

**INDONESIA - CERTAIN MEASURES  
AFFECTING THE AUTOMOBILE INDUSTRY**

**REPORT OF THE PANEL**

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## I. INTRODUCTION

### A. Background

#### 1. Complaint of Japan

1.1 On 4 October 1996, Japan requested consultations with Indonesia pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Article XXII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994") and Article 8 of the Agreement on Trade-Related Investment Measures (the "TRIMs Agreement") regarding certain measures affecting the automotive industry of Indonesia (WT/DS55/1).

1.2 On 29 November 1996, Japan requested additional consultations with Indonesia regarding the National Car Programme under Articles 1 and 4 of the DSU, Article XXII:1 of GATT 1994 and Articles 7 and 30 of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement") (WT/DS64/1).

1.3 On 5 November and 3 December 1996, Japan and Indonesia held the consultations requested on 4 October 1996. On 3 December 1996, also in Geneva, Japan and Indonesia held the consultations requested on 29 November 1996. No mutually satisfactory solution was reached.

1.4 On 17 April 1997, Japan requested the establishment of a panel, pursuant to Articles 4.7 and 6.1 of the DSU, Article XXIII:2 of GATT 1994, Article 8 of the TRIMs Agreement, and Article 30 of the SCM Agreement. Japan requested the panel to examine the consistency of various measures under the National Car Programme with Articles I:1, III:2, III:4, X:1 and X:3(a) of GATT 1994, Article 2 of the TRIMs Agreement, and Articles 3.1(b) and 28.2 of the SCM Agreement.

#### 2. Complaint of the European Communities

1.5 On 3 October 1996, the European Communities requested consultations with Indonesia pursuant to Article 4 of the DSU, Article XXII of GATT 1994, Article 8 of the TRIMs Agreement and Articles 7 and 30 of the SCM Agreement, with respect to certain measures affecting the automobile industry (WT/DS54/1).

1.6 The European Communities and Indonesia held consultations on 6 November 1996 and on 5 December 1996. No mutually satisfactory solution was reached.

1.7 On 12 May 1997, the European Communities requested the establishment of a panel pursuant to Article XXIII:2 of GATT, Article 6 of the DSU, Article 8 of the TRIMs Agreement (to the extent that it incorporates by reference Article XXIII of GATT) and Articles 7.4 and 30 of the SCM Agreement (to the extent that Article 30 incorporates by reference Article XXIII of GATT). The European Communities requested the panel to examine the consistency of the measures identified with Articles I:1, III:2 and III:4 of GATT 1994, and Article 2 of the TRIMs Agreement. The European Communities also requested the panel to examine its complaint that the measures identified constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement which cause "serious prejudice" to the Community's interest in the sense of Article 6 of that Agreement.

1.8 The European Communities also requested, in conjunction with its request for establishment of a panel, that the Dispute Settlement Body initiate the procedure provided in Annex V of the SCM Agreement pursuant to point 2 of that Annex.

### 3. Complaint of the United States

1.9 On 8 October 1996, the United States requested consultations with Indonesia pursuant to Articles 1 and 4 of the DSU, Article XXII:1 of GATT 1994, Article 8 of the TRIMs Agreement (to the extent it incorporates by reference Article XXII of the GATT 1994), Articles 7 and 30 of the SCM Agreement (to the extent Article 30 incorporates by reference Article XXII of the GATT 1994), and Article 64 of the TRIPS Agreement (to the extent it incorporates by reference Article XXII of the GATT 1994) regarding certain measures affecting trade and investment in the motor vehicle sector (WT/DS59/1).

1.10 The United States and Indonesia held consultations on 4 November 1996 and 4 December 1996, but failed to reach a mutually satisfactory solution.

1.11 On 12 June 1997, the United States requested the establishment of a panel pursuant to Article 6 of the DSU, Article XXIII:2 of the GATT 1994, Article 8 of the TRIMs Agreement (to the extent it incorporates by reference Article XXIII of the GATT 1994), Articles 7.4 and 30 of the SCM Agreement (to the extent Article 30 incorporates by reference Article XXIII of the GATT 1994), and Article 64 of the TRIPS Agreement (to the extent it incorporates Article XXIII of the GATT 1994). The United States requested the panel to examine the consistency of the measures identified with Articles I:1, III:2, III:4 and III:7 of GATT 1994, Articles 3, 20, and 65 of the TRIPs Agreement, Article 28.2 of the SCM Agreement, and Article 2 of the TRIMS Agreement. The United States also requested the panel to examine its complaint that the measures identified constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement which cause "serious prejudice" to the United States' interest in the sense of Article 6 and 27 of that Agreement.

