

CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

(WT/DS340)

**OPENING STATEMENT OF THE
UNITED STATES OF AMERICA
AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL**

May 22, 2007

1. Mr. Chairman, members of the Panel, and staff of the Secretariat, we thank you for your work on this matter. We are pleased to be here today before you.

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

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

4. These 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).

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

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

importance to the United States that the findings in this dispute address China's serious breaches of Article III.

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

8. 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.

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

10. The second element of an Article III:4 analysis is that the measures affect the internal sale, purchase, distribution or use of the like products. In this instance, China's Auto Policy, Decree No. 125 and Announcement No. 4 work together to create an incentive to purchase domestic auto parts. First, the system levies a charge based on the types and total value of imported parts used in the automobile. Second, the system imposes burdensome administrative recording requirements when imported parts are used in the manufacturing of vehicles. These aspects of its measure established a disincentive to purchase, use and distribute imported auto

parts. Thus the measures meet the second element of an Article III:4 analysis. China also does not dispute this element.

11. The third and last element for determining a breach of Article III:4 is to assess whether the measures accord less favorable treatment to imported products relative to the domestic product. Here, the measures treat foreign parts less favorably than domestic parts by creating different competitive conditions for the parts. This is done in two, or perhaps three, ways.

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

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

- a “self-evaluation” to determine the number of imported parts used in the assembly of a particular vehicle model, involving a catalogue of all the parts of each model it manufactures, and calculations of the thresholds for each assembly system and the overall price percentage of imported parts in the model;
- a registration of the vehicle model, including the annual production plan for the vehicle model; a list of all domestic and foreign suppliers; and a detailed list of all imported and domestic parts used in the model being filed;
- a requirement to constantly update the registration to take into account changes in the source and relative price of various parts of every automobile model, as well as changes to individual automobiles;
- monthly payments of charges, accompanied by the verification report, the previous month’s total production figures, and a list of parts and components used by the manufacturer in the prior month to assemble completed vehicles;
- and a requirement for the manufacturer to maintain – with respect to all parts not imported by the manufacturer itself – records regarding the importer of record, and any evidence of duties and value-added taxes paid.

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

15. Third, in describing its measures, China asserts that imported auto parts “are not in free circulation in the customs territory of China.”¹ As noted in the first U.S. submission, China’s measures appear to require burdensome “in-bond” requirements on all imported auto parts, but these measures do not appear to be enforced. China in its first submission, however, appears to claim otherwise. If indeed all imported parts in fact are subject to burdensome “in-bond” requirements that render them “not in free circulation,” then for this additional reason China is providing less favorable treatment to imported parts than to domestic parts. Again, this breach of Article III:4 is independent from any question of tariff rates allowed under China’s Article II tariff bindings.

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

17. To elaborate on this point, even if China’s charges were considered “customs duties,” and even if China were correct that it was entitled under its tariff bindings to charge a duty of 25% on all imported parts, China’s measures would still constitute a breach of Article III:4. The Article III:4 breach, as just discussed, is based on the fact 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.

¹ China’s First Submission, para. 46.

Similarly, the administrative burdens applicable only to users of imported auto parts, and the burdens relating to the bonded status of imported auto parts, are inconsistent with Article III:4, regardless of whether or not China’s charges are considered “customs duties.” These breaches of Article III:4 would exist regardless of any issue related to Article II; indeed, these breaches would exist even if China had not bound at all its tariff duties on auto parts.

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

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

20. I will turn to the inconsistency of China’s measures with Article III:2, and in particular, the first sentence of Article III:2. Unlike for Article III:4 and Article III:5, China’s first submission does discuss a possible defense to this breach. This defense, however, is unavailing. Moreover, China even appears to concede that at least some aspects of its measures are inconsistent with Article III:2.

21. A determination of an internal charge’s inconsistency with Article III:2, first sentence is a two step process: First, the imported and domestic products at issue must be “like.” As explained in our first submission, imported and domestic auto parts are like parts for the purpose of Article III:2. China does not contest this. Second, the internal charge must be applied to imported products “in excess of” those applied to the like domestic products. In this case, when the types or value of the imported parts used in the assembly of a vehicle in China exceed the thresholds established in the measures, the measures impose an internal charge on all imported parts in the vehicle. Domestic parts are exempt. Thus, the internal charge applied to imported parts is “in excess of” any charge imposed on domestic parts, resulting in a plain breach of Article III:2. Again, China does not contest this.

