet overlook that segmentation where it is unfavourable to them. To the contrary, the United States' argument regarding the Vectra in particular damns with faint praise. The United States concedes that the Vectra "is positioned slightly higher in the market than the Timor", that it is longer and has a more powerful engine. The United States maintains only that the Vectra "is not all that dissimilar" to the Timor, a test which would appear to fall short of the SCM Agreement's definition.

14.182 While the DRI market segmentation analysis is useful, we are not prepared to rely on it without confirming, through an independent comparison of their physical characteristics, that the EC and US models in question are "like" the Timor. The European Communities, the United States and Indonesia have all provided the Panel with detailed comparative information regarding the physical characteristics and performance of the models at issue. This information varies in some details, and it is not always clear which versions of particular models are being compared with which.[735] Nevertheless, the information before us generally provides a good overview of the similarities and differences between the models in question. However, the parties have sometimes chosen to emphasize different physical characteristics and features or to characterize differently the significance of the differences that exist. In testing the DRI market segmentation approach, therefore, we will outline the Indonesian view of market segmentation in Indonesia and then test that view against the physical characteristics and other criteria identified by Indonesia as significant.

14.183 Indonesia's argument is that the Timor is a "low-technology no-frills budget car" which fills a unique niche at the bottom of the Indonesian market. Indonesia contends that a proper market segmentation for passenger cars would divide those cars into three classifications -- small, medium and large -- and that each of the classifications in turn should be divided into a budget, normal/regular and luxury categories. Indonesia contends that the Timor and one other model (the Bimantara Cakra) are alone in the budget small car category.[736] It considers that all of the specific EC and US models sold in Indonesia which are alleged to be "like" the Timor belong in a different category, that of small normal/regular cars.

14.184 Indonesia's analysis begins with a comparison of various physical features of the Timor with those of other models -- Escort, 306, Optima, Vectra, Neon -- specifically alleged by complainants to be "like products" to the Timor. Indonesia contends that there are four basic physical characteristics or specification groupings that differentiate passenger cars: passenger compartment, power plant, steering and suspension and safety features. Indonesia considers that an examination of these four specification groupings demonstrates that the five models identified above are not like products to the Timor. We will examine each set of specification groupings in turn.

14.185 With respect to passenger compartment, Indonesia considers that the relevant aspects are interior dimensions and number of passengers. Indonesia acknowledges that the Timor, Escort, 306, Optima and Neon are comparable in this regard. However, Indonesia contends (and the complainants have not contested) that the Vectra has a substantially larger interior and accommodates five passengers as opposed to four passengers for the other models.

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[734] Neither the European Communities nor the United States sell any B Segment cars in the Indonesian market, and we have not been asked to decide whether such cars are like products to the Timor for the purposes of the SCM Agreement.

[735] The submissions of the parties refer to at least two versions of the Timor (S-515 and S-515i), three versions of the Optima (GLS, CDX and CDX A-BAG) and two versions of the 306 (M/T and A/T).

[736] According to the European Communities, the Cakra is a rebadged Hyundai Accent.

14.186 With respect to power plant, the engine capacity of the Timor is 1498 cc. That of the other five models, in ascending order, are the Escort (1597 cc), 306 (1761 cc), Optima (1796 cc), Neon (1996 cc) and Vectra (1998 cc). Thus, the Timor does in fact have the smallest engine of the group. On the other hand, the record indicates the Timor has a sixteen-valve engine, and at least one of the Timor models sold in Indonesia (the Timor S-515i)[737] has a dual overhead cam engine. The other models all have single overhead cam engines, and the 306 and Optima have only an eight-valve engine. According to data submitted by the parties, while the power output of the Timor S-515 is 58kw/5500rpm, that of the Timor S-515i is 77kw/5500rpm, as opposed to 66 kw/5400 rpm for the Optima, 70kw/6000 rpm for the 306, 75kw/5500 rpm for the Escort, 85 kw/5400 rpm for the Vectra, and 97kw/6000rpm for the Neon.[738] Accordingly, it would appear that the engine of the Timor S-515i is actually more powerful than those of the Optima, 306 and Escort, but somewhat less powerful than those of the Vectra and Neon.

14.187 With regard to steering and suspension, Indonesia differentiates between the Timor and the Escort, Vectra and Optima on the grounds that the latter three have power steering. However, sales brochures for the Timor indicate that it has power steering as a standard feature, while the United States contends that the Escort has power steering as an option only. Thus, it would appear that with respect to this feature the Timor may actually be more advanced than the 306 and Neon. Regarding suspension, although Indonesia's summary table suggests that there are differences between the Timor and all of the models compared to it, the detailed information supplied by Indonesia shows that all of the models have identical suspension: in the front "Independent MacPherson strut", and in the rear "fully independent multi-linked".[739]

14.188 With respect to "safety features", Indonesia identifies the braking system, fuel tank capacity and mileage, curb weight and passive restraints as relevant features. With respect to the braking system, all models would appear to have front disc and rear drum brakes. The Vectra has ABS, and it appears that some models of the Optima and 306 may also have ABS, while the Timor and Escort do not (the Neon offers ABS as an option). The fuel tank capacity, in ascending order, is: Timor (50 litres), Optima (52 litres), Escort (55 litres), Neon (57 litres), 306 (60 litres), and Vectra (61 litres). Data regarding fuel efficiency were unavailable for most models. The models weigh in at the following: Optima (980 kg), Timor (1055 kg), 306 (1100 kg), Neon (1102 kg), Escort (1110 kg) and Vectra (1150 kg). Documentation submitted by Indonesia shows that all models, except the Timor and 306, have airbags; however, the United States indicated that the Indonesian version of the Escort would not have been equipped with airbags, while documentation from the European Communities indicates that one Optima model has a single airbag while another does not.

14.189 In our view, the data provided by the parties tend to confirm the market segmentation analysis of DRI. Even limiting ourselves to those features on which Indonesia has chosen to focus, the Timor does not appear to be notably inferior to the 306, Optima or Escort, and in fact in some respects may be superior to those models. With respect to the Vectra, on the other hand, the superiority seems relatively clear -- the Vectra is the heaviest passenger car in the group (95 kgs more than the Timor),

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[737] Indonesia states in the Annex V process that the authorization to import the Timor from Korea applied both to the Timor S-515 and the S-515i and that the S-515i was the only national car produced in Indonesia. Thus, it is clear that at least some -- and perhaps most -- of the Timors to be sold in Indonesia are in fact the S-515i model.

[738] While in its rebuttal submission, Indonesia indicated that the Optima's engine generated 66kw/5400rpm, at another point it indicated that the Optima had a power of 87.3/5400rpm. It would appear to the Panel, however, that the 66kw/5400rpm is the correct figure.

[739] Indonesia's summary table mentions differences in tyre size in the context of "steering and suspension". It is not clear that tyre size is related to suspension, or is otherwise an important factor in defining the like product. Moreover, Indonesia's detailed table treats tyre size as a separate feature, unrelated to suspension.

shares honours with the Neon for the largest engine (roughly 500 cc larger than the Timor's), is the only one of the vehicles identified as appropriate for 5 passengers, and has all the features identified by Indonesia (power steering, ABS, airbags). The case of the Neon is intermediate: it is heavier and has a larger engine than the Timor and most of the other models in question, but it is not notably better equipped than the Timor in other respects. Thus, the data fit well with DRI's assessment that the Vectra is in a distinct market segment from the Timor while the Neon is in the upper end of the same market segment as the Timor.

14.190 A number of other factors combine to suggest that the Timor in fact belongs in the C Segment. First, according to DRI's *World Forecast*, Kia -- producer of the Sephia, parent car to the Timor --produces and sells in the Korean market a range of passenger cars, including entrants in Segments A (Morning) and B (Avella and Pride). Further, contrary to Indonesia's contention, DRI data show that several passenger cars classified by DRI in the B Segment (Suzuki Baleno, Toyota Starlet) are currently sold in the Indonesian market, and several others (Daihatsu Charade, Maleo Maleo) were sold in the Indonesian market as recently as 1996. We note that these B Segment cars would appear to be significantly smaller and, on the whole, less powerful than the Timor.[740] This undercuts Indonesia's arguments that the Timor and the Bimantara Cakra are in a class by themselves at the bottom of the Indonesian market.

14.191 In addition to comparing physical characteristics, Indonesia argues that the Timor differs from the other models alleged to be "like products" in terms of a variety of non-physical characteristics. Although Indonesia does not clearly identify which characteristics it considers to be non-physical, among the factors listed by Indonesia which arguably are not "physical characteristics" are brand loyalty, brand image/reputation, status, after-sales service and resale value. However, the only evidence cited by Indonesia in support of its view that the Timor should be distinguished from the other models in question on these bases is a single sentence in a newspaper article submitted as an exhibit by the United States, stating that "dealers say consumers ask a lot of questions about the quality of the Timor and the after-sales service."[741] Further, it is by no means clear that the models alleged to be "like" the Timor would necessarily fare any better than the Timor with respect to these factors. For example, Ford and Chrysler do not have a well-established brand in Indonesia, while sales of Peugeots and Opels have also been relatively small. In short, Indonesia has provided almost no evidentiary support for its view that there are differences in non-physical characteristics which are important to this analysis.

14.192 Finally, Indonesia seems to suggest that the Timor's low price places it into a special market niche and thus renders it "unlike" the more expensive US and EC models. We do not preclude that price might be a relevant consideration in performing "like product" analysis, particularly where differences in price represent one way to assess the relative importance of differing physical characteristics to consumers. In this case, however, the complainants allege that the Timor is being sold at undercutting prices as a result of subsidization. If we were to conclude that the low price of the Timor in the Indonesian market were to render the Timor "unlike" other models which are similar in physical characteristics to the Timor but priced higher, the result would be that, in cases where the subsidization and resulting price undercutting were sufficiently high, price undercutting claims under Article 6 could never prevail. Thus, we do not consider that the Timor's lower price is a basis to conclude that it is unlike the models alleged by the complainants to be "like" the Timor.

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[740] It appears that the car identified by Indonesia as the Daihatsu G102 series is a rebadged Charade. According to figures supplied by Indonesia, the Starlet, Charade and Baleno weigh 725 kg, 845 kg and 965 kg (as opposed to 1055 kg for the Timor), and have engines generating 53, 56 and 87 kw respectively. The Timor S-515i generates 77 kw.

