CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

(WT/DS340)

OPENING STATEMENT OF THE
UNITED STATES OF AMERICA
AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

As Delivered

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1. Mr. Chairman, members of the Panel, and staff of the Secretariat, we again thank you for your work on this matter.

2. Our opening statement today will summarize key U.S. positions, and respond to China's Rebuttal Submission.

3. China's rebuttal submission, though lengthy, adds very little to the substantive discussion of the issues in this dispute. Rather, China's submission mostly relies on rhetorical devices. First, China relies on rhetorical catch-phrases – such as "substance over form" and the "parts versus wholes." These phrases are nowhere contained in the WTO Agreement, or even in the Harmonized System, and are not helpful in resolving the issues in dispute. Moreover, as we will address in a few minutes, the catch-phrases repeatedly cited by China, when examined, in fact provide no support for China's defense of its measures in this dispute.

4. The second rhetorical device used in China's rebuttal submission is to mischaracterize complainants' positions. Most notably, China repeatedly claims that the complainants' agree with China on various issues and the issues thus have been "narrowed," and then China proceeds to build arguments based on these false premises. Again, such argumentation is not helpful in resolving the issues in dispute.

Article III and TRIMs Issues

5. As the United States has explained, China's measures amount to straightforward inconsistencies with China's national treatment obligations under Article III of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"). In particular, these measures impermissibly result in internal charges on imported parts in excess of those applied on domestic

parts (Article III:2); the measures accord treatment less favorable to imported parts with respect to requirements affecting internal sale, purchase, distribution, and use (Article III:4); and the measures directly or indirectly require that specified amounts or proportions of auto parts used in vehicle manufacturing must be supplied from domestic sources (Article III:5). For the same reasons, China's measures amount to a domestic content requirement that is inconsistent with China's obligations under Article 2.1 and Paragraph 1(a) of Annex 1 of the *Agreement on Trade-Related Investment Measures* ("TRIMs Agreement").

6. China's defense to the Article III issues is based solely on its argument that its measures involve customs duties, and that Article III cannot apply to a measure that involves customs duties. China has not otherwise even attempted to assert a defense – aside from a vague reliance on Article XX(d) – to these breaches of its WTO obligations.

7. In its rebuttal submission, China phrases its argument as follows, with the emphasis in the original: "If a particular measure implements and collects a charge that a Member is *allowed* to impose in accordance with Article II, it cannot be the case that the same charge must be in conformity with the requirements of Article III."[1] This statement has no basis in logic or the text of the GATT 1994. In fact, it is routine for a measure to be examined under the obligations set out under various provisions of the WTO Agreement in disputes under the DSU. The fact that a measure is or is not consistent with one obligation does not necessarily determine whether the measure is or is not consistent with a different obligation.

[1] China Rebuttal Submission, para. 124.

8. Perhaps China implies that there is something special in GATT Article II that somehow "allows" (as China puts it) Members to depart from other GATT obligations. But that issue has been considered, and rejected, by prior panels under the GATT 1947 and by the Appellate Body under the GATT 1994. As found in those disputes, GATT Article II and a Member's schedule of tariff commitments impose additional obligations on a Member, and consistency with those obligations cannot serve as a defense to breaches of other WTO obligations.

9. In its rebuttal submission (footnote 89), China tries to confuse the issue, and tries to imply a difference between views of the complaining parties, by noting that Canada has stated that Article III:2 does not apply to customs duties. But this is also the U.S. position, and follows from the understanding that the charges in this dispute are either internal ones (as complainants contend), or customs duties (as China asserts). The applicability (or not) of Article III:2 follows from Article III:2's use of the term "internal charges," and not from any notion (as China contends) that Article II provides "permission" for a violation of Article III. Thus, China's reference to Article III:2 in this context is off the mark.

10. Instead, the issue here is that China's charges (whether internal charges or customs duties) are straightforward violations of Articles III:4 and III:5 of the GATT 1994, as well as the TRIMs agreement. This is because the level of China's charges increases if the local content of a vehicle manufactured in China exceeds certain thresholds. As such, the measures provide less favorable treatment to imported parts with respect to laws affecting their internal sale, purchase, distribution and use under Article III:4, and impose a domestic mixing requirement within the meaning of Article III:5.

