CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

(WT/DS340)

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES OF AMERICA

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I. INTRODUCTION

1. 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 an internal charge of 25 percent that China imposes on imported auto parts, with no comparable charge on domestic auto parts. The measures provide that the 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.

2. 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).

3. Before proceeding with a detailed factual and legal analysis, the United States would emphasize the following two points. First, the measures are subject to Article III even though China has labeled them as "customs duties." China's measures are not applied at the border; rather, they are internal measures that apply charges and procedural requirements based on the specific details of the auto manufacturing processes that occur within China. It is not the label that a Member applies to its measure that determines whether an obligation under a covered agreement applies; rather it is the substance of the measure that matters. Otherwise the GATT 1994's core national treatment obligations under Article III would be eviscerated.

4. Second, although the detailed operation of China's measures on auto parts contain considerable complexity, the analysis of those measures under Article III is neither ambiguous nor complex. Rather, despite the complexity of China's auto parts scheme, the results of an analysis under the text of Article III, as clarified by prior GATT panel and WTO panel and Appellate Body reports, is clear – namely, China's measures are inconsistent with China's obligations under Article III.

II. ARGUMENT

A. The Disciplines of Article III of the GATT 1994 Apply to the Measures

5. Article III of the GATT 1994 ensures that "internal taxes and other internal charges . . . affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products" are not applied in a manner so as to afford protection to domestic production. China's Auto Policy, Decree No. 125, and Announcement No. 4 together establish internal charges and burdensome procedures that apply only to foreign goods and that indeed afford protection to domestic production.

6. Although China's measures label the 25 percent charge as an "import duty," the name assigned to the charge is not determinative in deciding whether the charge is an internal one – thus subject to the disciplines of Article III – or an import duty subject to tariff bindings under Article II of GATT 1994. Rather, it is necessary to examine whether the charge is based on the internal use and/or sale of the product, or if the charge is instead a border measure. In this dispute, China's measures apply after importation of the product, and cannot be considered border measures.

7. The distinction between internal charges and customs duties had 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. Belgium imposed the charge at issue on imported goods purchased by public bodies when the goods originated in a country whose system of family allowances failed to meet specific requirements. 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.

8. 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 "conditional upon the importation of a product or at the time or point of importation." Accordingly, the panel concluded that the EEC charges qualified as "internal charges" under Article III.

9. As in *Belgian Family Allowances* and *EEC – Parts and Components*, China's measures at issue in this dispute are internal ones, not border measures. 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 Decree No. 125.

10. 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 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 at the time the parts are used in the assembly process rather than at the time the parts enter the territory to which China's Schedule relates.

- 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 where 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.

- Official verification is performed by the Chinese authorities at the manufacturer's site, not at the border. And, this determination is not made by China Customs through normal customs procedures, but by a special administrative body pursuant to measures developed by agencies with industrial policy functions.

In short, the measures are not focused on importation, but rather on the internal use of imported parts in the manufacture of new automobiles. China's measures are thus internal ones, and are subject to the disciplines of Article III of the GATT 1994.

B. The Charges Are Inconsistent with Article III:2, First Sentence

11. The charges imposed under China's measures are inconsistent with the first sentence of Article III:2 of the GATT 1994. As confirmed by the Appellate Body in *Japan – Alcoholic Beverages*, 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." Second, the internal charge must be applied to imported products "in excess of" those applied to the like domestic products. "If the imported and domestic products are 'like products', and if the charges applied to the imported products are 'in excess of' those applied to the like domestic products, the measure is inconsistent with Article III:2, first sentence."

1. Imported Auto Parts and Domestic Auto Parts Are Like Products

12. Where the number or value of the imported parts used in the assembly of a vehicle in China exceeds the specified thresholds, the measures impose an internal charge of 25% on all imported parts in the vehicle. This internal charge applies only to parts of foreign origin – domestic parts are exempt.

13. Where a WTO Member draws an origin-based distinction in respect of internal charges, a case-by-case determination of "likeness" between the foreign and domestic product is unnecessary. As such, in this dispute, the requirement that the "like products" be established is readily satisfied.

2. Imported Auto Parts are Taxed in Excess of Domestic Auto Parts

14. When the number 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. This differential taxation of imported and domestic auto parts breaches Article III:2. Indeed, any taxation of imported products in excess of like domestic products, regardless of amount, is sufficient to render a charge inconsistent with Article III:2, first sentence.

