

***UNITED STATES - RULES OF ORIGIN FOR TEXTILES AND APPAREL PRODUCTS***

***(WT/DS243)***

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Oral Statement of the United States at the First Meeting of the Panel with the Parties

December 12, 2002

**I. Introduction**

1. Good afternoon, Mr. Chairman and members of the Panel. We are pleased to have this opportunity to appear before you to present the arguments of the United States in defense of the rules of origin found in Section 334 of the Uruguay Round Agreements Act and Section 405 of the Trade and Development Act of 2000. We will highlight the arguments we made in our first submission. We welcome any questions you may have, and we look forward to responding to them.

2. As we discussed in our first submission, the U.S. rules of origin are consistent with the *Agreement on Rules of Origin* (the “ARO”) and advance its objectives. India bears the burden of making a showing, based on more than mere allegations, that the U.S. rules of origin are inconsistent with the provisions of the ARO. India has not done so, not in its first submission, and not today.

3. Let us begin by taking a step back. The ARO was drafted because Uruguay Round negotiators wanted to ensure that rules of origin: (a) were clear and predictable and would through their application facilitate the flow of international trade; (b) were implemented through transparent laws, regulations and practices; and (c) were prepared and administered in an

impartial, transparent, predictable, consistent and neutral manner. The ARO prescribes a set of obligations that are guided by these principles. At the same time, while setting out the program for harmonization, the ARO drafters did not impose a single set of rules of origin at the close of the Uruguay Round. Instead, the ARO left policy flexibility in the hands of individual Members, and specifically set out various mechanisms that could be used (*See* Article 2(a)). Moreover, the ARO left flexibility both in Members' design of rules of origin, and in Members' right to alter those rules of origin from time to time. In addition, the ARO provides for changes to origin regimes in Article 2(i) and allows varying origin criteria to be used until harmonization is completed. The Panel should bear these Member decisions in mind as it evaluates both the U.S. rules of origin and India's legal arguments in this dispute.

4. In particular, when it looks at the U.S. measures, the Panel will see that the U.S. rules of origin for textiles and apparel products were drafted in such a way that they advance the ARO's objectives. And, when the Panel looks at India's arguments, it will see that, at bottom, India is hoping to impose a single set of rules of origin on the United States (and, implicitly, on all other Members) -- notwithstanding the fact that the ARO was intended to leave flexibility in the hands of Members. Of course, we recognize that the ARO imposed disciplines on Members. But the disciplines the ARO imposes are not the ones that India would like you to believe exist. India appears to argue that the ARO prescribes a specific determination of origin for, say, bedsheets, or that a particular outcome resulting from the application of rules of origin is somehow less than neutral because it is not a determination of origin that India agrees with.

5. The United States cannot help but note that India's approach to its own measures helps to demonstrate the benefits of the approach of the U.S. measures at issue. India has notified the

WTO that it does not have non-preferential rules of origin for textiles, apparel or other products, even though India maintains non-preferential commercial policy regimes that would appear to be implemented through origin determinations. India has not published any rules or policy guidance regarding its origin rules. Despite this, eight years after the United States enacted statutory rules of origin for textile and apparel products as part of the legislation implementing its Uruguay Round commitments, India is challenging the specific rules utilized by the United States because it disagrees with the content of those rules.

6. With that background, let us take a look at the legal arguments that India has put before the Panel. India asserted in its first written submission (“India First Submission”) that it would show that the U.S. rules of origin embodied in Section 334 of the Uruguay Round Agreements Act (“URAA”) were enacted to pursue protectionist trade objectives; that they restrict, distort, and disrupt trade; and are discriminatory and administered in an unfair manner, all in violation of Article 2 of the ARO. India also asserted that it would show that Section 405 of the Trade and Development Act of 2000 (“Trade Act”), which modified Section 334 pursuant to a settlement of WTO dispute settlement proceedings, is similarly inconsistent with Article 2.