11. In its rebuttal submission, China's response to these arguments (para. 124) is that it "does not understand." The United States submits that it has been sufficiently clear on this point. Perhaps, however, a more elaborate example would be helpful. Consider a vehicle manufacturer in China that has imported an auto part; call it Part A. Under China's measures, the importer/manufacturer must post a security for the 10 percent parts rate. Once Part A enters into inventory, the manufacturer has a decision with regard to what to do with this imported part. The manufacturer may decide to use the imported part in the production of a particular complete vehicle. However, the manufacturer must always be mindful of China's local content thresholds. If the use of Part A in manufacturing would result in a vehicle that exceeds the thresholds, then all other imported parts used in that vehicle would be subject to the 25 percent charge. By tying the use of Part A to increased charges on other parts, China's measures serve as a disincentive on the use of Part A in manufacturing. And, this disincentive is in addition to, and separate from, the level of the charge imposed on Part A itself. No comparable regulations affect the use of a comparable domestic Part A. Accordingly, China's measures are a violation of Article III, as a law affecting the use within China of an imported product.

12. China is wrong in asserting (para. 124) that customs duties would always constitute "a violation of the non-discrimination principles under Article III." The same type of discrimination does not apply to customs duties regularly imposed by WTO Members. That is, the level of charges on other imported products does not depend on how an imported part is used within the Member's territory.

13. Finally, the United States also notes, as we have previously stated, that the discrimination not only applies to the "use" of the imported product, but also applies to the "internal sale,

offering for sale, purchase, or distribution" under Article III:4. If the importer in the above example were instead a parts distributor or a parts producer, then the importer would want to sell or distribute imported Part A to manufacturers within China. Under China's measures, however, a manufacturer in China will have a disincentive to purchase imported Part A from the distributor. Specifically, because the use of imported Part A in manufacturing could result in the vehicle exceeding China's local content thresholds, and in the imposition of additional charges on all other imported parts, China's measures adversely affect the "internal sale, offering for sale, purchase, or distribution" of imported parts, with no comparable effect on a domestic Part A.

Internal Charges vs. Customs Duties

14. I will now turn to the additional charges at issue in this dispute and whether they are "ordinary customs duties" or internal charges. These charges can only be considered as internal ones. Under *EEC – Parts and Components*, charges are internal charges subject to Article III:2 of the GATT when based on the product as manufactured internally, regardless of the label adopted by the implementing Member. In this case, China's charges are based not on the goods as entered but instead on the use of the goods in manufacturing a vehicle within the territory of China. As the United States emphasized at the first substantive meeting, when a part is presented at the border, China imposes a revenue bond based on the 10 percent duty rate for parts, and applies the extra 15 percent charge only (1) if the imported part is actually used in the manufacture of a vehicle, and (2) if the amount of imported content in that vehicle exceeds the thresholds set out in China's measures. China's measures are focused on the amount of local content in the final assembled vehicle - the who, what, where, and hows of importation are irrelevant. As in *EEC – Parts and Components,* the charge must be evaluated based on its

substance – not its title. And, a charge which is assessed based on the level of local content contained in an internally manufactured product can only be considered an internal charge under Article III:2.

15. In its first submission, China tries to distinguish *EEC – Parts and Components*, but those efforts were unsuccessful. In particular, China's argument that the claimed purpose of collecting the charge is determinative was explicitly considered and rejected in *EEC – Parts and Components*.

16. In its second submission, China argues that its charges are just like regular customs duties because:

> "The classification of the import entry, and the assessment of the applicable duty rate, is based on the status of the auto parts and components when they were entered and declared to the Customs General Administration."[2]

17. This statement, however, is inconsistent with the actual content of China's measures. Rather, the rate of the charge, as noted above, is based on whether an imported part is used in manufacturing, and on the level of local content of the vehicle subsequently manufactured in China. Article 28 of Decree 125 (titled "Principles for Taxation and Calculation of Duty Charges") provides that:

> After the imported automotive parts are assembled and manufactured into whole vehicles, automobile manufacturers shall declare such items to Customs, and Customs shall, in accordance with the Customs Law of the People's Republic of China . . . proceed with categorization and duty collection.
>
> For imported parts that have been verified by the Center as Deemed Whole Vehicles, customs will categorize them as whole vehicles and will, according to the duty rate for whole vehicles, calculate and levy import duties and value added

[2] China's Rebuttal Submission, para. 117.