1.12 The United States also requested, in conjunction with its request for establishment of a panel, that the Dispute Settlement Body initiate the procedure provided in Annex V of the SCM Agreement pursuant to point 2 of that Annex. The United States noted that this procedure had already been invoked in the context of the European Communities' parallel request for establishment of a panel, and requested that the information-gathering process on the United States and European Communities claims be combined into a single exercise.

#### B. Establishment and Composition of the Panel

1.13 At its meeting on 12 June 1997, the DSB established a panel pursuant to requests by Japan and the European Communities (WT/DS55/6-WT/DS64/4, and WT/DS54/6, respectively). At its meeting of 30 July 1997, the DSB agreed to the United States' request for establishment of a panel (WT/DS59/6), and also agreed, as provided for in Article 9 of the DSU in respect of multiple complainants, that the Panel established on 12 June 1997 to examine the complaints by Japan and the European Communities would also examine the United States' complaint.

1.14 The terms of reference of the Panel are the following:

"To examine, in the light of the relevant provisions of the covered agreements cited by Japan in document WT/DS55/6-WT/DS64/4, by the European Communities in document WT/DS54/6, and by the United States in document WT/DS59/6, the matter referred to the DSB by Japan, the European Communities and the United States in those documents and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.15 Pursuant to a joint request by Japan and the European Communities, and as provided for in paragraph 7 of Article 8 of the DSU, on 29 July 1997 the Director-General composed the Panel as follows:

Chairman: Mr. Mohamed Maamoun Abdel Fattah  
Members: Mr. Ole Lundby  
Mr. David John Walker

1.16 India and Korea reserved their rights as third parties to the dispute.

C. Information-Gathering Procedure under Annex V of the SCM Agreement

1.17 At its meeting of 12 June 1997, the DSB agreed to the European Communities' request for the initiation of the Annex V procedure, and pursuant to paragraph 4 of Annex V, designated Mr. Stuart Harbinson as its representative for purposes of that procedure.

1.18 The 60-day period for the information-gathering procedure provided for in Annex V to the SCM Agreement with respect to the European Communities' complaint began on the date of establishment of the Panel to hear the European Communities' and Japan's claims, 12 June 1997, and ended on 11 August 1997.

1.19 The United States also invoked the 60-day information-gathering procedure provided for in Annex V to the SCM Agreement. Because the United States joined the dispute as a party only on 30 July 1997, the 60-day period related to its claims was a separate, later period, which ended 22 September 1997. All parties agreed that first submissions by complainants should be due four weeks after the end of the second phase of the Annex V procedure (related to the United States' claims), so that all information developed through that procedure could be used in the preparation of the first submissions. This postponement of the deadline for first submissions, to take account of both phases of the Annex V procedure, necessitated an equal postponement of the rest of the Panel's timetable.

D. Panel Proceedings

1.20 The Panel met with the parties on 3/4 December 1997 and on 13/15 January 1998. The Panel met with the third parties on 4 December 1997.

1.21 On 11 December 1997, the Chairman of the Panel informed the DSB that the Panel would not be able to issue its report within six months of the composition and establishment of the terms of reference of the Panel. The reasons for the delay are the postponement of the schedule due to the Annex V procedure, as discussed above and set forth in WT/DS55/9-WT/DS64/7-WT/DS54/9-WT/DS59/8.

II. FACTUAL ASPECTS

2.1 This dispute concerns a series of measures maintained by Indonesia with respect to motor vehicles and parts and components thereof. The following is a summary of the factual information presented to the Panel, with respect to the tax and tariff treatment of imported motor vehicles and parts and components thereof, and with respect to the measures at issue.

