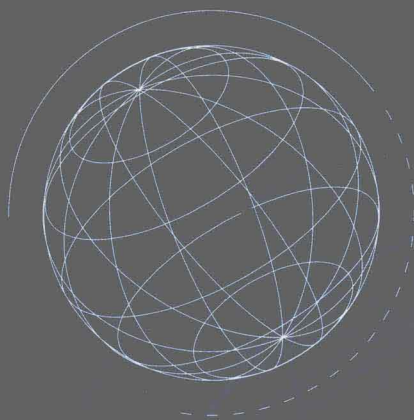




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ORGANIZATION

Dispute Settlement Reports 2009
Volume II: Pages 623 to 1288

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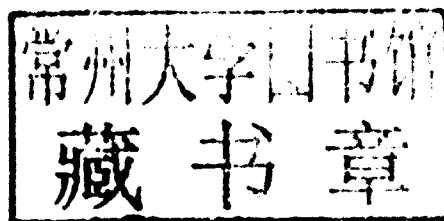
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CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

Reports of the Panel

WT/DS339/R, WT/DS340/R, WT/DS342/R

*Adopted by the Dispute Settlement Body
on 12 January 2009*

*as Upheld by the Appellate Body Report
and as Modified*

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ANNEX A-1

RESPONSES AND COMMENTS OF PARTIES TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING

A. Measures at Issue and Products at Issue

1. In respect of the criteria set out in Articles 21 and 22 of Decree 125:

(a) (China) Could China elaborate on the rationale behind these specific criteria.

Response of China

1. The rationale behind these specific criteria is to specify the groups of imported auto parts and components that China considers to have the essential character of a motor vehicle under General Interpretative Rule 2(a).

(b) (All parties) Are these types of criteria commonly used as standards by customs offices in determining whether parts and components of a product should be considered as a complete product?

Response of China

2. As discussed in response to question 117, there are a variety of factors that customs authorities consider in evaluating whether an incomplete or unfinished article (whether assembled or unassembled) has the essential character of the complete article. The types of criteria set forth in Articles 21 and 22 are consistent with these factors.

Response of the European Communities (WT/DS339)

3. The European Communities is not aware of any other WTO member using the same or similar criteria and such criteria are certainly not used by the EC.

4. Leaving aside that China is using the criteria internally within China, the use of the criteria in tariff classification would lead to a violation of Article II GATT as they do not respect the HS nomenclature (in particular rule 1 of the general rules for the interpretation of the Harmonized System and, to the extent rule 2(a) is relevant, the "as presented" and "essential character" criteria there under).

5. The only circumstances in which parts could be classified as the complete article could be in the context of certain knocked down kits, but that would require a case-by-case analysis. In this respect reference is made to the reply to question 47.

Response of the United States (WT/DS340)

6. The criteria set out in Articles 21 and 22 of Decree 125 are not the types of criteria commonly used as standards by customs officials in determining whether parts and components of a product should be considered as a complete product. The United States follows the long-standing principle that goods should be classified based on its condition as entered, regardless of what occurs to the goods after entry. US Customs officials apply General Interpretative Rule (GIR) 1 and classify merchandise in accordance with the terms of the headings and the relevant section and chapter notes. When components and parts of a motor vehicle are entered, US Customs officials will determine whether they meet the terms of a particular heading. For example, a vehicle body is specifically described by the terms of heading 87.07, which provide for: "Bodies (including cabs), for the motor vehicles of headings 87.01 to 87.05". A gasoline engine is specifically described by the terms of heading 84.07, which provide for: "Spark-ignition reciprocating or rotary internal combustion piston engine".

7. In situations where a finished good is entered unassembled (e.g., a complete kit to make 1 good), the United States will classify the imported good that is unassembled as if it were complete under General Interpretative Rule 2(a). In situations where incomplete or unfinished merchandise is imported, US Customs authorities will examine the merchandise as presented at the time of importation to determine whether the incomplete or unfinished merchandise has the essential character of the complete or finished good. For example, see General Explanatory Note to Chapter 87 (JE-37).

Response of Canada (WT/DS342)

8. No. Canadian customs officials perform assessments on a case-by-case basis of those parts as presented together at the border. They do not base their classification of those parts on a formula that is linked to the number of imported assemblies, much less the percentage of imported volume or value of parts used in imported assemblies. This is particularly the case with vehicles since they consist of a great number of individual parts, including assemblies and sub-assemblies.