[741] *Indonesia's national-car plan sputters under gaze of WTO*, in Nikkei Weekly, 17 November 1997.

14.193 In conclusion, we consider that the Optima, Escort and 306 are "like products" to the Timor within the meaning of the SCM Agreement. The Vectra, in contrast, is not a like product to the Timor within the meaning of the SCM Agreement. With respect to the Neon, the issue is more difficult. That model is not categorized in a different segment by DRI but is in the higher end of the C segment, and although it is larger and more powerful than the Timor, does not have the clear superiority in its features demonstrated by the Vectra. Thus, for the purposes of our further analysis, we will assume *arguendo* that the Neon is a like product to the Timor.

(b) Treatment of Cars Imported Unassembled

14.194 Indonesia maintains a duty of 200 per cent on imports of passenger cars, and as a result imports of CBU passenger cars (that is, completely-built-up cars) into Indonesia are very small. In fact, almost all passenger cars imported into Indonesia, including the 306 and the Optima, are imported as CKD (completely knocked-down) kits and assembled in Indonesia. The complainants have stated that the Escort and Neon would have been imported in CKD kit form and assembled in Indonesia as well. Article 6.3 provides that serious prejudice may arise where the effect of the subsidy is "to displace or impede the imports of a like product of another Member into the market of the subsidizing Member" or is "a significant price undercutting by the subsidized product as compared with the price of a like product of another Member." Thus, in the context of a displacement or impedance claim, the question arises whether imports of CKD kits are "imports of a like product [to the Timor] of another Member" where the final passenger car assembled in Indonesia is a "like product" to the Timor. In the case of price undercutting, the related question is whether a passenger car assembled in Indonesia from an imported CKD kit is a "like product of another Member."

14.195 In response to questions posed by the Panel, the complainants provided the following information regarding the form in which their passenger cars were imported. The European Communities indicated that virtually all cars were exported to Indonesia in CKD kits. These kits include "almost all" the parts and components necessary for assembling the cars, the only parts and components purchased in Indonesia being low cost universal components such as batteries and tires, or accessories such as radios, CD-players and loudspeakers. Further, the European Communities stated (and Indonesia did not contest) that data provided by Indonesia during consultations indicated that the "local content" of EC passenger cars assembled in Indonesia ranged from 6.4 to 8.3 per cent in 1996 (it is unclear whether Indonesia considered the Optima to be a US or EC passenger car; the same data indicate that US passenger cars contained between 7.7 and 11.1 per cent local content in 1996).[742] The United States indicated that Escorts would have been ordered in groups of 20 vehicles, packaged in waterproof, pre-engineered cases. The CKD kit 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." The local content initially would have been well under 20 per cent, although Ford planned on increasing that over time. The Neon would have been shipped in lots of 72 vehicles, filling 85 boxes. The items to be sourced locally would have included such things as paint, oil, gasoline and other commodities. No US or EC passenger car has achieved the 20 per cent local content level required to enjoy lower tariffs on imported parts and components.

14.196 It is not contested by Indonesia that the CKD kits imported or allegedly planned for importation into Indonesia are products "of another Member." Thus, the issue is whether those kits "have characteristics closely resembling", and are thus "like", completed Timors. In this respect we note, first, that the end uses of the imported CKD kits are the same as those of finished passenger cars

[742] According to Indonesia, "[t]he local content of cars assembled in Indonesia is based on local value added . . . . [E]ach part and component is given an average weighted value with reference to a finished car (weight averaged over each car category). The level of manufacturing that occurs in Indonesia also is factored into the local content calculation."

(although additional steps are required before that end use is achieved). Second, given that the local content of the CKD kits is quite low, the overwhelming majority of the components in the CKD kits not only closely resemble but are physically identical to those found in the final product, with the only difference being that those components are unassembled rather than assembled. Thus, the question is whether the unassembled components can properly be considered to be "like" the finished product assembled from those components, i.e., whether the difference between a product assembled and unassembled is sufficiently important that the unassembled product does not "closely resemble" the assembled product.

14.197 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[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.

(c) Products Not Originating in a Complaining Member

14.198 Before turning to an analysis of adverse effects, we must first consider whether the United States may claim that it has suffered serious prejudice as a result of displacement/impedance or of price undercutting with respect to a product which does not originate in the United States solely on the basis that the producer of that product is a "US company".

14.199 We have determined that US and EC companies sell, or allegedly would be selling but for the subsidies provided pursuant to the National Car programme, four passenger car models that are (or, in the case of the Neon, may be) "like products" to the Timor: the Escort, the Optima, the 306 and the Neon. During the course of the proceedings, both the European Communities and the United States asserted that they had suffered serious prejudice as a result of the displacement/impedance and price undercutting of the Optima and the Escort. In response to a question from the Panel, the United States confirmed that CKD kits for the Optima were sourced in the European Communities and that, had plans to sell the Escort gone ahead, those CKD kits also would have been sourced in the European Communities. The United States argues, however, that the producers of those CKD kits (General Motors and Ford) are undeniably US companies, and that serious prejudice to US interests may arise as a result of displacement/impedance or price undercutting with respect to their products, wherever sourced.

14.200 In considering this issue, our starting point is that both Article XVI of GATT and the SCM Agreement are Annex 1A multilateral agreements on trade in goods. It comes as no surprise, therefore that in its discussion of serious prejudice, Article XVI:1 focuses on the effects of subsidization on trade in goods. That article provides as follows:

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[743] *Alcoholic Beverages (1996)*, op. cit., Appellate Body Report, p. 21.

> If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly *to increase exports of any product from, or to reduce imports of any product* into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization *on the quantity of the affected product or products imported into or exported from* its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any *such subsidization*, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization. (emphasis added).

This focus on the trade effects of subsidization is carried over into Part III of the SCM Agreement. Article 5 provides that no Member should cause, through the use of any subsidy, "adverse effects to the interests of other Members." One such adverse effect is "serious prejudice to the interests of another Member," which the SCM Agreement indicates is used in the same sense as in Article XVI:1.[744] Article 6.3 provides that serious prejudice may arise where one or several of four listed situations exist. As we have seen, the United States alleges two such situations, i.e., (i) that "the effect of the subsidy is to displace or impede the *imports of a like product of another Member* into the market of the subsidizing Member"; and (ii) that "the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of *a like product of another Member* in the same market or significant price suppression, price depression or lost sales in the same market" (emphasis added).

14.201 In our view, the text of Article XVI and of Part III of the SCM Agreement make clear that serious prejudice may arise where a Member's trade interests have been affected by subsidization. We see nothing in Article XVI or in Part III that would suggest that the United States may claim that it has suffered adverse effects merely because it believes that the interests of US *companies* have been harmed where US *products* are not involved. The United States has cited no language in Article XVI:1 or Part III suggesting that the nationality of producers is relevant to establishing the existence of serious prejudice. Accordingly, given that serious prejudice may only arise in the case at hand where there is "displacement or impedance of imports of a like product from another Member" or price undercutting "as compared with the like product of another Member", we do not consider that the United States can convert such effects on products from the European Communities into serious prejudice to US interests merely by alleging that the products affected were produced by US companies.

14.202 In light of our view that the existence of alleged harm to US *companies* is not a basis for a claim of serious prejudice to the interests to the United States, the question remains whether one Member may bring a claim that another Member has suffered serious prejudice as a result of subsidization. In our view the answer is no. It will be recalled that Article 7 of the SCM Agreement sets forth the steps to be taken by a Member which believes that it has suffered adverse effects within the meaning of Part III. Article 7.2 provides that:

[744] SCM Agreement, Note 13 to Article 5.

> A request for consultations under paragraph 1 shall include a statement of available evidence with regard to *(a)* the existence and nature of the subsidy in question, and *(b)* the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice [footnote omitted] caused to the interests of the Member requesting consultations.

It is clear from Article 7.2 that the dispute settlement procedures set forth in Article 7 may only be invoked by a Member where that Member believes that it has itself suffered serious prejudice as a result of subsidization.

14.203 Our view on these issues is confirmed by Article 6.7, which allows a subsidizing Member to raise a defence to a displacement/impedance claim where "imports from the complaining Member" or "exports from the complaining Member" are affected by such factors as export prohibitions or restrictions, natural disasters, and arrangements limiting exports. These provisions of Article 6.7 assume that the products subject to a claim of serious prejudice arising from displacement or impedance originate in the complaining Member.

14.204 For the foregoing reasons, we find that the United States cannot assert that it has suffered serious prejudice as a result of displacement/impedance or price undercutting with respect to products that do not originate in the United States.[745]

4. Should the Panel consider the effects of subsidies provided pursuant to the June 1996 Car Programme?

14.205 It will be recalled that the National Car programme provides a number of subsidies for the Timor. Under the February 1996 car programme, Timors assembled in Indonesia benefit from an exemption from import duties with respect to imported parts and components, as well as an exemption from the luxury sales tax, provided those Timors meet specified local content requirements. Under the June 1996 car programme, PT TPN was authorized to import up to 45,000 CBU Timors from Korea exempt from (200 per cent) import duties during the period 30 June 1996 to 30 June 1997 and to sell those Timors free of luxury sales tax provided that certain requirements regarding counter-purchase and use of Indonesian workers in Korea were satisfied. It will further be recalled that Indonesia submitted the results of an audit indicating that those requirements had not been met, and indicated that a process would begin to seek repayment of the subsidies provided with respect to those Korean-origin Timors. Indonesia now argues that the Panel should not consider the effects of the subsidies provided pursuant to the June 1996 car programme because it has now expired. Because assembly on a significant scale of the Timor in Indonesia has not yet begun,[746] subsidies pursuant to the "February 1996 programme" have yet to be provided to any substantial degree. Thus, Indonesia contends, no actual serious prejudice may be found to exist.

14.206 We do not agree with Indonesia that we are precluded from considering the effect of subsidies pursuant to the June 1996 car programme when analysing whether the subsidies in this case have caused serious prejudice to the interests of the complainants. We agree with the complainants that in

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[745] We note that the issue addressed here is not whether the United States need demonstrate the existence of trade effects in order to establish the nullification or impairment of benefits arising from the violation of a provision of the WTO Agreement. It is well established that in such cases no demonstration of actual trade effects is required. *Superfund*, op. cit.. Rather, we are addressing a situation where the existence of adverse effects is the essence of the claim.