7. However, India has in fact not shown that the U.S. rules of origin regime is inconsistent with Article 2. Instead, India devotes significant discussion to the different origin determinations it believes would result from use of its interpretation of the “substantial transformation” concept. India also presents opinions from various commentators on why the U.S. interpretation of substantial transformation, as prescribed in Section 334 and Section 405, is not preferable as a matter of policy. However, when examined closely, these commentaries confirm that the rules in Section 334, as clarified in Section 405, were justified.

8. India is correct about one thing, that these rules represented a change from previous U.S. practice – a change to concise, predictable, published rules from the practice of interpreting substantial transformation on a case-by-case basis. India’s problem is that it does not like the certain and specific origin determinations that result from the product-specific rules of origin which the United States promulgated in order to bring greater certainty to the textile and apparel trade. India, in effect, is asking the Panel to read into the ARO certain specific criteria and, indeed, interpretations of what constitutes an operation that confers origin. However, the ARO does not permit such a reading.

9. As the United States will show, the rules of origin regime established in Section 334 and Section 405 are not inconsistent with Article 2(b)-(e), as read in good faith in accordance with the ordinary meaning to be given to their terms in their context and in the light of the object and purpose of the ARO. These rules were enacted to combat circumvention of established quotas, prevent transshipment, facilitate harmonization and best capture where a new product is formed. Furthermore, both Section 334 and its modification, Section 405, are maintained on an MFN basis, in accordance with WTO rules. As such, these rules are not inconsistent with the ARO. Rather, they facilitate the flow of international trade.<sup>1</sup>

*A. The Agreement on Rules of Origin*

10. Article 2 of the ARO prescribes a set of disciplines on Members to promote transparency and prevent trade distortion through rules of origin until the work programme for the harmonization of origin rules is completed. Specifically, Article 2 directs Members to ensure that, in relevant part:

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<sup>1</sup> See ARO preamble.

- notwithstanding underlying commercial policy, rules of origin are not to be used as instruments to pursue trade objectives directly or indirectly (Article 2(b));
- rules of origin do not themselves create restrictive, distorting or disruptive effects on international trade (Article 2(c));
- rules of origin do not discriminate between other Members (Article 2(d)); and
- rules of origin are administered in a consistent, uniform, impartial and reasonable manner (Article 2(e)).

11. India has failed to demonstrate any of its claims. At bottom, India's claims are based on a fundamental mischaracterization of the ARO – that the ARO precludes product-specific rules of origin and the application of different rules of origin to different products. However, Article 2(b)-(e) does not direct Members to adopt particular origin regimes before harmonization, nor does it require that the same rules be used for similar products or for particular manufacturing processes. Furthermore, nothing in these provisions can be read to imply that Members may not change their rules of origin. Finally, nothing in the ARO precludes a Member from settling disputes in a WTO-consistent manner, through an agreement to amend its rules of origin, as encouraged by the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the “DSU”).

*B. Section 334 of the Uruguay Round Agreements Act*

12. Section 334 established a body of rules that are based on the principle that the origin of fabric and certain textile products is derived where the fabric is woven, knitted or otherwise formed; and that the origin for any other textile or apparel product is where that product is wholly produced or assembled. If production or assembly occurs in more than one country,

origin is conferred where the most important assembly, or manufacturing process, takes place.

The U.S. system is based on the conclusion that origin is conferred where the most important assembly or manufacturing process takes place. This reflects the United States' judgment that assembly is generally the most important step in the manufacturing of assembled apparel and that fabric formation is the most important step in manufacturing fabric or flat goods. In enacting Section 334, the U.S. Congress expressed a policy of seeking to harmonize U.S. rules with those of other major importing Members, and to reduce circumvention of quota limits through illegal transshipment by providing greater certainty and uniformity in the application of origin rules.<sup>2</sup> For example, both the EC and Canada, among other Members who have rules of origin, do not recognize cutting as conferring origin.