Comments by the United States on China's response to question 1(b)

9. In its response, China refers to its response to the Panel's question 117. However, the factors that China relies on as justification for classifying the dif-

ferent combinations of auto parts and components is in contradiction to the terms of the Harmonized System and the proper application of the General Interpretative Rules. As demonstrated in the US Response to question 47, customs officials cannot group some assemblies together and claim that they have the essential character of a complete motor vehicle. For example, a single component (e.g., diesel engine sub-assembly A or sub-assembly B as described in Exhibit CHI-3) entered is classified under the terms of a heading that describes that component (e.g., heading 8409). If a group of components are entered together (e.g., diesel engine sub-assembly A and sub-assembly B as described in Exhibit CHI-3) that may form an assembly (e.g., a complete diesel engine), the United States would classify it under the heading that describes that assembly (e.g., heading 8408). If a group of components do not form an assembly, they are individually classified (e.g., a crankshaft and side panel would not constitute an assembly and would be individually classified). None of the assemblies listed in Exhibit CHI-3 ever constitutes incomplete or unfinished motor vehicles within the meaning of General Interpretative Rule 2(a); instead, they would be individually classified in accordance with the terms of General Interpretative Rule 1 (e.g., spark-ignition reciprocating or rotary internal combustion piston engines of heading 84.07, transmission shafts of heading 84.83, chassis fitted with engines of heading 87.06, bodies (including cabs) of heading 87.07).

2. (China) What were China's bound and applied tariff rates for "CKD and SKD kits", "motor vehicles" and "auto parts" prior to China's accession to the WTO and at the time of China's accession to the WTO?

Response of China

10. Prior to China's accession to the WTO, there were no bound tariff rate for "CKD and SKD kits," "motor vehicles" and "auto parts".

11. In 2001, immediately prior to China's accession to the WTO, the average applied tariff rate for "motor vehicles" was 63.6%, and the average applied tariff rate for "auto parts" was 24.7%. There were no separate tariff lines for "CKD and SKD kits" in China's Tariff Code. CKD and SKD kits were classified as complete vehicles according to GIR 2(a) and the applied rates were identical to the tariff rates applicable to the corresponding complete vehicle model.

12. In 2002, at the time of China's accession to the WTO, the average bound tariff rate for "motor vehicles" was 49.4%, and the average bound tariff rate for "auto parts" was 20.4%. Again, there were no separate tariff lines for "CKD and SKD kits" in China's Tariff Code, and these were classified as motor vehicles in accordance with GIR 2(a). In 2002, the average applied tariff rate for "motor vehicles" was 42.2%, and the average applied tariff rate for "auto parts" was 18.1%. These details can be summarized as follows:

	Complete Vehicle	CKD/SKD Kits	Parts
2001 Bound Rate	None	None	None
2001 Applied MFN Rate	63.6%	63.6%	24.7%
2002 Bound Rate	49.4%	49.4%	20.4%
2002 Applied MFN Rate	42.2%	42.2%	18.1%

Comments by the United States on China's response to question 2

13. In its response, China explained that immediately prior to its accession to the WTO on 11 December 2001, "the average applied tariff rate for 'motor vehicles' was 63.6%, and the average applied tariff rate for 'auto parts' was 24.7%. There were no separate tariff lines for 'CKD and SKD kits' in China's Tariff Code. CKD and SKD kits were classified as complete vehicles according to GIR 2(a) and the applied rates were identical to the tariff rates applicable to the corresponding complete vehicle model." While the United States does not dispute China's statements regarding the applied tariff rates for motor vehicles, it does dispute China's explanation regarding parts and CKD and SKD kits as being both inaccurate and incomplete.

14. From 1992 to 1995, China did maintain separate tariff lines for CKDs and SKDs. As China's exhibit CHI-30 shows, these tariff lines established tariff rates that were the same as the scheduled tariff rates applicable to motor vehicles. However, China normally did not apply these rates. Instead, the applicable rate for CKDs and SKDs was negotiated between an individual auto manufacturer and the Chinese authorities. The key factors in this negotiation were the amount of the auto manufacturer's investment in China and the extent to which the auto manufacturer used local content in the assembly of its vehicles, both at the time of the negotiation and under the auto manufacturer's future plans. Normally, an auto manufacturer with a larger amount of investment and a larger percentage of local content would be able to negotiate a lower tariff rate than would an auto manufacturer with a smaller amount of investment and a smaller percentage of local content. Particularly for the auto manufacturers that the Chinese authorities viewed as committed to China based on these factors, the negotiated tariff rates for CKDs and SKDs were substantially below the tariff rates for motor vehicles. In addition, the Chinese authorities would normally apply the same negotiated tariff rates to parts, as the negotiated tariff rates were often also below the tariff rates for parts set forth in China's tariff schedule.