C. The Charges and Reporting Requirements Applied to the Use of Imported Auto Parts Are Inconsistent with Article III:4 of the GATT 1994

15. In examining a claim under 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, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product.

1. Imported Auto Parts and Domestic Auto Parts Are Like Products

16. As with the Article III:2 analysis above, the determination of "like products" for purposes of Article III:4 is established where the measures at issue make distinctions between products based solely on origin. As noted above, China's measures at issue apply the internal charge, and the burdensome administrative requirements on car manufacturers, solely on an origin-based distinction. As such, foreign and domestic auto parts satisfy the "like products" requirement of Article III:4.

2. The Charges and Reporting Requirements Are Laws or Regulations Affecting the Internal Sale, Offering for Sale, Purchase, Distribution and Use of Imported Auto Parts

17. The second element of an Article III:4 analysis is that the measures "affect[] [the] internal sale, offering for sale, purchase, distribution . . . or use" of the like products. The Appellate Body has noted that the term "affecting" in Article III:4 should be interpreted as having a "broad scope of application." In addition, the panels in *EC – Bananas III* and *India – Autos* both concluded that the word "affecting" covered more than measures which directly regulate or govern the sale of domestic and imported like products. In fact, the term "affecting" was broad enough to cover measures that might "adversely modify the conditions of competition between domestic and imported products." Thus, in *India – Autos*, the panel found that a measure "affects" the internal sale, offering for sale, purchase and use of an imported product, because it provided an incentive to purchase local products. In *Canada – Wheat Exports*, the panel found that a Canadian measure "affects" internal distribution of like products, because it created a disincentive to accept and distribute imported grain.

18. 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. By establishing a system that (1) levies an internal charge equal to 25% of the total value of imported parts used in the

automobile, and (2) imposes burdensome administrative recording requirements when a certain threshold of imported parts are used in the manufacturing of vehicles, China has established a disincentive to purchase, use and distribute imported auto parts. Thus the measures at issue "affect" the international sale, offering for sale, purchase, distribution, and use of imported auto parts.

3. By Establishing Thresholds on the Use of Imported Auto Parts that Trigger Additional Internal Charges and Burdensome Procedural Requirements, the Measures Accord Less Favorable Treatment to Imported Auto Parts than to Domestic Auto Parts

19. The 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. Previous panels have found that measures meet this element of the analysis if they impose requirements on foreign products that are not imposed on domestic products; create an incentive to purchase and use domestic products or a disincentive to utilize imported products; or "adversely affect . . . the equality of competitive opportunities of imported products in relation to like domestic products." Significantly, the Appellate Body in *US – FSC (Article 21.5)* noted that a measure could still be inconsistent with Article III:4 even if unfavorable treatment did not arise in every instance.

20. Here, the measures treat foreign parts less favorably than domestic parts by creating different competitive conditions for the parts so that protection is afforded to the domestic products. This is done in two ways.

21. With respect to the first, *i.e.*, through the application of the additional charge, consider the following: When a manufacturer assembles a vehicle, the manufacturer can choose to include either an imported part or, if one is available, a domestic part. As explained above, the measures establish thresholds (*i.e.*, what constitutes "features of a complete automobile") for the number of imported parts that can be included in a finished vehicle; if the threshold is exceeded, then a charge equal to 25% of the value of each imported part (instead of the import duty on the imported part) is imposed on each and every imported part included in the vehicle. The measures accordingly alter the conditions of competition by creating a significant incentive to include domestic parts over imported parts.

22. 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 also create different competitive conditions for the imported parts so that protection is afforded to the domestic products.

23. Decree No. 125 requires manufacturers to perform a "self-evaluation" to determine the number of imported parts used in the assembly of a particular vehicle model. To perform this self-evaluation, a manufacturer must catalogue all the parts of each model it manufactures, determine whether, under the measures, the parts are foreign or domestic, and calculate the thresholds for each assembly system and the overall price percentage of imported parts in the

model. Should this self-evaluation result in a determination that the imported parts used constitute "features of a complete automobile," as defined in the Decree, the manufacturer must register the vehicle model with CGA. None of this is required if the manufacturer uses only domestic auto parts.

24. To register the vehicle model with CGA, the manufacturer must include the following information:

- a description of the manufacturer;
- 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.