A. Tax and Tariff Treatment in Indonesia of Imported Completely Built-Up Motor Vehicles

2.2 Completely Built-Up motor vehicles ("CBUs") imported into Indonesia are subject to luxury tax as set forth in Table 10 below, as well as to import duties. Indonesia's current import duty rates on CBUs are as follows:

Table 1  
Import Duty Rates on CBUs

Vehicle Category	Import Duty
Motor Vehicles for the Transport of Persons Sedan (Unit)	200%
Commercial Motor Vehicles <sup>1</sup>	80%
Category I (Unit)	70%
Category II/III (Unit)	105%
Category IV (Unit)	5%
Category V (Unit)	

B. Measures at Issue

2.3 The measures at issue are the measures comprising: (1) "the 1993 Incentive System", which was amended in 1995 and 1996 (referred to herein as the "1993 programme"), (2) "the National Car Programme", which encompasses the so-called "February 1996 programme" and "the June 1996 programme", and (3) a \$US690 million loan<sup>2</sup> to PT Timor Putra Nasional ("PT TPN" or "TPN"). All complainants raise claims with respect to the National Car Programme, and the European Communities and the United States also raise claims with respect to the 1993 programme. In addition, the United States raises claims with respect to the \$US690 million loan. These measures can be summarized as follows:

1. "1993 Programme"

2.4 In 1993, Indonesia adopted the so-called 1993 Incentive System. The 1993 Incentive System consists of:

- (a) import duty relief (reductions or exemptions) on imports of automotive parts and accessories based on (1) the per cent of local content of the finished motor vehicle in which the parts are used, and (2) the type of vehicle in which the parts are used.

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<sup>1</sup> The commercial vehicle categories are defined as follows:

- I Gross Vehicle Weight up to 5 tons, with single drive-axes.
- II Gross Vehicle Weight exceeding 5 tons up to 10 tons.
- III Gross Vehicle Weight exceeding 10 tons up to 24 tons.
- IV Gross Vehicle Weight up to 5 tons, with double drive-axes.
- V Gross Vehicle Weight exceeding 24 tons.

<sup>2</sup> These designations are used in this report for convenience. The United States has argued that the National Car Programme is all a single programme, comprised of the February 1996 measures, the June 1996 measures and the \$US690 million loan to TPN. Japan's view is that most of Government Regulation No. 20/1996 and Government Regulation No. 36/1996 are not related to "national motor vehicles" and are outside the scope of the "National Car Programme".



- (b) import duty relief on imports of "subparts" used to make automotive parts and accessories based on (1) the per cent of local content of the completed part or accessory, and (2) the type of motor vehicle in which the part or accessory is used.
- (c) exemption from or reduction of luxury sales tax on goods for certain categories of motor vehicles.
- (a) Decree No. 114/1993

2.5 The first decree in the 1993 programme was Minister of Industry Decree No. 114/M/SK/6/1993 (June 9, 1993) ("The Determination of Local Content Levels of Domestically Made Motor Vehicles or Components").<sup>3</sup> Decree No. 114/1993 defines "local components" or "local sub components" as "parts or sub parts of Motor Vehicles which are domestically made and have Local Contents at a level of more than 40 per cent for [light commercial vehicles and passenger cars] ...".<sup>4</sup> The decree sets forth import duties dependent on specified local content rates for passenger cars, commercial vehicles, and automotive parts and components.

2.6 The local content rates and corresponding import duty rates applicable under this decree to parts for passenger cars are set forth below:

Table 2  
Passenger Car Parts

Local Content Rates	Import Duty Rates
less than 20%	100%
20% to 30%	80%
30% to 40%	60%
40% to 60%	40%
more than 60%	0%

Thus, if the local content of a passenger car was less than 20 per cent, the importer paid an import duty of 100 per cent on imported parts, etc.

2.7 The local content rates and corresponding import duty rates applicable under this decree to parts for light commercial vehicles are set forth below:

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<sup>3</sup> Indonesia Exhibit 8.

<sup>4</sup> As used herein, the term "light commercial vehicles" refers to commercial motor vehicles with a gross vehicle weight up to 5 tons with single axle drives and commercial motor vehicles with a gross vehicle weight up to 5 tons with double axle drives, including such vehicles as jeeps, vans, minivans, sports utility vehicles, etc. The term "passenger car" as used herein refers to sedans and station wagons.