[746] PT TPN is temporarily assembling 1,000 units per year at a plant in Tambun. Its full-scale facility at Karawang, which will have an annual capacity of 63,000 Timors, was not to begin production until sometime in 1998.

this case there are a variety of different subsidy measures provided pursuant to a single National Car programme, and that it makes little sense to treat each one separately when analysing the existence of serious prejudice. Rather, we must assess the "effect of the subsidies" on the interests of another Member to determine whether serious prejudice exists, not the effect of "subsidy programmes." We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were "expired measures" while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice. Thus, we decline to proceed on the course suggested by Indonesia.[747]

5. Displacement and Impedance

14.207 Having determined that certain EC and US passenger car models are (or, in the case of the Neon, may be) like products to the Timor, we must next examine whether the complainants have demonstrated that the effect of the subsidies provided pursuant to the National Car programme has been to displace or impede the exports of those models from the Indonesian market.

(a) Market Share Data

(i) Relevance of Article 6.4

14.208 Before proceeding to an examination of the market share data submitted by complainants, we must consider the threshold legal issue of whether Article 6.4 of the SCM Agreement is relevant to a dispute, such as this, where the adverse effects alleged by the complainants relate to displacement or impedance of a like product into the market of the subsidizing Member under Article 6.3(a). That Article provides as follows:

> *For the purpose of paragraph 3(b),* the displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product (over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year). "Change in relative shares of the market" shall include any of the following situations: *(a)* there is an increase in the market share of the subsidized product; *(b)* the market share of the subsidized product remains constant in circumstances in which, in the absence of the subsidy, it would have declined; *(c)* the market share of the subsidized product declines, but at a slower rate than would have been the case in the absence of the subsidy. (emphasis added).

The European Communities and the United States acknowledge that Article 6.4 on its face does not apply to the displacement and impedance claims in this dispute, as their claims are based on Article 6.3(a) (effect in the market of the subsidizing Member) while Article 6.4 only applies "for the purpose

[747] We recall that, late in the Panel process, Indonesia indicated that it had terminated subsidies pursuant to the National Car programme. For the reasons set forth in paragraph 14.9 *supra*, we nevertheless will proceed to consider whether subsidies pursuant to the National Car programme are causing serious prejudice to the interests of the European Communities and the United States.

of" Article 6.3(b) (effects in the market of a third country). The complainants argue, however, that there is no reason why the type of analysis set forth in Article 6.4 should not be appropriate also in the case of claims of displacement and impedance of imports from the market of the subsidizing country. Indonesia, by contrast, contends that Article 6.4 is not relevant to this dispute.

14.209 The significance of this issue in terms of the obligations on the complainants is considerable. If the type of analysis set forth in Article 6.4 is appropriate in this case, then the complainants arguably could make a *prima facie* case of displacement or impedance simply by demonstrating that the market share of a subsidized product has increased over an appropriately representative period. If, on the other hand, the type of analysis set forth in Article 6.4 is not appropriate in this case, then the complainants must demonstrate that "*the effect of the subsidy* " is to displace or impede imports into Indonesia, that is, that they have lost export sales to Indonesia that they would otherwise have made and that those export sales were lost as a result of the subsidies provided pursuant to the National Car programme.

14.210 We agree with Indonesia that Article 6.4 is not relevant in this case. The drafting of the provision is unambiguous, and the specific reference to Article 6.3(b) creates a strong inference that an Article 6.4 type of analysis is not appropriate in the case of Article 6.3(a) claims. The complainants have identified nothing in the context of the provision or the object and purpose of the SCM Agreement that would suggest a different conclusion.

14.211 Our conclusion does not of course mean that market share data are irrelevant to the analysis of displacement or impedance into a subsidizing Member's market. To the contrary, market share data may be highly relevant evidence for the analysis of such a claim. However, such data are no more than evidence of displacement and impedance caused by subsidization, and a demonstration that the market share of the subsidized product in the subsidizing Member has increased does not *ipso facto* satisfy the requirements of Article 6.3(a).

(ii) Actual Sales and Market Share Data

14.212 Having determined that the EC and US models in the C1 Segment (and arguably those in the C2 Segment) are "like" the subsidized Timor, we consider it appropriate to analyze market shares for the C Segment.[748] A review of the data provided by Indonesia under the Annex V procedure demonstrates that the Timor quickly gained a very substantial share of the Indonesian C Segment passenger car market upon its introduction. As shown in Table 1, the Timor was not sold in 1995 and thus had a zero share of the C Segment market. In 1996, the year of introduction, the Timor captured a 16.9 per cent share of the Indonesian C Segment, while during the period January - May 1997 (the latest period for which we have been provided with data), that market share had climbed to 42.4 percent. Table 2 breaks this market share data down on a quarterly basis. These data indicate that Timor had no sales until the fourth quarter of 1996. In that quarter, its market share in the C Segment reached 40.9 per cent. It dropped to 38.8 per cent for the first quarter of 1997 but during the partial second quarter for which we have data (April-May) that share had climbed to 47.7 per cent.

14.213 In assessing whether this change in market share in fact amounted to a displacement or impedance of imports of EC and US origin products into Indonesia, our starting point is actual market shares for the three EC models we have found to be like products, and for the one US model which we assume *arguendo* to be a like product, to the Timor. The Neon was never introduced into the

[748] According to data supplied during the Annex V process, only one passenger car model in the C2 Segment currently is sold in Indonesia (the Mitsubishi Lancer). Thus, excluding C2 Segment passenger cars when calculating market shares would increase the absolute market shares of the Timor and of EC C1 models somewhat, but would not affect the relative shares.

Indonesia market (allegedly because of the National Car programme), and the market share of US-origin passenger cars in the C Segment of the Indonesian passenger car market was therefore zero. Because the Escort also was never introduced into the Indonesian market, the EC market share data are based solely on sales of the 306 and the Optima. As shown in Table 1, *infra* at p.385, the European Communities in 1995 had an Indonesian market share in the C Segment of 2.4 per cent. The EC share climbed to 5.7 per cent in 1996, but dropped to 3.7 per cent for the period for which we have data (January - May 1997). Table 2, *infra* at p. 386, breaks down these data on a quarterly basis. This analysis shows that in the first three quarters of 1996, EC market share in the C Segment ranged from 6.9 to 7.8 per cent. In the fourth quarter of 1996 (the quarter in which the Timor first entered the market), EC market share dropped to 3.7 per cent. In the first quarter of 1997, EC market share fell even further to 3.3 per cent, and remained at a relatively low 4.2 per cent in the partial second quarter for which we have data (April-May 1997).

14.214 Focusing on market shares alone, the data before us show a potentially significant correlation between the introduction of the subsidized Timor and the decline in EC market share in the C Segment of the Indonesian market. The quarterly data show that the EC market share for C Segment cars in Indonesia increased substantially during the first three quarters of 1996, but that, in the fourth quarter of 1996, coincident with the introduction of the Timor, the European models' market share dropped to 3.7 per cent, where it remained on average during the first five months of 1997. Thus, there seems to be little question that the EC market share in the C Segment dropped substantially relative to that of the subsidized Timor, and the close correlation in time between the introduction of the Timor and the drop in EC market share suggests a causal link between the two.

14.215 If Article 6.4 of the SCM Agreement applied in this dispute, this showing of a change in relative market shares to the disadvantage of the non-subsidized like product might well have been sufficient to establish the European Communities' *prima facie* case of displacement or impedance.[749] In the absence of that article, however, it is not enough for the European Communities to demonstrate a decline in relative market share; rather, the European Communities must demonstrate that "the effect of the subsidy is to displace or impede the imports" of an EC-origin "like product" into the Indonesian market, i.e., that some imports that would have occurred did not occur as a result of the subsidies. While declining market share may be relevant to establishing such a situation, we consider that we must proceed further with the analysis and look at actual sales figures for the products in question.

14.216 In spite of their declines in market share, the absolute volume of sales of the relevant EC models did not significantly decline after the introduction of the Timor. Rather, sales of C Segment vehicles from the EC were 419 units in 1995 and 1,445 units in 1996. For 1997 we have full data from the Annex V process on the C Segment only for January - May, and this shows EC sales of 611 units, which amounts to 1,466 units on an annualized basis. We also have sales figures for the Optima (257 units) and 306 (656 units) for the period January - August 1997 from the European Communities. These figures, totalled and annualized, show sales of 1,370 units for 1997. On a quarterly basis, sales of the Optima and 306 remained relatively constant during the period from the fourth quarter of 1996 through May 1997 at between 300 and 400 units per quarter[750].

[749] Assuming that the eight months of post-Timor data were considered to be "an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned" within the meaning of Article 6.4.

[750] In fact, the quarterly figure for the partial second quarter, if it continued for the rest of the quarter, would actually be 423 units, the highest quarter in the period 1995-second quarter 1997. Treating the period June-August as a quarter, EC C Segment sales amounted to 302 units.

14.217 The explanation for the loss of market share with no decline in absolute sales volume is that the size of the Indonesian market expanded after the introduction of the Timor. What is particularly relevant here is that the increase in the size of the market was largely attributable to sales of the Timor. In particular, between the third and fourth quarters of 1996, the market for C Segment cars increased by 6,326 units, of which the Timor accounted for 4,278 units (68 %). A similar pattern was evident during the first five months of 1997. Thus, relatively stable EC sales volumes in a rapidly expanding market resulted in market share declines but not in declines in absolute volumes.

14.218 We agree with the European Communities that a complainant need not demonstrate a decline in sales in order to demonstrate displacement or impedance. This is inherent in the ordinary meaning of those terms. Thus, displacement relates to a situation where sales volume has declined, while impedance relates to a situation where sales which otherwise would have occurred were impeded. The question before us is therefore whether the market share and sales data above would support a view that, but for the introduction of the subsidized Timor, sales of EC C Segment passenger cars would have been greater than they were.