15. After 1995, China eliminated the tariff lines for CKDs and SKDs, as China's response reflects. However, contrary to China's assertions, China even then did *not* apply tariff rates for CKDs and SKDs that were the same as the scheduled tariff rates applicable to motor vehicles. China continued to apply tariff rates for CKDs and SKDs (and parts) that were negotiated between an individual auto manufacturer and the Chinese authorities, just as it had in the period from 1992 to 1995.

16. These same tariff practices continued through the time of China's accession to the WTO and post-accession until China began to implement the measures at issue in this dispute.

17. From 1992 until the implementation of the measures at issue in this dispute, China pursued these tariff practices because it was focused on building up its capacity for the local assembly of motor vehicles, and it did not have sufficient domestic manufacturers of auto parts to supply domestic auto manufacturers. China therefore welcomed and encouraged imports of CKDs and SKDs (and parts) that could be assembled into motor vehicles in China, particularly by auto manufacturers that demonstrated a commitment to China.

18. China's policy of encouraging imports of CKDs and SKDs (and parts) that could be assembled into motor vehicles locally was facilitated by China's policy of maintaining import quotas on motor vehicles. In this regard, China maintained import quotas on vehicles prior to its accession to the WTO in 2001, and it negotiated the right to maintain import quotas on motor vehicles for three years after its accession, i.e., until 1 January 2005, as reflected in Part I, paragraph 7.1, and Annex 3 of China's Protocol of Accession, as explained more fully below under question 14(b).

19. China's tariff practices relating to CKDs and SKDs (and parts) during the period from 1992 until China's accession to the WTO at the end of 2001 help to explain why paragraph 93 of the Working Party Report accompanying China's Protocol of Accession reads the way it does. As the panel will recall, paragraph 93 provides:

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.

20. When negotiating this provision in the years leading up to China's WTO accession, WTO Members, including the United States, knew that China had separate tariff lines for CKDs and SKDs that scheduled tariff rates that were the same as those for motor vehicles from 1992 to 1995, and that China eliminated these tariff lines effective 1 January 1996. WTO Members also knew that the Chinese authorities had nevertheless been applying substantially lower tariff rates for CKDs and SKDs (and parts) than for motor vehicles, both when China had separate tariff lines for CKDs and SKDs and when it did not. In negotiating paragraph 93, therefore, WTO Members wanted to ensure that China would continue to treat CKDs and SKDs essentially as parts for tariff purposes after acceding to the WTO and that China would be unable to re-establish separate tariff lines for CKDs and SKDs, at higher rates, if its policy focus changed as its domestic auto industry evolved.

3. (All parties) Do automobile manufacturers themselves also assemble or manufacture the so-called "assemblies" listed in Article 4 of Decree 125? If so, how common is this in the automobile industry in general or in the Chinese automobile industry? Is there a clear distinction between automobile manufacturers and parts manufacturers?

Response of China

21. It is a common practice in China for automobile manufacturers to assemble some or all of the assemblies listed in Article 4 of Decree 125. For instance, a majority of auto manufacturers in China produce the body assembly by themselves. Many auto manufacturers in China have their own assembly lines for engines and transmissions.

22. Auto manufacturers and part manufacturers, however, are distinct in some respects. First, auto parts manufacturers normally focus on one particular type or series of parts, while auto manufacturers focus on the overall assembly of the vehicle. Second, auto manufacturers are normally in a position to articulate and define the parameters of parts and their quality standards, which must be met by their auto part suppliers.

23. The complainants have stated, and China agrees, that the auto parts industry is highly fragmented in China.¹ This makes most of the part suppliers dependent, legally or financially, on one auto manufacturer. All top auto manufacturers in China have stable and long-term supply chains for auto parts, as well as complex corporate structures in which many of the necessary auto parts are produced by subsidiaries and joint ventures. This feature, as China understands it, is common in Asian auto industries.

Response of the European Communities (WT/DS339)

24. The answer as to whether automobile manufacturers themselves also assemble or manufacture the so-called "assemblies" listed in Article 4 of Decree 125 depends on the business strategy of each manufacturer. However, the European Communities understands that in the most typical situations at least some elements of the "assemblies" would be manufactured by the manufacturer of the complete vehicle. This concerns in particular the vehicle body, which is an element of a vehicle that is usually separate for each model. In contrast, for example the steering system and the brake system are typically assembled and manufactured by suppliers and sold to the vehicle manufacturer. However, there are no general rules that apply to all manufacturers and all models.