> tax at the import stage; for those that have been verified as not being Deemed Whole Vehicles, Customs will categorize them as parts and will, according to the corresponding applicable duty rate, calculate and levy import duties and value-added tax at the import stage. (Emphasis added) (Ex. JE-27).

(I would note that this quotation is from complainants' translation, but there is no significant difference in China's translation of this part of Decree 125 so this is not a translation issue.) Article 29 of Decree 125 further provides (i) that the additional charges are likewise imposed on imported parts purchased from suppliers within China, if upon manufacturing those parts are used in Deemed Whole Vehicles; and (ii) that parts declared at the border as Deemed Whole Vehicles will nonetheless not be subject to the additional 15 percent charge if such parts are not used in manufacturing within one year. In short, the charge is based on how the part is actually used internally, and not on the condition of the part as imported.

18. For obvious reasons, China would like to characterize its measures to try to make them seem more like regular customs duties. In this context, the United States would like to emphasize that the meaning of the measures in dispute is a factual issue, to be determined by the Panel just like any other factual issue in dispute. And in this instance, China's measures are clear on their face in providing that the level of the charge is based on the details of an internal manufacturing operation, and that the documentation required by China upon the importation of the parts is not determinative.

19. The United States would also like to respond to China's argument in paragraphs 113-119 of its rebuttal submission, which China contends "reinforces" its position that its additional charges are customs duties, not internal ones. As the United States understands it, China's argument is that no parts are actually "imported" until the final duties are assessed after

manufacturing, because as a formal matter China (in most but not all cases) will not have settled – until after the final manufacture of a complete vehicle – the financial guarantee required upon entry. This argument is not and cannot be correct. Otherwise, a Member could avoid its Article III disciplines by the simple ruse of structuring its customs laws so that no product is actually "imported" – as China proposes the term be interpreted – until after discriminatory internal charges and other discriminatory measures had been applied. Rather, the only sensible way to view "imported" in this context is with its normal meaning, that is, the time when the product enters the Member's customs territory.

20. The United States also would note that if the Panel in fact were to agree with China's apparent argument that no parts are to be considered "imported" until after manufacturing, then the measures would amount to import restrictions under Article XI of the GATT 1994, as alleged in the U.S. request for the establishment of a panel. This result would follow from the fact that China's measures are mandatory for vehicle manufacturers who wish to import parts. And, if those measures prohibit the importation of parts until after the completion of a manufacturing operation, the measures would amount to restrictions on the ability of manufacturers to import parts.

21. Finally, the United States notes the irony of China's continual recital of the importance of "substance" over "form." As explained above, the substance of China's measures is that they are internal charges, based on the local content of a vehicle manufactured in China. And it is thus China, not the complaining parties, that is trying to elevate form over substance by labeling its charges as "customs duties."

GIR 2(a) Would Not Provide China With a Defense under GATT Article II

22. As the United States has explained, China's additional charges on imported auto parts are internal charges, subject to obligations under Article III:2 of the GATT 1994, and not "ordinary customs duties" under GATT Article II:1(a). Even aside from this fact, GIR 2(a) of the Harmonized System would not provide a defense to a breach by China of its tariff commitments.

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

24. As the United States has explained, China's tariff classification argument based on GIR 2(a) is entirely without merit. To summarize,

> A) Although China has based its case entirely on a "circumvention" theory, nothing in GIR 2(a) mentions anything about "circumvention."
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> B) GIR 2(a) uses the language "as presented" and "presented," which makes clear that customs authorities are to classify the goods in the condition as presented to customs upon importation. There is no notion in GIR 2(a) that a customs authority should classify a part based on the amount of local content contained in a complete article assembled after importation. Also, there is no notion in GIR 2(a) that a customs authority should seek out all bulk entries of parts, by different importers, from different suppliers, at different times, and even of different national origin, and then proceed to collect them into some fictitious unassembled product.
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> C) China's interpretation of GIR 2(a) is inconsistent with the object and purpose of the Harmonized System Convention to establish uniform tariff nomenclature rules for the purpose of comparing trade statistics (between exports and imports, and between different

parties to the Convention). In fact, under China's interpretation, the comparability of trade statistics collected by different members, and between import and export statistics, would be destroyed.