This information must then be constantly updated 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 (*e.g.*, if optional imported parts are fitted on an individual vehicle).

25. Further, if imported parts are used, China's special payment system for the internal charges requires that the imported parts – if entering China through a port not administered by the local customs office where the manufacturer is located – be "transferred" to the local customs office, where the manufacturer is required to maintain a general financial guarantee in an amount no lower than the average total amount of total duties payable by the enterprise for its average monthly imports of parts and components. The manufacturer is required to make payments on a monthly basis, at which time the following information is required: 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.

26. Should the manufacturer use imported parts that he himself did not import, the manufacturer is required to maintain records regarding the actual importer of record, and any evidence of duties and value-added taxes paid.

27. 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 competitive conditions for the imported parts so that protection is afforded to the domestic products. In sum, the imposition of internal charges and burdensome procedural requirements on manufacturers who use imported rather than domestic parts results in a breach of Article III:4 of the GATT 1994.

D. China's Measures Are Inconsistent with Article 2.1 and Paragraph 1(a) of Annex 1 of the TRIMs Agreement

28. China's measures are inconsistent with Article 2 of the TRIMs Agreement. First, these measures fall within the types of measures covered in the Illustrative List in the Annex to the TRIMs Agreement. The Chinese measures at issue provide an advantage, *i.e.*, an exemption from paying the internal charge and related burdensome administrative requirements, for auto

manufacturers that decide to purchase or use domestic auto parts. Thus, the measures require "the purchase or use by an enterprise of products of domestic origin or from any domestic source" so as "to obtain an advantage"; they fall squarely within the Illustrative List of measures covered by the TRIMs Agreement.

29. Further, under Article 2 of the TRIMs Agreement, a TRIM that is inconsistent with Article III of the GATT 1994 is also inconsistent with the TRIMs Agreement. As the measures at issue are already determined to be "trade-related investment measures" in that they fall squarely within Illustrative List 1(a) of the TRIMs Agreement, and they are also inconsistent with China's obligations under Article III:4 (as discussed above), these measures are thus inconsistent with Article 2 of the TRIMs Agreement as well.

E. China's Measures are Inconsistent with Article III:5 of the GATT 1994

30. China's measures are also inconsistent with Article III:5 of the GATT 1994. China's measures at issue impose additional internal charges and burdensome administrative requirements if, among other things, the quantity of the imported parts and components used by a car manufacturer (1) exceed specified limits on the number of imported assembly systems, or (2) results in the total price of the imported parts and components being 60% or more of the total price of all parts and components in the finished vehicle. Given that these provisions are expressed in quantitative terms, they are by their nature "quantitative regulations." Moreover, given that their terms specify the quantitative amounts of imported parts that would result in the internal 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," 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. As such, the Chinese measures are inconsistent with Article III:5 of the GATT 1994.

F. China's Measures Are Inconsistent with Part I.7.2 of the Accession Protocol

31. Part I.7.2 of China's Accession Protocol states in relevant part: "In implementing the provisions of Articles III and XI of the GATT 1994 and the Agreement on Agriculture, China shall eliminate and shall not introduce, re-introduce or apply non-tariff measures that cannot be justified under the provisions of the WTO Agreement." Therefore, by introducing measures that are inconsistent with Article III:2, Article III:4, and Article III:5 of the GATT 1994 and that thus cannot be justified under the provisions of the WTO Agreement, China's measures at issue consequentially are in breach of Part I.7.2 of China's Accession Protocol.

G. China's Measures Are Inconsistent with Part I.7.3 of the Accession Protocol and Paragraph 203 of the Working Party Report

32. Part I.7.3 of China's Accession Protocol states in relevant part: "China shall, upon accession, comply with the TRIMs Agreement, without recourse to the provisions of Article 5 of the TRIMs Agreement. China shall eliminate and cease to enforce . . . local content . . . requirements made effective through laws, regulations or other measures." Paragraph 203 of the

Working Party Report on the Accession of China (WT/MIN(01)/3) ("Working Party Report") reiterates this obligation.

33. In light of the earlier discussion that China's measures are inconsistent with obligations under Article 2 of the TRIMs Agreement, and in light of the fact that the measures effectively maintain the local content requirement initially set forth in China's *Automotive Industry Industrial Policy* of July 3, 1994, China's measures at issue consequentially are inconsistent with China's obligations under Part I.7.3 of China's Accession Protocol and paragraph 203 of the Working Party Report.