¹ Canada's first written submission, para.17; EC's first written submissions, para.18; US's first written submission, para.21.

25. There is no difference between the automobile industry in general and the Chinese automobile industry with the very important exception of the way in which the contested measures affect the strategy of vehicle and parts manufacturers in China. As explained by the European Communities in its first written submission the Chinese measures force vehicle manufacturers to depart from their normal business strategies in the rest of the world (in particular paragraphs 68 to 74). The measures require in all situations that the vehicles contain a certain proportion or combination of locally made parts and components (or "assemblies"). If the necessary local content is not ensured, the manufacturer will be obliged to pay the 25 % duty on all imported parts, which due to very small profit margins will mean that the given model will not be competitive in the Chinese market.

26. With regard to the distinction between vehicle manufacturers and parts manufacturers the answer again depends on the specific context. Sometimes parts manufacturers may belong to the same industrial group as the vehicle manufacturers but more often the parts manufacturers are independent and provide parts to many different vehicle manufacturers. Indeed, there are far more parts manufacturers than vehicle manufacturers. Of course, due to constant changes in the industry a part manufacturer may become part of the same group as the vehicle manufacturer and vice versa. Mergers and acquisitions are an every day phenomenon in most industries. However, it is also important to underline that a vehicle manufacturer often acts as the supplier of a given part or "assembly" to another vehicle manufacturer. Even competitors in the same market may co-operate in the context of certain vehicle models. All of this depends on the strategy of the manufacturers. The Chinese measures seriously compromise the ability of the foreign industry to choose the most efficient business strategies in the Chinese market.

Response of the United States (WT/DS340)

27. Automobile manufacturers commonly assemble within their own operations and facilities at least a few of the listed assembly operations. For example, most automobile manufacturers assemble the body, whether from stampings provided by a supplier, stampings they make themselves, or a combination of both. Engine assembly is also a common operation for automobile manufacturers. The same holds true for chassis assembly, assuming that chassis means what is also referred to as the "frame". It is extremely common, if not universal, that automobile manufacturers perform one or more of the listed assembly operations, although they may not all perform the same ones or combinations thereof.

28. With respect to the listed assembly operations, a clear distinction cannot be made between automobile and parts manufacturers.

Response of Canada (WT/DS342)

29. Manufacturers sometimes prepare the "assemblies" listed in Decree 125, as do parts manufacturers. This is relatively common both in general and in China, to the extent that commonly understood commercial practices are not affected by the measures. That noted, even where vehicle manufacturers do produce particular assemblies, many of the key parts in such assemblies used in China come from so-called "Tier 1" suppliers. There is a commercial distinction between automobile manufacturers (which usually control not only the manufacturing and final assembly of a whole vehicle, but also its design, marketing and branding) and parts manufacturers (whether Tier 1, 2 or 3). Tier 1 parts manufacturers may engage in value-added activities related to the parts that they manufacture (such as research and development), which activities used to be carried out solely by vehicle manufacturers. Commercial practice may evolve in respect of which company produces parts and which company processes or assembles them. However, automobile manufactures and parts manufacturers remain distinguished by the "brand". Auto manufacturers produce vehicles under different brands with which consumers are familiar; parts manufacturers produce parts, components or modules used in the vehicles and do not have their own vehicle brands.

4. (China) Could China please explain the "Public Bulletin" referred to in Article 7 of Decree 125, including what purpose it serves, whether all automobile manufacturers in China have to apply for it and what is the reason for having "Characterized as Complete Vehicle" marked on the Bulletin for auto parts falling under this scope.

Response of China

30. Being listed in the Public Bulletin is required for auto manufacturers to produce and sell motor vehicles and for consumers to register and use motor vehicles in China. A vehicle model can be listed in the Public Bulletin only if it satisfies all requirements in respect of various regulations that apply to motor vehicles. Listing a vehicle model's registration status under Decree 125 is simply one of the regulatory characteristics of the model that is disclosed in the Public Bulletin. This disclosure aids customs officials and others in the automotive industry by designating the customs status of that vehicle model, including the customs status of parts and components that are imported for its assembly.

5. (China) Please clarify, by referring to the relevant provisions of the measures at issue, when the decision of whether certain imported auto parts should be characterized as complete vehicles is made.