14.219 In a usual case, a decline in market share in a stable or growing market, corresponding in time with the introduction of a subsidized product, might suggest that sales would have been higher but for the introduction of the subsidized product. This would be particularly the case where, in the period prior to the introduction of the subsidized product, the market share of the non-subsidized product had been rising. In this case, however, Indonesia contends that the introduction of the subsidized Timor was itself responsible for the rapid expansion of the market through the introduction of a new, highly affordable passenger car within the reach of first-time buyers. While the European Communities dismisses this argument as "purely speculative," the sales data in terms of volume of sales discussed above provide some support for this view. Thus, one possible interpretation of the data is that, if the subsidized Timor had not been introduced, the Indonesian C Segment market would have remained relatively stable or in any event would have posted during the last quarter of 1996 and the first eight months of 1997 more gradual increases, comparable to those experienced during the period between the first quarter of 1995 and the second quarter of 1996.

14.220 Assuming that, had the subsidized Timor not been introduced, the Indonesian C Segment market would have remained stable or grown at a more moderate rate during the period for which we have data, the question is whether sales of EC C Segment models in absolute terms would have been higher than those actually achieved. Here, the data are inconclusive. While the European Communities contend that its market share had been steadily increasing and that this trend would have continued but for the introduction of the subsidized Timor, actual sales consisted of only two models, the Optima and 306.[751] As Table 2 shows, quarterly sales data for the Optima do not demonstrate any clear upward trend in the six quarters prior to the introduction of the subsidized Timor.[752] Rather, the increase in EC sales was a result of the introduction of the 306 in the first quarter of 1996. While the European Communities state that 1996 sales of the 306 (1,086 units) were 400 units lower than planned, we have no knowledge of the basis for those sales forecasts. Sales of the 306 for partial year 1997 were at an annualized rate of between 984 units (January - August data) and 1,070 units (January to May data), down slightly from the annualized rate in the first half of 1996 of 1,214

[751] The European Communities pointed in its submissions to the rapid growth in its overall share of the Indonesian passenger car market from 1993 (9.9 per cent) to 1995 (23.72 per cent). However, this rapid growth in market share, which reflects EC gains in high-end vehicles such as Mercedes and BMW, is not relevant to displacement or impedance of "like products" to the Timor.

[752] It is possible that Optima sales would have increased upon the introduction of a new model. We discuss Opel's plans to introduce a new model of the Optima in paragraphs 14.228 to 14.232 *infra*.

units.[753] Thus, if we assume that in the absence of the Timor the market would have remained stable or continued a more gradual increase through August 1997,[754] and that the 306 would have maintained the market share it had achieved in the first half of 1996, these sales might have been expected to increase at most slightly. Such a conclusion is, in any event, highly speculative based on the facts available.[755]

14.221 Finally, we note the limitations inherent in the data before us. Full information about sales in the C Segment of the Indonesian market is only available through May 1997, i.e., for less than three quarters after the introduction of the Timor. Additional information regarding sales of the Optima and 306 through August 1997 cannot be placed in the context of the overall market situation. Further, the volume of sales of the EC models in question is small, to the point where the statistical significance of the changes in volume may be questioned. We note, for instance, that the sales volume for the Optima in 1995 (a year not affected by the subsidized Timor) jumped from 36 units in the first quarter to 186 units in the second quarter before dropping to 98 and 99 units in the third and fourth quarters espectively.

14.222 In short, the dramatic fall in EC market share in the C Segment is not in this case decisive evidence of displacement or impedance, as the data lend some credence to the Indonesian view that the introduction of the subsidized Timor actually created much of the market growth. Thus, we are required to speculate as to how the market would have performed in the absence of the introduction of the Timor, and as to the share of the market which EC models could have been expected to obtain in that hypothetical situation. It is quite possible that the Indonesian market would have remained stable or increased somewhat in late 1996 and early 1997, even without the introduction of the subsidized Timor, and that EC models would have at least maintained their market share, such that EC sales would have increased slightly. This conclusion is however highly tentative, and does not in our view satisfy the requirement, in the present case, that serious prejudice be demonstrated by positive evidence.

[753] The European Communities have stated that Opel has not ordered any new CKD Optimas since June 1996, although assembly of Optimas (presumably from inventory) continues.

[754] We note that the Indonesian economy entered a period of serious difficulties beginning in the late summer of 1997. Thus, we must treat the European Communities' figures for January-August 1997 cautiously, particularly in the absence of any overall figures for the Indonesian market after May 1997.

[755] Sales of the 306 actually climbed slightly from the third quarter (229 units) to the fourth quarter (250 units) of 1996, after the introduction of the Timor. It seems likely, however, that -- as argued by the United States -- the market as a whole in the third quarter was depressed in anticipation of the introduction of the Timor. Thus, third quarter 1996 data may not be reliable.

Table 1

Analysis of Market Share for "C" Class Automobiles in Indonesia
By Year

(Units)

Model	1995	1996	Jan-May 1997	Jan-August 1997
Toyota Corolla/Corona	8,415	7,116	2,537	N/A
Honda City/Civic	2,358	4,112	2,317	N/A
Nissan Sunny/Sentra	960	1,686	864	N/A
Ford Laser	2,814	3,597	1,720	N/A
Mitsubishi Lancer	1,597	1,360	149	N/A
Mazda 323/MR 90	868	597	80	N/A
Bimantara Cakra*	0	1,058	1,012	N/A
Daewoo Nexia*	0	20	305	N/A
Opel Optima	419	359	165	257
Peugeot 306	0	1,086	446	656
Timor*	0	4,278	7,058	N/A
Total	17,431	25,269	16,653	N/A
European models: Quantity Market share	 419 2.4%	 1,445 5.7%	 611 3.7%	 913 N/A
Timor: Market share	0%	16.9%	42.4%	N/A

N/A Not available
*The DRI sales figures, on the basis of which the "C" class models were identified, refer to the Bimantara Cakra as the Hyundai Accent, to the Daewoo Nexia as the Daewoo Cielo, and to the Timor as the Kia Sephia.

Source: AV/3, attachment A-39/1-B, except January-August data, which were provided by the European Communities

Table 2
Analysis of Market Share for "C" Class Automobiles in Indonesia
Quarterly

(Units)

Mfr/Model	1995				1996				1997		
	I	II	III	IV	I	II	III	IV	I	II (April-May)	III (June-August)
Toyota Corolla/Corona	2,093	2,451	2,044	1,827	2,405	1,687	1,420	1,604	1,448	1,089	N/A
Honda City/Civic	703	566	440	649	1,209	1,477	522	904	1,767	550	N/A
Nissan Sunny/Sentra	0	223	233	504	233	307	646	500	561	303	N/A
Ford Laser	0	748	799	1,267	611	1,179	759	1,048	951	769	N/A
Mitsubishi Lancer	543	204	421	429	100	357	231	672	75	74	N/A
Mazda 323/MR 90	54	107	322	385	181	183	147	86	69	11	N/A
Bimantara Cakra*	0	0	0	0	0	0	89	969	709	303	N/A
Daewoo Nexia*	0	0	0	0	0	0	0	20	163	142	N/A
Opel Optima	36	186	98	99	74	57	95	133	87	78	92
Peugeot 306	0	0	0	0	275	332	229	250	242	204	210
Timor	0	0	0	0	0	0	0	4,278	3,848	3,210	N/A
Total	3,429	4,485	4,357	5,160	5,088	5,579	4,138	10,464	9,920	6,733	N/A
European models:											
Quantity	36	186	98	99	349	389	324	383	329	282	302
Market share	1.1%	4.2%	2.2%	1.9%	6.9%	7.0%	7.8%	3.7%	3.3%	4.2%	N/A
Timor: Market share	0	0	0	0	0	0	0	40.9%	38.8%	47.7%	N/A

N/A - Not available.
*The DRI sales figures, on the basis of which the "C" class models were identified, refer to the Bimantara Cakra as the Hyundai Accent, to the Daewoo Nexia as the Daewoo Cielo, and to the Timor as the Kia Sephia.
Source: .... AV/3, attachment A-39/1-B, except June-August 1997 data, which were provided by the European Communities.

(b) Non-introduction of New Models

14.223 The complainants' arguments of displacement and impedance are not limited to the effects of the subsidies provided pursuant to the National Car programme on models currently sold in Indonesia. Rather a key element of their arguments would appear to be that, but for those subsidies, they would have proceeded with plans to introduce new C Segment models, thereby increasing their sales and exports of passenger cars like the Timor to the Indonesian market. Specifically, the complainants contend that, but for the National Car programme, the Escort and Neon would have been introduced to the Indonesian market. It is further claimed that a new model of the Optima would have been introduced.

14.224 As previously noted, we consider that displacement and impedance may exist not only where there has been a decline in sales, but also where it is demonstrated that, in the absence of a subsidy, sales would have increased. Of course, the complainants have the burden to demonstrate their serious prejudice claim by positive evidence. With this in mind, let us examine the information presented by the complainants in support of these contentions.

(i) EC-Origin Model

14.225 The complainants have argued that Ford would have introduced the EC-origin Escort in the Indonesian market but for the subsidies provided under the National Car programme to the Timor. Specifically the European Communities have alleged that, "[a]t the time the National Car programme was adopted, Ford was about to start importing CKD Escorts made at its plant in Saarlouis (Germany)." Both the European Communities and the United States have stated that Ford had already committed US$1 million to the Escort programme. The source for these statements would appear to be a joint letter from GM and Ford to the US Trade Representative, dated 27 November 1996.[756] This letter indicates that the US$1 million commitment "included production and assembly equipment, tooling, component parts and engineering, all of which were in Indonesia prior to the National Vehicle programme." It further indicates that Ford had "an approved investment plan of $US56.0 million with the feasibility of future investment in assembly to be determined based upon the needs of the market and manufacturing requirements," and that "Ford's total planned investment was committed to the establishment of Escort in the market with both local assembly and increasing local content, ultimately reaching 40% by the fourth year." The European Communities indicated that, under a 1995 business plan, Ford would have exported substantial quantities of CKD Escorts to Indonesia,[757] while the joint letter indicated projected sales of 15,100 Escorts in the first four years.[758]

[756] See paragraph 8.298 of the Descriptive Part.

[757] The European Communities contend that, according to a business plan adopted in 1995, Ford would have exported to Indonesia the following quantities of CKD Escorts:

1996	1,323	**1997**	3,468	**1998**	5,156	**1999**	7,370	**2000**	12,026	**2001**	13,867
2002	16,026	**2003**	18,433								

[758] The joint letter also makes a variety of broader statements regarding Ford's commitment to the Indonesian market. However, in light of evidence in the record suggesting that Ford sources its Indonesian products in a number of countries, including Japan, these more general claims are of limited value to a specific assessment of whether *EC-origin like products* to the Timor would have been sold in the Indonesian market.