H. In the Alternative, China's Measures Are Inconsistent with Article II of the GATT 1994 and Paragraph 93 of the Working Party Report

34. As the United States has explained above, China's measures at issue are internal charges and other internal requirements, not border measures. Accordingly, the United States submits that these measures are to be analyzed under (and are inconsistent with) the obligations set out in Article III of the GATT 1994.

35. Nonetheless, even if the measures were considered border measures, China's measures would be inconsistent with Article II of the GATT 1994 and Paragraph 93 of the Working Party Report.

36. First, if China's measures are considered to result in the imposition of customs duties subject to Article II obligations, the measures would result in the imposition of customs duties in an amount greater than allowed under Article II. Under China's Schedule of Concessions and Commitments, most motor vehicles are classified under items 8702 through 8704, while auto parts and components are classified under several different items including 8407-8409 (engines and engine parts), 8707 (bodies for motor vehicles), and 8708 (parts and accessories of motor vehicles). China's final bound tariff rate for complete vehicles is 25%, while its bound rate for auto parts and components is 10% (and in some cases, even lower). Accordingly, should the 25 percent charges under the measures be considered customs duties on auto parts, those charges would violate China's tariff binding (of 10 percent or lower) on such parts.

37. Second, should China's measures be considered border measures rather than internal measures subject to Article III, the 25 percent charge on imported CKDs and SKDs would be inconsistent with China's commitments in Paragraph 93 of the Working Party Report. 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.

38. 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.

39. To the extent that the charges imposed by the measures are considered to be tariffs, the measures would in effect specify a tariff line for CKDs and SKDs that imposes a 25% tariff, rather than a 10% tariff as required under the Working Party Report.

I. China's Measures Constitute an Import Substitution Subsidy in Breach of Articles 3.1(b) and 3.2 of the SCM Agreement

40. China's measures impose additional duties and other requirements on imported auto parts, thereby resulting in a breach of China's obligations under Article III of the GATT 1994. Another way to view these charges is that they exempt manufacturers from the charges otherwise due if they use domestic auto parts rather than imported auto parts. From this perspective, the measures constitute an import substitution subsidy in breach of Articles 3.1(b) and 3.2 of the SCM Agreement.

41. The reduction available for using domestic parts is a subsidy pursuant to Article 1.1 of the SCM Agreement. First, pursuant to the chapeau of Article 1.1(a)(1), the reduction is a "financial contribution" by the Chinese Government, where "government revenue that is otherwise due is foregone or not collected." Under China's measures, on domestic parts the government foregoes the difference between the across-the-board 25 percent charge on auto parts and the customs duty (10 percent or less) applied to imported parts. Likewise, on certain imported parts, the government foregoes the difference between the across-the-board 25 percent charge and the customs duty (10 percent or less) when the thresholds for using domestic parts in a finished vehicle are satisfied. Second, this financial contribution results in a "benefit . . . conferred," pursuant to Article 1.1(b) of the SCM Agreement, because the auto manufacturer is able to retain the amount of money equivalent to the amount of revenue foregone by the government.

42. Article 2.3 of the SCM Agreement further specifies that a subsidy shall be deemed "specific" if it falls within the provisions of Article 3 of the SCM Agreement relating to "prohibited" subsidies. As shown below, China's measures are "prohibited" and therefore are deemed "specific" within the meaning of Article 2.3 of the SCM Agreement.

43. China's measures are "prohibited" within the meaning of Article 3.1(b) because they are "contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." China's measures are contingent upon the use of domestic over imported goods, in that the subsidy provided by these measures is only available to an auto manufacturer when (1) the quantity of the domestic parts and components used by the auto manufacturer exceeds specified thresholds on the number of domestic assembly systems or (2) the quantity of the domestic parts and components used by the auto manufacturer results in the total price of the

domestic parts and components being more than 40 percent of the total price of all parts and components in a finished vehicle. As such, the measures violate Articles 3.1(b) and 3.2 of the SCM Agreement, which provide that a Member shall neither grant nor maintain subsidies contingent upon the use of domestic over imported goods.

44. Since China's measures amount to a prohibited subsidy, the provisions of Article 4.7 of the SCM Agreement apply. Those provisions provide that the panel shall recommend that the subsidizing Member withdraw the subsidy without delay, and that the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.