D) China's interpretation of GIR 2(a) is inconsistent with the object and purpose of the Harmonized System Convention to facilitate international trade. China's intricate, complicated system for classification destroys the certainty and predictability of tariff classification, and can only serve as a serious impediment to trade.

E) China's interpretation ignores the obligations under the Convention to "use all the headings and subheadings of the Harmonized System without addition or modification, together with their related numerical codes." As the United States and its co-complainants have pointed out, China in its submissions ignores the most fundamental of the GIR's: GIR 1, which provides that "classification should be determined according to the terms of the headings and any relative section or chapter notes." Under China's measures, however, China classifies parts as whole vehicles, despite the fact that the HS contains specific headings for auto parts and assemblies.

25. It was striking that China, in its opening statement today, although continually referring to the interpretation of GIR 2(a) and the Vienna Convention, never responded to our explanation of how China's interpretation is inconsistent with the object and purpose of the HS Convention.

26. The United States submits that China has provided and can provide no answers to these fundamental arguments. Most notably, China's argument that only China's interpretation would allow "substance" to triumph over "form" is meaningless, and completely ignores the reality of modern automobile manufacturing. As the United States has explained, manufacturers import bulk shipments of parts because this is the usual and most efficient means of conducting large-scale automobile manufacturing, and <u>not</u> because manufacturers are trying to avoid duties owed on the import of knock-down kits.

27. The United States also has three additional points on China's tariff binding argument based on GIR 2(a). First, China's submission repeatedly claims that GIR 2(a) is addressed to the issue of "parts vs. wholes." This characterization of GIR 2(a) is incorrect. Rather, the HS

addresses "parts vs. wholes" under the HS tariff nomenclature: that is, whole articles and parts (and assemblies) of articles are classified in separate headings. The HS nomenclature for autos and auto parts is particularly well developed. Accordingly, the general issue of "parts vs. wholes" is governed by GIR 1, which provides that articles must be classified in accordance with the relative headings. In contrast, GIR 2(a) is only addressed to the limited issue of the classification of articles presented unassembled or disassembled, and does not address the classification of bulk parts shipments.

28. Second, the United States recognizes that the WCO Secretariat has no formal role under the Convention to provide definitive interpretations of the HS, nor to provide definitive advice to other bodies. The United States does note, however, that the response of the WCO Secretariat to the Panel's questions acknowledges the point made by the United States regarding the phrase "elements originating in or arriving from different countries," as used in the HSC decision cited by China. In particular, as the United States explained in its answer to Panel Question 138 and its comment on China's answer to Question 138, the committee's discussion of "elements" from different countries was in the context of discussing the application of rules of origin, and does not in any way indicate that the committee was considering a measure (such as China's) that would artificially combine bulk shipments of parts from different countries in order to create a fictional collection of parts to be used in the assembly of a complete vehicle.

29. Third, the United States notes that it is not the role of the Panel in this dispute, as China appears to suggest, to make determinations on the proper interpretation of a non-WTO Agreement such as the HS Convention. Rather, the only pertinence of the HS Convention is to assist in interpreting China's Schedule of tariff commitments. More specifically, the only role of

the HS Convention is to assist in determining the common intent of WTO Members with respect to China's tariff commitment on specific auto parts, such as radiators and brakes. The United States submits that regardless of any issues raised by China regarding the precise meaning of HS interpretive notes and WCO discussions of interpretive notes, nothing in the HS Convention could support an interpretation of China's WTO tariff commitments such that bulk shipments of brakes and radiators should receive the same tariff treatment as whole automobiles. In other words, the issues in this case turn on the interpretation and application of the WTO Agreement, not other international agreements.