14.226 The complainants have also alleged the existence of plans to replace the existing Optima with a new model. The European Communities state that Opel had "advanced plans" to expand and upgrade its assembly facilities in Indonesia, including the introduction of a new model of the Optima, while the United States states that GM "was considering investing in plant expansion, and had approval to bring in new models of the Opel Optima and Opel Vectra." The United States asserts that, while the precise figures are confidential, GM's business plan called for sales of Optimas and Vectras "in excess of 1,000 cars in 1996 and around 3,000 cars in 1997, with progressive increases in subsequent years." The joint letter discussed above contains similar information. The parties have not informed the Panel what portion of these planned sales would have been of the Optima.

14.227 In the context of a claim of serious prejudice arising from displacement or impedance, we must review the above information with an eye to whether it demonstrates that (i) there were concrete plans to increase sales of EC-origin passenger cars to the Indonesian market through the introduction of new models; and that (ii) the new models were not introduced because of the subsidies pursuant to the National Car programme.

14.228 Several factual elements have been alleged which could support the European Communities' assertions regarding the existence of concrete plans to introduce the Escort into Indonesia. We note the European Communities' statement that there was an "approved plan" to invest $US56 million for assembly of the Escort in Indonesia. Clearly, such information could be highly relevant to our analysis. The factual information before us with respect to such a plan is, however, extremely limited, and supporting documentation non-existent. Thus, we do not know, for instance, by whom and at what level this plan was "approved."[759] Similarly, the fact that Ford projected substantial sales of the Escort in Indonesia could be highly relevant, but we know nothing about the bases for the projections. Under these circumstances, it is difficult for the Panel to judge the weight to be given to these factors. The concreteness of Ford's plans is to some extent confirmed by the statement of the European Communities that Ford had already spent US$1 million to acquire production equipment which was already in Indonesia; such a commitment of resources suggests the Ford had moved beyond mere consideration of the Escort project and was in the process of implementation.[760] With respect to the reasons why Ford abandoned its plans to introduce the Escort into Indonesia, however, no direct evidence has been presented by the complainants. The United States cites Ford estimates that, if it had introduced the Escort in the Indonesian market, the Timor would have undercut the price of the least expensive version by at least US$5000. We have no basis to judge, however, whether this assessment had been made at the time Ford abandoned its project nor whether it represented the basis for the abandonment of those plans.

14.229 With respect to the Optima, there is even less factual evidence to support the European Communities' assertions than with respect to the Escort. Basically, the complainants are asking the Panel to conclude that the new model of the Optima would have been introduced but for the National Car programme on the basis of a statement regarding the existence of "advanced plans" and a statement that GM had approval to bring in the new model of the Optima. While this type of information could be highly relevant to the issue, the Panel again lacks any detailed evidence. We have been presented with virtually no information about these "advanced plans," e.g., whether a final decision had been taken within GM management and whether funds had been committed. With respect to the question of approval to bring in the Optima, we assume that this means approval by the

[759] The plan apparently was not "approved" by the Government of Indonesia, as Indonesia has stated that Ford "did not submit a single application for approval of the development of passenger car production or assembly facilities in Indonesia during the period 1993 to the present." See paragraph 8.357 of the Descriptive Part.

[760] Indonesia does not challenge that this is a factually correct statement. It does, however, seek to discount the significance of the amount involved in light of Ford's size and huge global sales volume.

Government of Indonesia, but we have no further information. Regarding the reasons why these plans were abandoned, again we have no evidence beyond the statements of company representatives in the joint letter and in newspaper articles.[761]

(ii) US-Origin Models

14.230 The only US-origin model which the United States has alleged would have been sold in the Indonesian market but for subsidies provided pursuant to the National Car programme is the Neon. The following represents the argument and record before the Panel with respect to that allegation.

14.231 The United States stated in its first submission that, prior to the introduction of the National Car programme, Chrysler assembled Jeeps in Indonesia, and that Chrysler "had plans to introduce the Neon but, like GM and Ford, it had to abandon these plans once the National Motor Vehicle Programme was introduced." Its cited sources for this statement were articles in two publications,[762] which contain no further information beyond that found in the US submission. In its second submission, the United States repeated that "Chrysler was planning to introduce the Neon to the Indonesian passenger car market, but that Chrysler, too, had to cancel its plans following the introduction of the National Car programme." In its response to a question from the Panel, the United States stated that "the Chrysler Neons would have been sourced from the United States; specifically, from Chrysler's plant in the state of Illinois." The United States indicated in its oral statement at the Panel's second meeting that "Chrysler's plan called for 1,000 - 2,000 Neons in 1997", and in response to a question from the Panel indicated that, "[a]ccording to Chrysler officials, the launch date for the Neon project would have been mid-1997 had the project not been cancelled due to the National Car Programme." Finally, the United States at the second meeting submitted as an exhibit a letter from Chrysler dated 19 December 1997 stating that, "[a]s noted in the attachment, announcement of the National Motor Vehicle Programme rendered non-viable Chrysler plans for additional investment in Indonesia." The full text of that attachment is as follows:

Chrysler Corporation - Indonesia

- Prior to introduction of the National Motor Vehicle Programme, Chrysler was already assembling Jeep Cherokee and Wrangler vehicles in Cikarang, West Java. Chrysler, together with Lippo Group and Ningz Pacific, was studying an assembly joint venture located in Lippo City to assemble Neon passenger cars and other passenger vehicles. Planned investment in this joint venture would have been more than $150 million. Although the precise figures are confidential, Chrysler's business plan called for initial sales of more than 15,000 vehicles per year, including 1,000 to 2,000 Neons per year, with volumes progressively rising thereafter.

- Chrysler's plan for investment in Indonesia was part of a broader Asian strategy under which Chrysler was already manufacturing or selling vehicles in Thailand, Malaysia, China, Taiwan and Japan.

- However, because of the National Motor Vehicle Programme, Chrysler had to put its plans for additional investment in Indonesia on hold, and did not

[761] The European Communities attaches as an exhibit in support of this statement an article in the Financial Times, *GM Halts Indonesia Move Over National Car Policy* (date illegible). That article quotes a GM official extensively regarding plans to halt new investments as a result of the National Car programme; however, it states that the official "did not indicate the scale or nature of the expansion being put on hold."

[762] See paragraph 8.300 of the Descriptive Part.

> proceed to the final approval stage. In addition, Chrysler was forced to significantly reduce production of Jeep vehicles at its existing assembly plant. Based on Chrysler's internal estimates, if Chrysler had gone ahead with its plans to produce and sell the Neon in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Neon by more than $5,000.

14.232 The evidence before the Panel regarding the intention to introduce the Neon to the Indonesian market is in our view extremely limited. We are told that Chrysler was "studying" an assembly joint venture to assemble the Neon in Indonesia, but we have no basis to judge how concrete those plans were.[763] With respect to the reason why those plans were cancelled, we are presented with no supporting argumentation or evidence beyond the bald statements of the United States and of Chrysler.

(iii) Assessment

14.233 The Panel notes certain factual elements which indicate the existence of plans to introduce the Escort, a new model of the Optima and the Neon to the Indonesian market. This information, if properly developed and documented, might have been highly probative. However, the evidence is very general, and supporting documentation, with the exception of newspaper reports and letters prepared by GM, Ford and Chrysler for the purpose of this dispute, is non-existent. This makes it very difficult for the panel to assess the degree of commitment of the companies to the plans, much less the reasons why those plans were abandoned.[764]

14.234 We do not mean to suggest that in WTO dispute settlement there are any rigid evidentiary rules regarding the admissibility of newspaper reports or the need to demonstrate factual assertions through contemporaneous source information. However, we are concerned that the complainants are asking us to resolve core issues relating to adverse trade effects on the basis of little more than general assertions. This situation is particularly disturbing, given that the affected companies certainly had at their disposal copious evidence in support of the claims of the complainants, such as the actual business plans relating to the new models, government documentation indicating approval for such plans (assuming the "approval" referred to by the complainants with respect to the Optima means approval by the Indonesian government), and corporate minutes or internal decision memoranda relating both to the initial approval, and the subsequent abandonment, of the plans in question.[765]

14.235 We note the United States' stated concern for the confidentiality of company business plans. However, an invitation by the Panel for proposals to ensure adequate protection of such information was not taken up.[766] While complainants cannot be required to submit confidential business information to WTO dispute settlement panels, neither may they invoke confidentiality as a basis for

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[763] As with respect to Ford, Indonesia states that Chrysler had not applied for approval to develop passenger car production or manufacturing facilities since 1993.

[764] Indonesia offered a variety of explanations why in its view Chrysler, Ford and GM did not proceed with their plans to introduce new models into the Indonesian market. These included the small size and dominance of Japanese manufacturers in that market; inadequate return on investment resulting from low profit margins on entry-level cars; and more attractive investment incentives in other Asian countries. In the absence of adequate evidence from the complainants, the Panel lacks a factual basis to accept or reject these alternative explanations.

[765] For example, if Ford and Chrysler in fact abandoned their plans to introduce the Escort and Neon after determining that the Timor would undercut the prices of those models by US$5000, contemporaneous company documents reflecting this assessment could have been submitted and might have been highly probative.

[766] See paragraphs 14.5 to 14.8, *supra*.

their failure to submit the positive evidence required, in the present case, to demonstrate serious prejudice under the SCM Agreement.

(c) Conclusion

14.236 In the view of the Panel, neither the European Communities nor the United States has demonstrated by positive evidence that the effect of subsidies to the Timor pursuant to the National Car programme has been to displace or impede imports of like passenger cars from the Indonesian market within the meaning of Article 6.3(a) of the SCM Agreement.

6. Price Undercutting

14.237 In addition to arguing that serious prejudice has been caused to their interests through displacement or impedance of their exports to Indonesia, the complainants assert that the subsidized Timor significantly undercuts the prices of EC and US like products in the Indonesian market.

14.238 In determining whether serious prejudice within the meaning of Article 5(c) arises from price undercutting, we must first consider Article 6.3(c) of the SCM Agreement. That provision states that

> "serious prejudice in the sense of paragraph 5(c) may arise in any case where one or several of the following apply:
>
> .....
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
>
> .....