Table 3  
Light Commercial Vehicle Parts

Local Content Rates	Import Duty Rates
less than 20%	40%
20% to 30%	30%
30% to 40%	20%
more than 40%	0%

2.8 The local content rates and corresponding import duty rates applicable under this decree to parts for subparts for passenger cars and light commercial vehicles are set forth below:

Table 4  
Subparts of Passenger Cars and Light Commercial Vehicles

Local Content Rates	Import Duty Rates
less than 20%	40%
20% to 30%	30%
more than 30% up to 40%	20%
more than 40%	0%

(b) Decree No. 645/1993

2.9 The purpose of the second decree forming part of the 1993 Programme, Minister of Finance Decree No. 645/KMK.01/1993 (June 10, 1993) (“The Relief of Import Duty on the Import of Certain Parts and Accessories of Motor Vehicles for the Purpose of Automotive Assembling and/or Manufacture”), is to authorize the incentives identified above under Decree No. 114/1993.<sup>5</sup>

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<sup>5</sup> Indonesia Exhibit 36.

(c) Decree No. 647/1993

2.10 A third decree forming part of the 1993 Programme, Minister of Finance Decree No. 647/KMK.04/1993 (June 10, 1993) ("The Kinds and Types of Motor Vehicles Subject to Sales Tax on Luxury Goods") provides reduced Indonesian sales tax on luxury goods for motor vehicles with specified local content rates.<sup>6</sup> Specifically, passenger cars with cylinder capacities of 1600cc or less and jeeps are subject to a luxury tax of 20 per cent provided that their local content exceeds 60 per cent.<sup>7</sup> (An exception is made for motor vehicles used for public purposes, such as police vans, ambulances, fire-engines, etc.). If the local content is not in excess of 60 per cent, the applicable luxury tax rate is 35 per cent.

2.11 The local content rates and corresponding luxury tax rates applicable under this decree to passenger cars with cylinder capacities of 1600 cc or less and jeeps are set forth below:

Table 5  
Passenger Cars < 1600 cc and Jeeps

Local Content Rates	Luxury Tax Rate
greater than 60%	20%
60% or less	35%

(d) Decree No. 223/1995

2.12 In 1995, through Minister of Finance Decree No. 223/KMK.01/1995 (May 23, 1995) ("The Improvement of Decree of the Minister of Finance Number 645/KMK.01/1993 on the Relief of Import Duty on Parts and Accessories of Motor Vehicles for the Purpose of Automotive Assembly and/or Manufacture"), Indonesia modified the schedule of import duty rates corresponding to specified local content rates.<sup>8</sup> The local content rates and corresponding import duty rates for imported parts used in the manufacture or assembly of passenger cars and commercial vehicles were modified as set forth below:

Table 6  
Parts for Passenger Cars and Commercial Vehicles

**Sedans and station wagons (HS 87.03)**

<u>Local content (%)</u>	<u>Import duty (%)</u>
less than 20	65
20-30	50
30-40	35
40-50	20
50-60	10
More than 60	0

<sup>6</sup> Indonesia Exhibit 33.

<sup>7</sup>Article 3 of Decree No. 647/1993 defines "jeeps" as "multi-purpose four wheeled motor vehicles, with double differential gears, chassis, total g.v.w. of 5 (five) tons or less and capacity of transporting less than 10 (ten) people.

<sup>8</sup>Indonesia Exhibit 27.

**Pick-ups (HS 87.04), Minibuses (HS 87.02 or 87.03) and Jeeps (HS 87.03)**

<u>Local content (%)</u>	<u>Import duty (%)</u>
Less than 20	25
20-30	15
30-40	10
more than 40	0

**Buses (HS 87.02) and Trucks (HS 87.04) with a total weight of more than 5 tons but not more than 24 tons**

<u>Local content (%)</u>	<u>Import duty (%)</u>
Less than 20	25
20-30	15
more than 30	0

**Two-wheeled motor vehicles (HS 87.11)**

<u>Local content (%)</u>	<u>Import duty (%)</u>
Less than 20	25
20-30	15
30-40	10
more than 40	0

2.13 The local content rates and corresponding import duty rates for imported subparts used in the manufacture or assembly of parts and accessories for passenger and commercial vehicles were modified as set forth below:

Table 7  
 Subparts of Passenger and Commercial Vehicles

**Sedans and Station wagons (HS 87.03), Pick-ups (HS 87.04), Minibuses (HS 87.02 or 87.03) and Jeeps (HS 87.03)**

<u>Local content (%)</u>	<u>Import duty (%)</u>
Less than 20	25
20-30	15
30-40	10
more than 40	0

