

CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

(WT/DS340)

**EXECUTIVE SUMMARY
OF THE REBUTTAL SUBMISSION
OF THE UNITED STATES OF AMERICA**

July 2, 2007

INTRODUCTION

1. China’s measures amount to clear and 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”).

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

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

4. The United States will address and refute the two main assertions – one factual and one legal – that underlie China’s defense of its measures. As discussed in the next section below, the importation of bulk shipments of parts is routinely undertaken by automotive plants around the world, and such bulk shipments cannot be analogized to China’s hypothetical case of the “split shipment” of a pre-organized kit. As discussed in the last section, the Harmonized System has only limited, specific relevance to the interpretation of WTO obligations, and even then, GRI 2(a) does nothing to support China’s measures.

CHINA’S ANALOGY BETWEEN THE ROUTINE IMPORT OF AUTO PARTS FOR MANUFACTURING PURPOSES AND THE HYPOTHETICAL CASE OF A KIT SEPARATED INTO “SPLIT SHIPMENTS” IS FUNDAMENTALLY FLAWED

5. China’s defense is built on a simple paradigm: that of a kit (either an SKD or CKD) containing all parts of a single automobile, or at least all parts of what amounts to something with the essential characteristics of an automobile. Under China’s customs laws, China argues, it treats such kits as complete automobiles. Now, China asks rhetorically, should an importer be allowed to change the tariff treatment of the kit by the simple expediency of splitting that kit into

two boxes? Of course not, asserts China. China simply and reasonably has adopted a measure to address that problem of “circumvention.”

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

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

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

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

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

11. In short, China has no basis for comparing the streams of parts used by a manufacturing plant to the conduct of purported “circumvention” involved in splitting a kit before import. The imported parts used by manufacturing plants are not and cannot be put into kits. This is the commercial reality, and does not, as China asserts, raise any issue of “circumvention.” Thus, the

purported goal of China’s measures – merely to stop “circumvention” in the form of splitting preorganized kits – is in no way consistent with actual scope and operation of China’s measures. Rather, contrary to China’s argument about “circumvention,” the measures as actually constructed impose a local content requirement on all automobiles manufactures in China, and thus are plainly intended to encourage the growth of the domestic parts industry by discriminating against imported auto parts.

CHINA CANNOT RELY ON GRI 2(A) AS THE BASIS FOR THE DEFENSE OF ITS MEASURES

GRI 2(a) Only Relates to the Interpretation of China’s Obligations under Its Schedule of Tariff Commitments and Not to the Interpretation of Other WTO Obligations

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

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

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

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

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

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

The Dispositive Issues in This Dispute Do Not Turn on GRI 2(a) or Any Other Issue of Tariff Classification

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

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

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

applicable only to users of imported auto parts are inconsistent with Article III:4, regardless of whether or not China's charges are considered "customs duties."

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

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

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

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

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

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

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

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

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

26. 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, GRI 2(a) of the Harmonized System would not provide a defense to China's plain breach of its tariff commitments (if the charges are considered tariffs) in its schedule.

27. Before proceeding to a consideration of GRI 2(a) itself, the United States emphasizes that China's entire defense under Article II is based on GRI 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 tariff schedule, when read in conjunction with GRI 2(a), China reserved itself the right to treat imported parts used for manufacturing purposes as if those parts were complete vehicles.

28. In addition, the United States notes its disagreement with China's contention that GRI 2(a) should be considered as "context" for the purpose of interpreting China's schedule of tariff concessions. The United States takes note of the Appellate Body findings in *EC-Computer Equipment* and *EC-Chicken Cuts*. Those two reports, however, are quite careful and limited in their reasoning, and do not express an across-the-board rule that the Harmonized System is "context" for the purpose of every part of every Member's schedule of tariff commitments. In *EC-Computer Equipment*, the Appellate Body found that the Panel should have examined the Harmonized System (including Explanatory Notes), but the Appellate Body did not specify whether the Harmonized System fit under the customary rules of interpretation reflected in