Further elaboration on the application of Article 6.3(c) is provided in Article 6.5 of the SCM Agreement, which provides as follows:

> For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

(a) United States

14.239 As noted in paragraph 14.213, no U.S.-origin passenger car that is a "like product" to the subsidized Timor currently is sold in Indonesia. In the absence of any such sales in the Indonesian market, the United States by definition cannot demonstrate that the effect of the subsidies provided pursuant to the National Car programme was a significant price undercutting by the subsidized product as compared with the price of a like product of the United States in the Indonesian market. In any event, we note that the United States did not present any information regarding the price at which the Neon, the sole US-origin passenger car allegedly planned for sale in Indonesia, would have been sold in that market. Rather, the United States merely made the unsubstantiated statement that, if

Chrysler had gone ahead with its plans to sell the Neon in Indonesia, the Timor would have undercut the price of the least expensive model of the Neon by more than US$5000. We do not consider that such a conclusory statement, unbacked by any supporting explanation, calculations or documentation, is sufficient to meet the United States' burden to demonstrate the existence of a significant price undercutting by positive evidence.

14.240 For the foregoing reasons, we find that the United States has not demonstrated through positive evidence that the effect of the subsidies to the Timor pursuant to the National Car programme was to cause serious prejudice to the interests of the United States through a significant price undercutting as compared with the price of US-origin like products in the Indonesian market.

(b) European Communities

14.241 We now turn to the EC argument that the prices of the subsidized National Cars significantly undercut the prices of like passengers cars imported from the European Communities. In support of their price undercutting arguments, the European Communities rely on data regarding the list and market prices for passenger cars sold in Indonesia which show that the Timor has both a list and a market price which are much lower than the list and market prices for the 306 and the Optima, which we have determined to be like products (of another Member) to the Timor.

14.242 With respect to list prices, data submitted by Indonesia during the Annex V process show that the Timor had the lowest list price of any passenger car in the Indonesian market except the Mazda MR-90 as of November 1996 and March 1997 . As shown in Table 3, the list prices for the Timor (ranging from 33 million rupiahs for the S-515 to 36.9 million rupiahs for the S-515i Metallic) were far lower than that of the Optima (70 million rupiahs) and the lowest-priced model of the 306 (59.5 million rupiahs).[767]

[767] See paragraphs 8.384 to 8.387 of the Descriptive Part.

Table 3
List Prices
(Rupiah)

Model	August 1995	November 1996	March 1997
TIMOR			
S 515 1500 cc Solit	-	33,000,000	33,000,000
S 515 1500 cc Metalic	-	33,500,000	33,500,000
S 515i 1500 cc Solit	-	-	36,400,000
S 515i 1500 cc Metalic	-	-	36,900,000
PEUGEOT			
306 M/T, 1761 cc	-	62,500,000	63,000,000
306 A/T, 1761 cc	-	64,750,000	65,500,000
306 M/T, 1761 cc	-	59,000,000	59,500,000
OPEL			
Optima GLS 1900 cc	65,500,000	69,500,000	70,000,000

14.243 With respect to market prices, the data before the Panel relate only to the last quarter of 1996 and were provided by the European Communities during the Annex V process (see Table 4).[768] These data do not indicate whether the model under consideration is the S-515 or the S-515i. It would appear from the list price information, however, that in November 1996 the Timor S-515i was not yet available in the Indonesian market, and it thus seems probable that the price identified for the Timor is for the S-515. The data show that the Timor's market price was the same as its list price, while the Optima and 306 both sold at a discount from list price. Even after those discounts, however, the Timor S-515 had a price advantage of 27.25 million rupiahs over the model of the 306 for which we have market price information and of 23.25 million rupiahs over the lowest-price model of the Optima.

[768] See paragraphs 8.289-8.290 of the Descriptive Part.

Table 4
List and Market Prices
(Fourth Quarter 1996; Rupiah)

Model	List price	Market price
Kia Timor	35,750,000	35,750,000
Peugeot 306 PST	64,000,000	63,000,000
Opel Optima GLS	69,500,000	59,000,000
Opel Optima CDX	74,000,000	62,000,000
Opel Optima CDX - A-Bag	76,000,000	64,000,000

14.244 Article 6.5 of the SCM Agreement requires that, when performing an analysis of price undercutting under Article 6.3(c), "[t]he comparison [of prices] shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability." In this case, the 306 and Optima are imported in CKD form, and if the prices of these CKD cars were compared to prices of finished Timors, the difference between the assembled and unassembled cars clearly would be a factor affecting price comparability. Further, to the extent that there are transaction prices for the CKD cars, these would presumably be at a different level of trade than the retail prices for the finished Timor. These potential problems of comparability do not arise in the price comparisons proposed by the European Communities, however, as the prices they propose for comparison are retail prices for finished 306s, Optimas and Timors. It would appear that the prices are in fact at the same level of trade and at comparable times, and Indonesia has raised no concern in this regard. Rather, the key issue with respect to this claim would appear to be whether the European Communities have taken due account of other factors affecting price comparability.

14.245 Indonesia argues that Article 6.5, taken in conjunction with the positive evidence standard set forth in Article 27.8, means that the European Communities have the burden of quantifying and making appropriate price adjustments for the physical characteristics and consumer preferences and perceptions that distinguish the Timor from the Optima and the 306. Indonesia submitted a table identifying specific physical differences between the three models. In addition, it submitted a second table listing various physical and non-physical characteristics (power, technology, comfort, safety, workmanship, brand image) and rating the three models with respect to the characteristics on a scale of L (low) through H2 (high). In Indonesia's view, the Timor ranked low in all these regards, while the Optima and the 306 ranked medium or medium-high.[769] In Indonesia's view, the European Communities have failed to meet their burden with respect to adjustments for these differences and accordingly have failed to demonstrate the existence of a significant price undercutting through apples-to-apples comparisons. The European Communities argue that there are no relevant physical differences which may affect significantly price comparability and state that there are no physical or other product differences, or any other factor, that could account for the 43-52% price undercutting which they allege to exist.

14.246 In examining the arguments of the parties, we first turn to the issue of identifiable physical differences between the Timor, the Optima and the 306. The record in this dispute includes extensive information about the physical characteristics of the models in question,[770] and this information

[769] See paragraphs 8.221 to 8.225 of the Descriptive Part.
[770] See Section VIII.B.3 of the Descriptive Part.

reflects a variety of potentially significant differences in physical characteristics between the models. These include differences between the Timor and one or both of the other models in terms of the size, features and power of the engines; tyre size; safety features (ABS, airbags); and extra features (alarm system, rear folding seats, interior trim). While these differences are not sufficient to render the three models unlike, they must clearly affect price comparability to some extent.

14.247 Given that the existence of these physical differences is clear from the record, and that the burden in this case is on the complainants to demonstrate the existence of serious prejudice by positive evidence, it would have greatly facilitated the work of the Panel had the European Communities made some effort to quantify the impact of these differences on price comparability. We specifically requested the European Communities to identify any differences, including differences in physical characteristics, that could affect price comparability, and to explain how allowance should be made with respect to them.[771] Their failure to respond in detail to this request has resulted in a thin record with respect to this issue, and in a closer case where the degree of the price differential was not so large might well have been fatal to their claim.

14.248 Nevertheless, the information on the record in this dispute does allow us to take account of some of the salient physical differences between the three models. In this respect, we first note that the seemingly most significant difference between the Timor on the one hand and the Optima and the 306 on the other is engine size. Specifically, the Timor's engine is 263cc smaller than that of the 306 and 298cc smaller than that of the Optima. The European Communities have argued, the record confirms, and Indonesia has not contested, however, that any potential advantage of the Optima and the 306 over the S-515 in terms of power due to their larger engine size was compensated for by the introduction of a sixteen-valve, dual overhead cam injection engine in the S-515i; in fact, the S-515i's engine generates more power than that of either the Optima or the 306. As indicated above, only list price (and not market price) information is available with respect to the Timor S-515i. However, we note that the difference in the list prices of the S-515 and 515i provides an indication of the possible difference in market prices of the two models. In particular, the difference in list price between the S-515 (which is equipped with an engine less powerful than those of the Optima and 306) and the S-515i (which, as previously noted, is equipped with an engine more powerful than those of the Optima and the 306) was 3.9 million rupiahs in March 1997. Thus, by adjusting the market price for the Timor S-515 upward by this difference in list prices between the S-515 and S-515i, we can take account of the differences between the Timor S-515, the Optima and the 306 with respect to engine power.

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[771] At its first meeting with the parties, the Panel asked the parties the following question:

> In its first submission, the EC states that the Timor S-515 significantly undercut the prices of the closest EC models, the Peugeot 306 and Opel Optima. . . . Article 6.5 of the SCM Agreement states that, when performing a price comparison, "due account shall be taken of any other factor affecting price comparability." Are there factors that affect price comparability? Specifically, are there any differences between the models which must be taken into account when comparing these prices? If so, please identify these factors, and explain in detail how these factors should be taken into account when performing the price comparison.

The European Communities responded that:

> The EC believes that there are no relevant "other factors" (including differences in physical characteristics) which may affect significantly price comparability between, on the one hand, the Timor S-515 and, on the one hand, the Opel Optima and Peugeot 306. Indonesia itself has not been able to identify any such "other factor", let alone any factor which may account for a level of price undercutting of 50%.

14.249 Indonesia notes that the Timor does not come equipped with airbags, while one model of the Optima does. With respect to this feature, however, we know from price list information provided by Indonesia that the Optima CDX with airbag costs two million rupiahs more than the same model without an airbag, and that the Optima GLS does not come equipped with an airbag at all; thus, we can also discount for this physical difference by restricting our comparison to the price of the Optima GLS, which does not come equipped with an airbag.

14.250 What of the remaining physical differences? Although the record is conflicting, it would appear that some models of the Optima and the 306 may have ABS (anti-skid braking system), while the Timor S-515i does not. The Optima comes equipped with an alarm system, while the Timor S-515i does not. The fuel tanks of the Optima and 306 are slightly larger than those of the Timor S-515i. The rear seats of the Optima and the 306 fold down, while that of the Timor S-515i does not. The Optima and the 306 have larger tires than the Timor S-515i. The Timor S-515i has cloth seats, while the Optima has velour seats and one model of the 306 has leather seats. Some versions of the Optima and the 306 have light alloy wheels, while that is an option for the Timor S-515i. The Optima has "additional headlamps", while the Timor S-515i does not.