13. India goes to great lengths to try to portray Section 334 as a complicated, unmanageable, discriminatory set of rules. They are not. These rules are clear because they are published and product-specific and bring certainty to users. This is in stark contrast to the chaos of having no rules (as in India). Further, these rules are based on a simple principle that the process that results in the creation of a new apparel product, and therefore merits a change of country of origin, is assembly. They are, therefore, "readily understandable, published in easily understood language, uncomplicated and predictable in application."<sup>3</sup>

14. Moreover, the rules make practical sense. As India notes, under the new rules a number of products under various Harmonized Tariff Schedule of the United States ("HTS") subheadings will have origin conferred where the fabric is formed, rather than where the fabric is cut or

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<sup>2</sup> H.R. Rep. 103-826(i), Uruguay Round Agreements Act, P.L. 103-465, October 3, 1994. Exhibit US-2.

<sup>3</sup> See N. David Palmeter, "The U.S. Rules of Origin Proposal to GATT: Monotheism or Polytheism," *Journal of World Trade* (1990) 24:2, pp. 25-36, at 28-9. (Exhibit INDIA-1.)

assembled.<sup>4</sup> From an examination of these subheadings, it is clear that these products require little if any assembly (for example: infant woven cotton diapers, quilted textile products in the piece, blankets, floorcloths, needlecraft sets consisting of woven fabric and yarn).<sup>5</sup>

15. India vigorously asserts that Section 334 was such a dramatic change from previous U.S. practice that it significantly distorts trade. Setting aside the fact that an effect on trade should not be equated with distortion of trade, the prior application of substantial transformation was criticized for being “too subjective, too inconsistent in the results it produce[d], too vulnerable to political pressure in its administration.”<sup>6</sup> For an effect to be a distortion, it must have real commercial impact. Moreover, as India itself notes, prior to Section 334, the origin determination was based on a number of empirical tests that were less predictable and transparent than the Section 334 rules. In this context, it is difficult to understand how Section 334's enactment distorted trade. Increasing certainty and transparency in accordance with the ARO cannot be equated with “distorting trade.”

*C. Section 405 of the Trade and Development Act of 2000*

16. Section 405 amended Section 334 in order to settle a WTO dispute brought by the European Communities (“EC”) alleging that Section 334's provisions had negatively affected trade in specific exporting sectors of the EC, most notably Italian silk products.<sup>7</sup> The United States held extensive consultations with the EC. Although the United States did not consider that

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<sup>4</sup> India First Submission, para. 26.

<sup>5</sup> *Id.* footnote 23.

<sup>6</sup> Palmeter, at 27. (Exhibit INDIA-1.)

<sup>7</sup> H.R. Conf. Rep. 106-606, Section 405, Clarification of Section 334 of the Uruguay Round Agreements Act, p. 232 (2000). Exhibit US-3.

the EC's claims had any legal merit, in order to settle the dispute, the United States agreed to amend Section 334, creating two exceptions to Section 334's "fabric formation rule":

- for silk, cotton, man-made and vegetable fiber fabric, origin would once again be conferred by dyeing and printing and two or more finishing operations;
- and for certain textile products excepted from the assembly rule, origin would be conferred where dyeing and printing and two or more finishing operations took place, with exceptions.

17. These amendments apply to all WTO Members, not just the EC. India's complaint that they are discriminatory has no merit.

## **II. Legal Analysis**

18. The United States rules of origin regime is consistent with the ordinary meaning of Article 2 of the ARO, in its context and in light of the object and purpose of the ARO. It is India's burden to show that the U.S. regime does not comport with the provisions of Article 2. At a minimum, India would have to establish with factual data, not mere opinions and anecdotes, that the U.S. rules of origin are inconsistent with Article 2(b)-(e) of the ARO. India has not and cannot do so.