Article 31 or under Article 32 of the Vienna Convention. In *EC-Chicken Cuts*, the Appellate Body did find that the Harmonized System was “context” under the customary rules of interpretation reflected in Article 31(2)(a) of the Vienna Convention, but the reasoning in that report was carefully limited to the facts and circumstances of that particular dispute. In particular, the Appellate Body emphasized that during the Uruguay Round, tariff negotiations for agricultural products were based on the Harmonized System, and the Appellate Body refers to a “Modalities” document – applicable only to agriculture – which confirmed this understanding of the negotiators. The Appellate Body reasoned that these particular facts and circumstances established an “agreement” among all parties that the Harmonized System would be used in the interpretation of scheduled commitments on agricultural products. In short, these findings in *EC-Chicken Cuts* regarding the Harmonized System are only directly applicable to schedules negotiated during the Uruguay Round, and only with respect to agricultural products.

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

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

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

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

32. Two aspects of GRI 2(a) are apparent on its face. First, although China has based its case entirely on a “circumvention” theory, nothing in this rule of interpretation mentions anything about “circumvention.” Second, the rule uses the language “as presented” and “presented,” which makes clear that customs authorities are to classify the goods in the condition as presented to customs upon importation. There is no notion in GRI 2(a) that a customs authority should seek out all entries of diverse parts, by different importers, from different suppliers, at different times, and even of different national origin, and then proceed to collect them into some fictitious unassembled product, to then be classified as the assembled product. To the contrary, if China’s

interpretation of GRI 2(a) were adopted, the words “as presented” and “presented” would be rendered absolutely without meaning.

33. China also ignores the object and purpose of the Harmonized System Convention. In relevant part, the Preamble to the Convention provides:

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

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

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

36. China’s interpretation of GRI 2(a) is also at odds with the object and purpose of facilitating trade. Under China’s measures, goods are not classified as imported at the border, but only after the goods have been used in manufacturing, and only after the manufacturer has completed and verified a complex analysis of the local content of the final product. This

intricate, complicated system for classification destroys the certainty and predictability of tariff classification, and can only serve as a serious impediment to trade.

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

Article 3: Obligations of Contracting Parties

1. Subject to the exceptions enumerated in Article 4:

(a) Each Contracting Party undertakes, except as provided in subparagraph (c) of this paragraph, that from the date on which this Convention enters into force in respect of it, its Customs tariff and statistical nomenclatures shall be in conformity with the Harmonized System. It thus undertakes that, in respect of its Customs tariff and statistical nomenclatures:

- (i) it shall use all the headings and subheadings of the Harmonized System without addition or modification, together with their related numerical codes;
- (ii) it shall apply the General Rules for the interpretation of the Harmonized System and all the Section, Chapter and Subheading Notes, and shall not modify the scope of the Sections, Chapters, headings or subheadings of the Harmonized System; and
- (iii) it shall follow the numerical sequence of the Harmonized System.

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

39. Furthermore, the fact that the application of the GRIs is obligatory undercuts China’s arguments. That is, if China is right that GRI 2(a) provides for the classification of bulk auto parts used in manufacturing as the complete, manufactured product, then the obligation to classify parts in this manner would apply to each and every party to the Convention. Yet, China has failed to provide any evidence that any other party to the Convention has adopted measures at all comparable to China’s measures on auto parts. Moreover, China has conceded that even China itself does not use similar classification schemes for parts other than auto parts. In sum,

either (a) every party to the Convention, and China itself with respect to all goods except auto parts, is acting inconsistently with the obligations under the Convention to apply the GRIs (including GRI 2(a)), *or (b)* GRI 2(a) – as it plainly states in the text – applies to goods “as presented,” and China’s treatment of auto parts is inconsistent with GRI 2(a). For the reasons stated above, the United States submits that *(b)* – GRI 2(a) applies to goods as presented upon importation – is the only possible answer.