14.251 These foregoing differences, for which the European Communities have not made allowance in their price comparisons, are not insignificant, and it seems clear to us that consumers would be willing to pay a premium for some of them at least. However, we note that the United States has identified and sought to place a value on a number of features of the S-515i (such as tilt steering, mud flaps, colour key bumpers, and colour key/foldable mirrors) which the Optima at least lacks, and which may to some extent offset the value of some of the features of the Optima. More fundamentally, looking specifically at the November 1996 market prices for the Timor S-515, the Optima and the 306, and even after adding 3.9 million rupiahs to the price of the Timor S-515 to account for the differences in engine power between that model and the S-515i, the price of the Timor undercuts the price of the least expensive Optima (without airbag) by 19.35 million rupiahs (33 per cent)[772] and undercuts the price of the 306 by 23.35 million rupiahs (37 per cent)[773] . While the physical differences between the Timor, the Optima and the 306 for which we have not been able to make due allowance clearly would affect their prices, we agree with the European Communities that the differences identified in the preceding paragraph could not possibly account for these enormous differences in price.

14.252 This is confirmed by the fact that, according to price data submitted by Indonesia, the Timor not only is priced lower than the C Segment Optima and the 306, but in March 1997 had a list price in the Indonesian market[774] that was also significantly lower than the list prices of such B Segment cars as the Toyota Starlet (48.1 million rupiahs) and the Suzuki Baleno (44.75 million rupiahs). A comparison of the physical characteristics of the Timor S-515 with those of the Starlet is particularly instructive. The Starlet is a lesser car than the Timor S-515 in almost every respect, including length (3.72 metres for the Starlet, 4.36 metres for the Timor); weight (725 kg for the Starlet, 1,055 kg for the Timor); engine size (1,296 cc for the Starlet, 1,498 cc for the Timor); and engine power (53 kw/6,200 rpm for the Starlet, 58 kw/5,500 for the Timor S-515, 77 kw/5500 rpm for the Timor S-515i). Like the Timor, the Starlet lacks ABS and airbags. Yet the list price of the top-of-the-line Timor S-515i is 11.2 million rupiahs less than that of the Starlet.

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[772] Market price of Optima GLS (59 million rupiahs) [minus] market price of Timor S-515 (35.75 million rupiahs) [plus] the difference between list price of Timor S-515 Solit and Timor S-515i Metalic (3.9 million rupiahs) [equals] 19.35 million rupiahs.

[773] Market price of the 306 PST (63 million rupiahs) [minus] market price of Timor S-515 (35.75 million rupiahs) [plus] the difference between list price of Timor S-515 Solit and Timor S-515i Metalic (3.9 million rupiahs) [equals] 23.35 million rupiahs.

[774] 33 million rupiahs for the S-515i Solit, 36.9 million rupiahs for the S-515i Metalic.

14.253 Indonesia also argues the existence of numerous non-physical differences between the Timor, the Optima and the 306. We note, however, that while the record clearly demonstrates the existence of differences in physical characteristics between the models in question, Indonesia has presented little if any evidentiary support for their proposition concerning non-physical differences (such as brand image or after-sales service) between the models. While we agree with Indonesia that the European Communities bear the burden of proof to demonstrate the existence of all elements of their serious prejudice claim, including the existence of price undercutting, the record does not show that there are any significant non-physical differences for which due allowance must be made, much less any differences that could account for the extent of the differences in price between the Timor, the Optima and the 306.

14.254 We note that under Article 6.3(c) serious prejudice may arise only where the price undercutting is "significant." Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice. This clearly is not an issue here. To the contrary, it is our view that, even taking into account the possible effects of these physical differences on price comparability, the price undercutting by the Timor of the Optima and 306 cannot reasonably be deemed to be other than significant.

14.255 Finally, we note that serious prejudice may arise under Article 6.3(c) only where the price undercutting is "the effect of the subsidy." In this case, we agree with the European Communities that Indonesia, in information that it provided in the Annex V process effectively concedes that the tariff and tax subsidies under the National Car programme are responsible for the significant level of price undercutting. The table cited by the European Communities contains data for 1998 and 1999 regarding the Timor S515i that will be assembled at the Karawang facility. Row 4 of that table (Unit Dealer Price) indicates that the effect of the tariff and tax subsidies of the National Car programme is to lower the price of the Timor S-515i by US$7,243-9,158, i.e., by approximately 33-38 per cent.[775]
14.256 For the foregoing reasons, we find that the effect of the subsidies to the Timor pursuant to the National Car programme is to cause serious prejudice to the interests of the European Communities in the sense of Article 5(c) of the SCM Agreement through a significant price undercutting as compared with the price of EC-origin like products in the Indonesian market.

7. Threat of Serious Prejudice

14.257 The European Communities argue that, if the Panel were to find that the evidence did not warrant a finding of actual serious prejudice, the facts support a finding that subsidies provided pursuant to the National Car programme pose a threat of serious prejudice to the interests of the European Communities. In light of our affirmative finding of actual serious prejudice, it is not necessary to reach this alternative claim.

I. Claims under Article 28 of the SCM Agreement

14.258 Finally, we turn to the United States' claim under Article 28 of the SCM Agreement. The United States argues that, via Decree No. 223/1995, Decree No. 82/1996, and Regulation No. 36/1996, Indonesia has extended the scope of its local content-based tariff and tax subsidies for certain motor vehicles in violation of Article 28.2. Indonesia responds that Article 28.2 applies only to subsidies that are "inconsistent" with the SCM Agreement, and since Article 27.3 of the SCM Agreement exempts Indonesia's local content subsidies from the prohibition that would otherwise

[775] See paragraphs 8.395 and 8.408 of the Descriptive Part.

apply under Article 3.1(b), these subsidies are not "inconsistent" with the Agreement and thus not subject to Article 28.

14.259 Article 28 of the Agreement provides as follows:

Existing Programmes

> 28.1 Subsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement *and which are inconsistent with the provisions of this Agreement* shall be:
>
> (a) notified to the Committee not later than 90 days after the date of entry into force of the WTO Agreement for such Member; and
>
> (b) *brought into conformity with the provisions of this Agreement within three years* of the date of entry into force of the WTO Agreement for such Member and until then shall not be subject to Part II.
>
> 28.2 *No Member shall extend the scope of any such programme*, nor shall such a programme be renewed upon its expiry. (emphasis added).

14.260 Article 28.1 of the SCM Agreement specifies that subsidy programmes which are "inconsistent with the provisions of this Agreement" must be notified to the Committee within 90 days after the date of entry into force of the WTO Agreement for the Member and brought into conformity with the provisions of the SCM Agreement within three years of that date. Article 28.2 specifies that no Member shall extend the scope of "any such programme." In our view, this reference to "any such programme" can only refer back to the types of programmes identified in Article 28.1. Accordingly, the question we must address is whether Indonesia has extended the scope of a subsidy programme which is "inconsistent" with the provisions of the SCM Agreement.

14.261 We consider that the ordinary meaning of the term "inconsistent with the provisions of this Agreement", when read in its context, cannot reasonably be considered to extend to the Indonesian subsidy programmes under review in this dispute. The United States concedes that, under Article 27.3 of the SCM Agreement, the prohibition of paragraph 3.1(b) of the SCM Agreement does not apply to the Indonesian programmes for a period of five years from the date of entry into force of the WTO Agreement, i.e., until the year 2000. The United States contends that the term "inconsistent" is not synonymous with "prohibited", and implies that a subsidy programme may be inconsistent with the provisions of the SCM Agreement if it satisfies the substantive conditions of Article 3, whether or not the Article 3 prohibitions are applicable. In the SCM Agreement, however, the drafters have chosen to express the concept of subsidies meeting the substantive conditions of Article 3 by referring to subsidies "falling under the provisions of Article 3" (See Article 2.3). If they had intended to express the same concept in Article 28, they could have used comparable language.

14.262 Because we consider that the Indonesian subsidy programmes under review in this dispute are not "inconsistent" with the provisions of the SCM Agreement within the meaning of Article 28, we reject the claims of the United States that Indonesia has extended the scope of certain subsidy measures in violation of Article 28.2 of the SCM Agreement.

J. Claims under the TRIPS Agreement

14.263 As we understand it, the United States is making the following claims:

- Indonesia is in violation of its obligations under Article 3 of the TRIPS Agreement on national treatment because the provisions of its National Car Programme discriminate against nationals of other WTO Members with respect to the acquisition and maintenance of trademarks, and the use of trademarks as specifically addressed in Article 20 of the TRIPS Agreement;

- Indonesia is in violation of its obligations under Article 65.5 of the TRIPS Agreement because provisions of the National Car Programme which were introduced by Indonesia during its transition period under the TRIPS Agreement put special requirements on nationals of other WTO Members in respect of the use of their trademarks which are inconsistent with the provisions of Article 20 of the TRIPS Agreement.

1. Article 3

14.264 Article 3 of the TRIPS Agreement, entitled "National Treatment", reads as follows:

> "1. Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection[3] of intellectual property, subject to the exceptions already provided in, respectively, the Paris Convention (1967), the Berne Convention (1971), the Rome Convention or the Treaty on Intellectual Property in Respect of Integrated Circuits. In respect of performers, producers of phonogram and broadcasting organizations, this obligation only applies in respect of the rights provided under this Agreement. Any Member availing itself of the possibilities provided in Article 6 of the Berne Convention (1971) or paragraph 1(b) of Article 16 of the Rome Convention shall make a notification as foreseen in those provisions to the Council for TRIPS.
>
> 2. Members may avail themselves of the exceptions permitted under paragraph 1 in relation to judicial and administrative procedures, including the designation of an address for service or the appointment of an agent within the jurisdiction of a Member, only where such exceptions are necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of this Agreement and where such practices are not applied in a manner which would constitute a disguised restriction on trade.
>
> ---
>
> [3]For the purposes of Articles 3 and 4, "protection" shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in this Agreement."

14.265 As mentioned earlier, in regard to matters covered by the expression "protection of intellectual property" in respect of which WTO Members are required to grant national treatment, the United States has made claims in regard to three of the items specified in the footnote, namely "acquisition", "maintenance", and "those matters affecting the use of intellectual property rights specifically addressed in this Agreement", in this case in Article 20.