### *A. Section 334 of the URAA and Section 405 of the Trade Act are Consistent with the Provisions of Article 2(b)-(e)*

19. The text of Article 2, read in its context and in light of the ARO's object and purpose, does not preclude Members from determining the origin of goods based on assembly, type of material, or type of product. India distinguishes between the product-specific tariff shift rules



and rules based on case-by-case applications of “substantial transformation” criteria. However, India’s criticism of this distinction is based on its own interpretation of what, in its view, the product specific result *should* be, ignoring the greater certainty and clarity brought about by Section 334 as against the case-by-case subjective origin determinations which had preceded it. To require the U.S. to utilize a particular rule for a specific product, as India advocates, would be to add an obligation not contained in the ARO during the current transition phase.

1. Section 334 is Consistent with Article 2(b)

20. The United States agrees with India that the operative clause in Article 2(b) is the obligation that rules of origin are not to be used “as instruments to pursue trade objectives.”<sup>8</sup> Likewise, the United States agrees that the Preamble to the ARO provides the relevant “object and purpose” of the ARO. However, the United States submits that India’s interpretation of a “trade objective” is incorrect, as it is overly broad. If “trade objective” is understood to be any objective related to trade, rules of origin could not be used to pursue transparency or predictability, two trade-related goals. Such an interpretation would be at odds with both the object and purpose of the ARO and the context of this provision. Nevertheless, the United States accepts India’s contention that protection of a domestic industry is an “impermissible” trade objective for purposes of Article 2(b).

21. India makes three vague arguments with respect to its claim that Section 334 is inconsistent with Article 2(b): 1) the objective of the United States in formulating its rules of origin was to protect its domestic industry; 2) the Panel should look to the measures or instruments of commercial policy listed in Article 1.2 and assess whether the U.S. rule of origin

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<sup>8</sup> India First Submission, para. 42.

“achieves the same results;” and 3) “the design, architecture and structure” of Section 334 “demonstrate that it was adopted to protect the domestic textile industry.”<sup>9</sup>

22. As we discussed in our first submission, the Section 334 rules of origin do not have as their objective the protection of domestic industry. Instead, the purpose of these rules of origin is found in the Statement of Administrative Action (the “SAA”). The SAA is clear on what its objectives were: to prevent quota circumvention and address illegal transshipment, to advance harmonization, and to more accurately reflect where the most significant production activity occurs. In the U.S. experience, the type of finishing operations presented to the Customs Service for determination of origin and application of quotas had grown, and under the increasing number of case-by-case applications by the Customs Service of the substantial transformation criteria, the list of processes that were deemed to confer origin also expanded, sometimes including processes that in retrospect were understood not to be significant. Section 334 was designed to remedy these errors. India points to no evidence to support its assertion that Section 334 has been used to achieve protection of the domestic industry.

23. Rather, India’s quarrel is with certain specific determinations of origin for particular products. That is, India disagrees with the judgment of the United States that certain processes constitute sufficient “transformation” to merit changing the origin of a product, while others do not. Not only is there nothing in the text of the ARO that says that Members must confer certain origin determinations, there is nothing in Article 2(b) that indicates that if a Member does not include certain finishing operations in a determination of origin the Member is thereby using its rules of origin to pursue trade objectives. It is the policy decision of the United States that origin

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<sup>9</sup> *Id.* paras. 46-49.

conferring production is based on manufacturing or formation of either fabric or apparel, not a finishing operation. The U.S. rules take into account which operations merit changing origin, and that may vary based on the type of product.

24. Moreover, as we have noted, Article 2(a) sets forth a range of criteria that can be used by a Member in formulating its rules of origin, and the United States rules of origin for textile and apparel products are consistent with these criteria. Specifically, Article 2(a)(i) directs Members that apply a tariff classification criterion to specify headings or subheadings in the rule. Both Section 334 and Section 405 meet this directive. Article 2(a)(ii) directs that where a manufacturing or processing criterion is prescribed, the operation that confers origin must be precisely specified. This is exactly what the U.S. rules do. India's arguments, that the U.S. should not confer origin based on where the product is formed or assembled, essentially renders Article 2(a) a nullity by its sweeping view of the subsequent provisions.