**Buses (HS 87.02) and Truck (HS 87.04) with a total mass of more than 5 tons but not more than 24 tons**

<u>Local content (%)</u>	<u>Import duty (%)</u>
Less than 10	25
10-20	15
more than 20	0

**Two wheel motor vehicles (HS 87.11)**

<u>Local content (%)</u>	<u>Import duty (%)</u>
less than 20	25
20-30	15
30-40	10
more than 40	0

(e) Decree No. 36/1997

2.14 Minister of Finance Decree No. 36/KMK.01/1997 (January 21, 1997) ("The Granting of Import Duty Relief to Certain Parts and Accessories of Motor Vehicles for the Assembly and or Manufacturing of Motor Vehicles")<sup>9</sup> reissues the schedule of import duty relief set forth in Decree No. 223/1995 in light of changes in the underlying customs statutes.

2. "The National Car Programme"

2.15 Two sets of measures have been identified by all parties under the 1996 National Car programme:

2.16 The first set of measures - the February 1996 Programme - provides for the grant of "pioneer" or National Car company status to Indonesian car companies that meet specified criteria as to ownership of facilities, use of trademarks, and technology. Maintenance of pioneer status is dependent on the National Cars' meeting increasing local content requirements over a three year period. The benefits provided are exemption from luxury tax on sales of National Cars, and exemption from import duties on parts and components.

2.17 The second set of measures - the June 1996 Programme - provides that National Cars manufactured in a foreign country by Indonesian nationals and which fulfil the local content requirements prescribed by the Minister of Industry and Trade, shall be treated the same as National Cars manufactured in Indonesia, i.e. exempt from import duties and luxury tax. In accordance with Decree 142/96, imported National Cars are deemed to comply with the 20 per cent local content requirement for the end of the first production year if the overseas producer manufacturing the National Cars "counter-purchases" Indonesian parts and components that account for at least 25 per cent of the C&F value of the imported cars.

2.18 The United States alleges a third element of the National Car Programme - a series of loans, totalling US\$690 million with a maturity of 10 years, made on 11 August 1997, to TPN (the only pioneer company) for TPN to carry out the national car project. The loans allegedly were made by a consortium of state-owned and private banks at the direction of the Government of Indonesia, with the state-owned banks providing at least 50 per cent of the financing.

(a) "The February 1996 Programme"

2.19 The so-called February 1996 programme consists of a series of decrees and regulations published in February and March 1996.

(1) Presidential Instruction No. 2/1996

2.20 Presidential Instruction No. 2/1996 ("The Development of the National Automobile Industry") was issued on 19 February, 1996.<sup>10</sup> The purpose of Presidential Instruction No. 2/1996 is "to continue to strengthen the self-reliance of the nation, particularly in providing means of land transportation in the form of the production of a national car . . ." Presidential Instruction No. 2/1996 directs the Minister of Industry and Trade, the Minister of Finance, and the State Minister for the Mobilization of Investment Fund/Chairman of Capital Investment Coordinating Board to implement a series of "provisions."

2.21 First, Presidential Instruction No. 2/1996 directs these ministers collectively to implement "measures in close coordination to realize as fast as possible the development of the national car

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<sup>9</sup>Indonesia Exhibit 9.

<sup>10</sup>Indonesia Exhibit 1.

industry, which meets the following criteria: (a) the use of a brand name of its own; (b) domestically produced; (c) the use of components which are domestically produced.”

2.22 Second, Presidential Instruction No. 2/1996 directs the Minister of Industry and Trade “to foster, guide and grant facilities, in accordance with the use of provisions of laws in effect such that the national car industry: (a) uses a brand name of its own; (b) uses components produced domestically as much as possible; (c) is able to export its products.”

2.23 Third, Presidential Instruction No. 2/1996 directs the Minister of Finance to “grant the following facilities in the field of taxation in accordance with regulations in force: (a) import duty exemption for importation of components produced domestically as much as possible which still need to be imported; (b) the assessment of the Value Added Tax at the rate of 10 per cent upon the delivery of the produced automobiles; (c) payment of the Sales Tax on Luxury Goods which is owed upon the delivery of the produced automobiles will be borne by the Government.”