China's Article XX(d) Defense

30. In its second submission, China for the first time provides some additional discussion of its defense under Article XX(d). As an initial matter, the United States notes that China, as the disputing party asserting an affirmative defense, has the burden of proving each element of the defense. China has not met that burden.

31. China's basic argument under Article XX(d) is that its measures are "necessary to secure compliance with laws or regulations" needed to collect the 25 percent duty that China is permitted under its tariff bindings to collect on the importation of whole vehicles. As China has done throughout this dispute, China uses this language to mean two very different things – neither one of them supports an Article XX(d) defense.

32. First, China uses this language to mean that under its domestic tariff schedule, China is to charge a whole-vehicle rate of duty on any imported part, so long as that part is used to manufacture within China a vehicle with a foreign content that exceeds the thresholds under China's measures. This aspect of China's argument does match the reach and scope of the

measure that China actually has adopted. However, as the United States has explained, there is no possible interpretation of China's national treatment obligations under Article III, nor of China's WTO Schedule, that would allow for China to impose a 25 percent duty on bulk shipments of parts imported for manufacturing purposes. Thus, if China is asserting that its domestic tariff schedule requires a 25 percent duty on manufacturing parts, then China's domestic tariff schedule is inconsistent with its WTO obligations. Accordingly, China's purported Article XX(d) defense fails to present any "laws or regulations which are not inconsistent with the provisions of this Agreement," as required by Article XX(d).

33. Second, China uses the same language – about ensuring its ability to collect the 25 percent whole-vehicle duty – to mean something entirely different: namely, that China must be able to address certain limited, though still hypothetical, examples of "evasion" (as China puts it), such as the case of a CKD split into two shipments, or a whole vehicle entered with the tires removed.

34. For two reasons, this asserted rationale fails to meet the requirement of necessity under Article XX(d). China has still failed to show a single instance where any importer ever engaged in the specific practices identified by China. In its rebuttal submission (paras. 173 and 174), China claims that a certain manufacturer evaded China's duties on kits by switching to the import of subassemblies. Leaving aside that China did not submit any actual data, even on their face China's assertions do not prove the existence of the practice that China is asserting. Rather, as the United States has explained, it is normal business practice for a manufacturer to start operations with the assembly of kits, and then to move to full assembly operations using separate shipments of parts and assemblies. The data provided by China is thus entirely consistent with

the conduct of normal business operations, and China has provided no evidence that the manufacturer was splitting CKD kits into separate shipments for the sole purpose of trying to change the tariff treatment.

35. In fact, as the United States has explained, China's course of conduct has shown that it has not been concerned about tariff evasion at all. Rather, Chinese authorities have controlled the tariff process by requiring auto manufacturers to negotiate the rates that would be applicable for all types of kits and parts, with the key factors in the outcome of that negotiation being a manufacturer's commitment to investing in China and using local content in assembling vehicles.

36. Moreover, China's asserted "circumvention" rationale does not match the scope of China's measures. Before addressing this point, the United States would like to be absolutely clear that it does not agree, as China claims, that a hypothetical measure intended to address split shipments of kits would be consistent with China's WTO obligations. Rather, China in fact has not adopted any such measures in this dispute, and it is not meaningful for the United States (nor the Panel) to engage in an analysis of hypothetical, vaguely defined measures not actually adopted by China.

37. Nonetheless, China bases its Article XX(d) defense on the assertion that it would be entitled to adopt such hypothetical measures to combat "evasion", and thus that China is entitled to adopt the measures at issue in this dispute. But this argument, of course, is entirely unavailing. Whether or not China would or would not be entitled to adopt measures to address hypothetical instances of what China considers "evasion," China has not adopted such measures and those measures are not the measures in dispute. Rather, as discussed above, China's measures sweep broadly to cover all imports of bulk parts for manufacturing purposes, not just instances of what

China calls "tariff evasion." Given the far broader scope of the measures China has actually adopted, they cannot be considered "necessary" under Article XX(d) to meet China's asserted policy concern with "evasion."

38. Mr. Chairman, members of the Panel, that concludes our opening remarks. We would be happy to address any questions.