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

23. As discussed in the first U.S. submission, the distinction between internal charges and customs duties has been addressed in prior panels under the GATT 1947. In one of the first GATT 1947 reports, *Belgian Family Allowances*, the panel examined whether a particular charge should be treated as an “internal charge” within the scope of Article III:2 of the GATT or an

“import charge” within the scope of Article II. The panel concluded that because the charge (a) “was collected only on products purchased by public bodies for their own use and not on imports as such” and (b) “was charged, not at the time of importation, but when the purchase price was paid by the public body,” the charge constituted an internal charge. In other words, because the charge depended on the internal use of the product, it could not be considered a border charge.

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

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

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

- The determination of whether imported parts constitute “features of a complete automobile” is made based on the details of the operations of an internal assembly process, rather than on the conditions of the parts at the time of entry.
- Under the measures, all of the parts of a completed vehicle are combined for the determination of whether the 25 percent charge applies, regardless of the countries from which those parts originate, when or where they entered the territory of China, or who imported them. Even if a part has been imported by a supplier, and even if the supplier has already paid customs fees and duties, the part is nonetheless grouped together with parts imported by the manufacturer itself when making the determination.
- The 25 percent charge is imposed not on the importer, but on the manufacturer – whether or not the manufacturer is actually the importer of the part in question.

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

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

Part IV.G, referred to by China in this footnote, is the section in China’s submission stating that any breaches of other GATT articles are justifiable under GATT Article XX(d). Thus, the way

the United States reads this footnote, and we think it is fair, is that China is conceding that the imposition of a charge on a part imported by a third party is an internal charge – not a customs duty – inconsistent with Article III, but that China nonetheless has an Article XX(d) defense.

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

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

30. Second, China argues that its measure is different because it is imposed for the purpose of collecting customs duties. But this type of argument was explicitly considered and rejected in *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.”

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

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

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

34. As a result, the United States submits that the proper mode and order of analysis in this dispute should be as follows. The Panel should first examine China’s measures under Article III disciplines, and – as the United States has shown, find them to be inconsistent with those obligations. To the extent that China’s discussion of tariff classification and Article II bindings

have any relevance in this dispute, it would be as part of China's attempt to meet its burden of establishing an Article XX(d) defense to its Article III breaches.

35. The EC in particular has discussed, including this morning, Article II issues at length, so in this statement, the United States will just make the following brief comments. In our view, any Article XX(d) defense by China would be tantamount to the following argument: that China wishes to breach Article II, and is thus justified to commit a primary breach of Article III. In other words, the United States submits that China does not even have the beginnings of an Article XX defense to its Article III breaches.

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

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

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

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

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

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

42. Paragraph 93 of the Working Party Report provides,

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

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

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

45. China also has no basis for asserting, as it does in its first submission, that many other WTO Members have put in place measures in any way similar to China's regime for imported auto parts. For example, China cites a U.S. regulation (Ex. CHI-27) regarding "multiple conveyances" as somehow being supportive of China's proposed interpretation of GRI 2. But, to

the contrary, the regulation shows precisely the opposite. As explained in the regulation, it covers entities which, due to their size and nature, cannot be shipped in a single conveyance, and instead must be imported in an unassembled or disassembled condition. The rule was adopted for the convenience of importers, who wanted their products classified as the complete product under GRI 2, but could not previously do so because the entity was too large to fit on a single conveyance (usually meaning a single ship). The rule eases customs regulations to allow a disassembled product to benefit from GRI 2 even if the product must be imported on more than one ship. Nothing in this rule is anything like China’s auto parts regime, which requires that separate shipments of parts must receive the tariff treatment of a complete vehicle. Indeed, the U.S. regulation goes out of its way to assure importers that they “may, of course, continue to file a separate entry for each portion of an unassembled or disassembled shipment as it arrives, if they so choose.” (Ex. CHI-27, at 31,922, emphasis added)

46. In sum, without any entitlement to impose 25 percent duties on imported auto parts, China has no basis for any Article XX(d) defense for any measures intended to ensure the collection of such duties.

47. Mr. Chairman, Members of the Panel, that concludes my remarks for this morning. We would be happy to address any questions.