2. Section 405 is Consistent with Article 2(b)

25. India's arguments that Section 405's amendment of Section 334 constitutes an impermissible use of rules of origin fail.<sup>10</sup> First, the modifications in Section 405 apply to all Members on an MFN basis. India was a third party to the EC disputes; as such India was well aware of the very specific nature of the EC's complaints.<sup>11</sup> In particular, India knew that it had an important interest in whether or not dyeing and printing and additional finishing operations conferred origin. If India did not believe that the scope of the EC's consultation request captured its concerns, it could have sought separate consultations.

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<sup>10</sup> See India First Submission, paras.69-85.

<sup>11</sup> See India First Submission, note 48.

26. As a result of extensive consultations with the EC, as well as representatives of its textile industry, the United States agreed that, at least with respect to goods of silk, certain cotton blends, and fabrics made of man-made and vegetable fibers (specifically silk scarves and flat products such as linens), dyeing and printing along with two or more finishing operations were significant enough to confer origin. Therefore, modification of Section 334 to reflect this would serve as an appropriate mutually satisfactory solution to the issues in dispute.

27. And while we do not wish to belabor the point today, we have also explained in our first submission that it would be absurd to penalize a Member for reaching a mutually satisfactory settlement of a dispute with another Member, pursuant to the provisions of the DSU, where the benefits of the settlement accrue to all Members. Yet that is precisely what India asks of this Panel.<sup>12</sup> Does India perhaps wish to discourage Members from achieving mutually satisfactory solutions? That would be the likely consequence of accepting the logical leap that India urges on the Panel.

3. Section 334 and Section 405 are Consistent with Article 2(c)

28. India has also failed to meet its burden of showing that Section 334 and Section 405, in and of themselves, restrict, distort and disrupt trade. To begin with, India presents no textual support in the ARO for its argument that rules favoring one product over another, or one fabric over another, for that reason alone, restrict, distort or disrupt trade.<sup>13</sup> The single exhibit presented by India to support its allegations is a letter from the Cotton Textiles Export Promotion Council, which does not help India establish a *prima facie* case in this dispute.<sup>14</sup> That letter refers to a

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<sup>12</sup> See India First Submission, para. 84.

<sup>13</sup> *Id.*

<sup>14</sup> See India First Submission, para.93, exhibit INDIA-15.

program in which India exported greige fabric to Sri Lanka for manufacture into bed linens.

India asserts that Section 334 caused the export of fabric to Sri Lanka to “suffer a major setback” because the products were considered Indian, not Sri Lankan, and India’s quota was exhausted. However, India does not address the possibility that Sri Lankan producers may have decided to weave their own fabric or to source it from elsewhere. There is simply no causal connection between Section 334 and either the rise or fall of Indian fabric exports to Sri Lanka.

29. In fact, data on India's exports of cotton woven fabric, available from the United Nations, indicates that quite to the contrary, India's exports to the world (as well as to the United States) increased between 1995 and 1996 (from \$959.6 million to \$ 1 billion), and while exports declined slightly in 1997 (to \$974.5 million), the 1997 value of exports was higher than that in 1995. Similarly, again according to United Nations data, India’s exports of bed linen, to the world increased between 1995 and 1996 (from \$3.2 million to \$4.7 million), and increased again in 1997 (to \$5.3 million). These statistics do not bear out a claim of trade disruption.

30. India also argues that the rules disrupt trade by “their sheer complexity.” Importantly, India has not demonstrated that ‘complexity’ is a prohibited criterion, nor has India demonstrated that the U.S. rules are inordinately complex. It would seem that India’s view incorrectly equates ‘simplicity’ either with the absence of non-preferential rules of origin (such as is the situation in India) or perhaps with an origin regime that operates through case-by-case origin determinations that will, by its very nature and operation, involve subjectivity and greater administrative discretion than what currently exists in the U.S. origin regime. In addition, India presents no evidence that the rules have discouraged exporters from shipping their products to the United States because they simply could not understand them. Indeed, India supplies nearly \$ 3 billion

in textiles and apparel products to the United States, which strongly suggests that Indian exporters have not had too much difficulty understanding the rules.

