CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

(WT/DS340)

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

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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 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.

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. China's defense is twofold – its measures all involve customs duties, and those customs duties are consistent with Article II. China's Article II argument is utterly without merit. Were China to charge an import duty on imported auto parts of 25 percent, China would be in outright breach of its Article II tariff bindings.

4. 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 percent 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.

5. 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.

6. 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. 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.

7. 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 percent 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. 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.

8. China's measures are also inconsistent with Article III:5 of the GATT 1994. 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.

9. In its submission, China does not dispute this fundamental Article III:5 analysis. And again, with one caveat, China's defense in its first submission does not touch on any issue related to Article III:5. 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.

10. Unlike for Article III:4 and Article III:5, China's first submission does discuss a possible defense to the breach of the first sentence of Article III:2. This defense, however, is unavailing.

11. 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 the first U.S. 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.

12. 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. 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.

13. As discussed in the first U.S. submission, the distinction between internal charges and customs duties has been addressed in two prior panels under the GATT 1947: *Belgian Family Allowances* and *EEC – Parts and Components*. As was the case in those two disputes, 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.

14. China argues that its measure is different than the measures at issue in *Belgian Family Allowances* and *EEC – Parts and Components* because its measure 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."

15. 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.

16. China's first submission contains an important concession on the part of China with respect to its argument that its measures impose customs duties, not internal charges. In particular, in footnote 20 of its first submission, China concedes 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.

17. 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.

18. 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.

19. The United States would now turn to the caveat – mentioned several times above – 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.

20. 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.

21. In the view of the United States, 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.

22. 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.

23. 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.

24. 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.

25. 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.

26. China's working party report further confirms that China may not try to classify auto parts as complete vehicles. Paragraph 93 of the Working Party Report provides that "If China created . . . tariff lines [for completely knocked-down kits for motor vehicles (CKDs) or semi-knocked down kits for motor vehicles (SKDs)], the tariff rates would be no more than 10 per cent." 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.

27. 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 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."

28. 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.