14.266 As a preliminary point, we note that Indonesia has been under an obligation to apply the provisions of Article 3 since 1 January 1996, Article 3 not benefiting from the additional four years of transition generally provided by Article 65.2 to developing country Members.

(a) Acquisition of trademarks

14.267 According to the United States, Indonesia discriminates against foreign nationals in respect of the acquisition of trademarks, because any trademark that could apply to a "national motor vehicle" must be acquired by an Indonesian company, be that company a joint venture or a wholly-owned Indonesian company.

14.268 The TRIPS Agreement requires WTO Members to provide certain treatment to the nationals of other WTO Members in respect of the protection of their intellectual property. The issue to be examined therefore in regard to the United States' claim relating to the "acquisition" of trademarks is whether, under the Indonesian law and practice which is before us, the treatment accorded to foreign nationals in respect of the acquisition of trademark rights, through the applicable procedures, is less favourable than that accorded to the Indonesian company in the National Car Programme. We do not consider that any evidence has been produced in this case to support such a claim. The facts brought before us do not point to any difference in the applicable law for acquiring trademark rights between that applying to companies of other WTO Members and that applying to the company operating under the National Car Programme. It is true that the cars marketed under the National Car Programme have to bear a trademark belonging to an Indonesian-owned company which has created that trademark, and, therefore, that trademarks owned by United States' and other foreign companies may not be employed for this purpose. While this may give rise to questions regarding the scope for the use of trademarks owned by United States' companies on cars under the National Car Programme, it does not, in our view, pose a problem regarding the acquisition of trademark rights. The fact that only certain signs can be used as trademarks for meeting the relevant qualifications under the National Car Programme, and many others not, does not mean that trademark rights, as stipulated in Indonesian trademark law, cannot be acquired for these other signs in a non-discriminatory manner.

14.269 We therefore find that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the acquisition of trademark rights.

(b) Maintenance of trademarks

14.270 The United States has advanced two arguments as to why, in its view, the Indonesian system discriminates against United States nationals in respect of the maintenance of trademark rights. The first argument is that the Indonesian system puts United States companies in a position that, if they were successful in becoming a partner in the National Car Programme, they would be unlikely to use in Indonesia the mark normally used ("global" mark) on the vehicle marketed as a "national motor vehicle" in Indonesia, for fear of creating confusion (i.e., confusion resulting from using different marks on the same car), and consequently it was more likely that the "global" mark would be subject to cancellation for non-use in Indonesia.[776]

14.271 We do not accept this argument for the following reasons. First, no evidence has been put forward to refute the Indonesian statement that the system, in requiring a new, albeit Indonesian-owned, trademark to be created, applies equally to pre-existing trademarks owned by Indonesian

[776] Many countries provide in their national legislation that failure to use a trademark during a certain period of time (under the TRIPS Agreement a minimum of three years) may lead to the cancellation of the registration of the mark. The purpose is to avoid the trademark register becoming clogged with unused marks. Various provisions of the TRIPS Agreement relate to this matter, notably Article 19.

nationals and foreign nationals. Second, if a foreign company enters into an arrangement with a Pioneer company, it would do so voluntarily, with knowledge of any consequent implications for its ability to maintain pre-existing trademark rights, as indeed the United States itself has acknowledged in its submissions to the Panel (see paragraph 11.32 above).

14.272 The second argument advanced by the United States relating to discrimination in respect of the maintenance of trademark rights is that foreign holders of trademarks in Indonesia are at a de facto disadvantage in meeting use requirements in relation to the Indonesian holder of a trademark satisfying the National Car Programme requirements, because the tariff, internal tax and other benefits to which the Indonesian company is entitled give it a competitive advantage in the marketing of cars bearing trademarks over foreign companies.

14.273 In considering this argument, we note that any customs tariff, subsidy or other governmental measure of support could have a "de facto" effect of giving such an advantage to the beneficiaries of this support. We consider that considerable caution needs to be used in respect of "de facto" based arguments of this sort, because of the danger of reading into a provision obligations which go far beyond the letter of that provision and the objectives of the Agreement. It would not be reasonable to construe the national treatment obligation of the TRIPS Agreement in relation to the maintenance of trademark rights as preventing the grant of tariff, subsidy or other measures of support to national companies on the grounds that this would render the maintenance of trademark rights by foreign companies wishing to export to that market relatively more difficult.

14.274 For the above reasons, we find that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the maintenance of trademark rights.

(c) Use of trademarks as specifically addressed in Article 20

14.275 As is made clear by the footnote to Article 3 of the TRIPS Agreement, the national treatment rule set out in that Article does not apply to use of intellectual property rights generally but only to "those matters affecting the use of intellectual property rights specifically addressed in this Agreement". In putting forward its claim on this point, the United States has developed arguments relating to the use of trademarks specifically addressed by Article 20 of the TRIPS Agreement. It is the first sentence of this Article, which is entitled "Other Requirements", to which the United States has made reference. This sentence reads as follows:

> "The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings."

14.276 The main issues before us in examining this claim of the United States are therefore: first, is the use of a trademark to which the Indonesian law and practices at issue relates "specifically addressed" by Article 20; and, second, if so, does this aspect of the system discriminate in favour of Indonesian nationals and against those of other WTO Members.

14.277 In taking up the first of these questions, the issue to be considered initially is whether the Indonesian law and practices in question constitute a special requirement that might encumber the use of the trademarks of nationals of other WTO Members in terms of Article 20 of the TRIPS Agreement. The United States has put forward two basic arguments on this question, which are similar to the arguments it has put forward also in regard to the maintenance of trademarks (see paragraphs 14.270 and 14.270 above). The first argument is that a foreign company that enters into

an arrangement with a Pioneer company would be encumbered in using the trademark that it used elsewhere for the model that was adopted by the National Car Programme. We do not accept that this argument establishes an inconsistency with the provisions of Article 20, for the reason, as indicated in paragraph 14.271 above, that, if a foreign company enters into an arrangement with a Pioneer company it does so voluntarily and in the knowledge of any consequent implications for its ability to use any pre-existing trademark. In these circumstances, we do not consider the provisions of the National Car Programme as they relate to trademarks can be construed as "requirements", in the sense of Article 20.

14.278 The second United States argument is that non-Indonesian car companies are encumbered in using their trademarks in Indonesia by being put at a competitive disadvantage because the cars produced under the National Car Programme bearing the Indonesian trademark benefit from tariff, subsidy and other benefits flowing from that programme. In regard to this argument, we also feel that the points developed in our earlier discussion of the United States claims regarding the maintenance of trademarks are relevant, in particular in paragraph 14.273 above. Moreover, the United States has not explained to our satisfaction how the ineligibility for benefits accruing under the National Car Programme could constitute "requirements" imposed on foreign trademark holders, in the sense of Article 20 of the TRIPS Agreement.

14.279 For the reasons outlined above, we find that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the use of trademarks specifically addressed in Article 20.

2. Article 65.5 in Conjunction with Article 20

14.280 Article 65.5 of the TRIPS Agreement reads as follows:

> "5. A Member availing itself of a transitional period under paragraphs 1, 2, 3 or 4 shall ensure that any changes in its laws, regulations and practice made during that period do not result in a lesser degree of consistency with the provisions of this Agreement."

14.281 The question, therefore, to be examined in considering this claim of the United States is whether during the transitional period to which Indonesia is entitled in respect of the application of the provisions of Article 20 Indonesia has made any changes in its laws, regulations and practice that have resulted in a lesser degree of consistency with the provisions of that Article.

14.282 The arguments put forward by the United States in support of its claim are essentially the same as those that have been considered in paragraphs 14.277 and 14.278 above. For the reasons set out in those paragraphs above, we find that the United States has not demonstrated that measures have been taken that reduce the degree of consistency with the provisions of Article 20 and which would therefore be in violation of Indonesia's obligations under Article 65.5 of the TRIPS Agreement.

XV. CONCLUSIONS AND RECOMMENDATIONS

15.1 In the light of the findings above,

(a) We conclude that the local content requirements of the 1993 and of the 1996 February car programmes to which are linked (i) sales tax benefits on finished motor vehicles incorporating a certain percentage value of domestic products or on National Cars and (ii) customs duty benefits for imported parts and components used in finished motor vehicles incorporating a certain percentage

value of domestic products or used in National Cars violate the provisions of Article 2 of the TRIMs Agreement.

(b) We conclude that the sales tax discrimination aspects of the 1993 and the February and June 1996 car programmes in favour of domestic motor vehicles incorporating a certain percentage value of domestic products and National Cars violate the provisions of Article III:2 of GATT.

(c) We conclude that the customs duty and sales tax benefits of the June 1996 car programme in favour of imported National Cars and the customs duty benefits of the February 1996 car programme in favour of imported parts and components to be used in National Cars assembled in Indonesia violate Article I of GATT.

(d) We conclude that the European Communities have demonstrated by positive evidence that Indonesia has caused, through the use of specific subsidies provided pursuant to the National Car programme, serious prejudice to the interests of the European Communities within the meaning of Article 5(c) of the SCM Agreement.

(e) We conclude that the United States has not demonstrated by positive evidence that Indonesia has caused, through the use of specific subsidies provided pursuant to the National Car programme, serious prejudice to the interests of the United States within the meaning of Article 5(c) of the SCM Agreement.

(f) We conclude that Indonesia has not violated Article 28.2 of the SCM Agreement.

(g) We conclude that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the acquisition of trademark rights or the maintenance of trademark rights or in respect of the use of trademarks specifically addressed in Article 20 of the TRIPS Agreement nor has it demonstrated that measures have been taken that reduce the degree of consistency with the provisions of Article 20 and which would therefore be in violation of Indonesia's obligations under Article 65.5 of the TRIPS Agreement.

15.2 Under Article 3.8 of the DSU, in cases where there is infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits under that agreement. Accordingly, we conclude that to the extent that Indonesia has acted inconsistently with the provisions of covered agreements, as described in the preceding paragraph, it has nullified or impaired the benefits accruing to the complainants under those agreements.

15.3 With respect to the conclusion of serious prejudice to the interests of the European Communities, Article 7.8 of the SCM Agreement provides that, "[w]here a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining the subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy."

15.4 The Panel *recommends* that the Dispute Settlement Body request Indonesia to bring its measures into conformity with its obligations under the WTO Agreement.