31. India’s argument is tantamount to saying that these rules could never be changed - - that the ARO established a ‘standstill’ for origin regimes. There is no foundation for such an assertion. As we have noted, Article 2(i) clearly allows for changes in rules of origin. In the case of Section 334, the change was to establish product-specific rules of origin. Thus, Section 334 created greater certainty, and thereby an environment that facilitates trade.

32. Moreover, since the ARO, in Article 2(i), clearly allows changes in rules, some effect on international trade must have been envisioned, including the possibility that products would have different countries of origin as a result of those changes. After all, what would it mean for there to be “changes” in the rules if the origin determinations never changed? And why would Article 2(i) contain a discipline on non-retroactivity if origin determinations had to remain unchanged after each change in the rules of origin? Accordingly, India needs to show more than anecdotal indicia of an effect on trade to meet its burden of making a *prima facie* case of restriction, distortion and disruption of international trade. It has not.

4. Consistent with Article 2(d), the Rules are not Discriminatory

33. As a preliminary matter, it appears that India is making a claim regarding Article 2(d) only with respect to Section 405, and that the applicable provision of Article 2(d) India claims is being violated is that rules “shall not discriminate between other Members irrespective of the affiliation of the manufacturers [*sic*] of the goods concerned.”<sup>15</sup> In respect of this claim regarding Article 2(d), however, India makes no attempt to show how the settlement with the EC, which is

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<sup>15</sup> See India First Submission, paras. 98-9.

applicable to India and all other Members on an MFN basis, is discriminatory. Accordingly, India has failed to meet its burden to establish that Sections 334 and 405 are inconsistent with Article 2(d).

5. The Administration of the Rules is Consistent with Article 2(e)

34. Finally, India makes no effort to show how the *administration* of Section 334 and Section 405 is inconsistent with Article 2(e)'s instruction that Members ensure that "rules of origin are *administered* in a consistent, uniform, impartial and reasonable manner" (emphasis added). Rather, India attempts to *add* words to this provision: "members should adopt rules that lend themselves to being administered in a consistent, uniform, impartial and reasonable manner;" and that the rules should not be "complex and arbitrary."<sup>16</sup>

35. In other words, India attempts to recast this obligation in order to challenge attributes of the rule itself, rather than of its administration. However, India may not by fiat amend the terms of Article 2(e) so as to challenge the law itself, rather than its administration. Just as claims under Article X:3 of the GATT 1994 must fail if they are based on challenges to aspects of the laws themselves, rather than their administration,<sup>17</sup> so too must claims under Article 2(e) fail if they are based on perceived infirmities of the rules themselves, rather than their administration. The Panel should therefore reject India's claims.

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<sup>16</sup> See India First Submission, para. 101.

<sup>17</sup> Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas*, adopted 25 September 1997, WT/DS27/AB/R, para. 200. A similar provision is found in Article 1.3 of the *Agreement on Import Licensing Procedures*. para. 203.

### **III. Conclusion**

36. Where then do India's arguments lead? They lead to one of two impermissible results:

(1) that the United States should have no rules of origin for textile and apparel products and instead simply make case-by-case determinations of origin, or (2) that the Panel should determine what the specific rules of origin should be. Neither of these results is allowed under the ARO, nor do they advance the goals of the ARO - to provide transparency, clarity and predictability in a rules of origin regime.

37. Accordingly, the United States respectfully requests that the Panel find that India has failed to establish that Section 334 of the Uruguay Round Agreements Act and Section 405 of the Trade and Development Act of 2000 are inconsistent with Article 2(b)-(e) of the Agreement on Rules of Origin.