(2) Decree No. 31/1996

2.24 Also on 19 February 1996, Indonesia issued Minister of Industry and Trade Decree No. 31/MPP/SK/2/1996 (“The National Motor Vehicle”).<sup>11</sup> Decree No. 31/1996 identifies its purpose as “to implemen[t] Presidential Instruction No.2 of 1996 on the Development of the National Car Industry ... in the framework of promoting industry ... .”

2.25 Decree No. 31/1996 sets forth the requirements for designation as a “national motor vehicle”. Specifically, national motor vehicles are those which:

- (a) are made domestically at production facilities owned by national industrial enterprises or Indonesian corporations, the shares of which are wholly owned by Indonesian citizens;
- (b) use "a brand name of its own which has never been registered by any other party in Indonesia and which is owned by an Indonesian companies/citizen"; and
- (c) are "developed with technology, construction, design and engineering based on national capability applied by stages."

The Decree also provides that “the motor vehicle industrial enterprise which produces national motor vehicles in accordance with the requirements set forth in Article 1 will be granted the status of ‘Pioneer enterprise.’”

2.26 Decree No. 31/1996 sets forth a schedule of local content rates to be achieved by a “national motor vehicle industrial enterprise given ‘Pioneer status’”:

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<sup>11</sup>Indonesia Exhibit 2.

Table 8  
Local Content Schedule for National Motor Vehicle

Time Period	Local Content Rate
end of the first year	> 20%
end of the second year	> 40%
end of the third year	> 60%

(3) Decree No. 82/1996

2.27 The third measure issued on February 19, 1996, was Decree of the Minister of Finance No. 82/KMK.01/1996 (“The Improvement of the Decree of the Minister of Finance No. 645/KMK.01/1993 on the Grant of Import Duty Relief to Certain Parts and Components of Motor Vehicles for the Assembly Purposes and/or Manufacture of Motor Vehicles as Previously Improved by the Decree of the Minister of No. 223/KMK.01/1995”).<sup>12</sup> Decree No. 82/1996 establishes that parts and components imported by a producer/assembler of National Cars, for assembly or manufacture of National Cars fulfilling the local content rates identified above, are exempted from import duties.

(4) Government Regulation No. 20/1996

2.28 The final measure issued on February 19, 1996, was Government Regulation No. 20 (“The Amendment of Government Regulation No. 50 of 1994 Regarding the Implementation of Law No. 8 of 1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as Amended by Law No. 11 of 1994”).<sup>13</sup> By this regulation, National Cars fulfilling the specified requirements, including local content rates, were exempted from luxury tax.

2.29 Thus, Regulation No. 20/1996 established the following luxury tax structure:

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<sup>12</sup>Indonesia Exhibit 21.

<sup>13</sup>Indonesia Exhibit 20.

Table 9  
 Luxury Tax Rate Schedule

Type of Motor Vehicle	Luxury Tax Rate
passenger cars > 1600cc jeeps with local content ≤ 60%	35%
light commercial vehicles (other than jeeps) using diesel	25%
passenger cars ≤ 1600cc jeeps with local content > 60% light commercial vehicles (other than jeeps) using gas	20%
national motor vehicles	0%

- (5) Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No. 01/SK/1996

2.30 On 27 February 1996, Indonesia issued Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No. 01/SK/1996 ("Investment Regulations Within the Framework of the Realization of the Establishment of the National Automobile Industry").<sup>14</sup> The decree provided that "to realise the establishment of [a] national car industry, the investment approval will be issued to the automobile industry sector with tax facilities in accordance with legal provisions enacted specifically for that purpose."

- (6) Ministry of Industry and Trade Decree No. 002/SK/DJ-ILMK/II/1996

2.31 On 27 February 1996, Decree No. 002/SK/DJ-ILMK/II/1996 of the Ministry of Industry and Trade was issued.<sup>15</sup> This Decree designated PT Timor Putra Nasional ("TPN") as "a pioneer national motor vehicle enterprise." On 5 March 1996, Decision No. 02/SK/1996 of the State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board was issued. This decision designated TPN "to establish and produce a National Car."

2.32 The National Car, the "Timor", was to be based on the design and other technology of the Kia Sephia, model produced by Kia Motors of Korea. The Timor was to be produced initially in knock-down form in Korea by Kia Motors, for export to Indonesia, where it was to be assembled at TPN's facility at Karawang, Indonesia. (At the time that the February 1996 programme was announced, construction of this facility had not yet begun.) TPN was to gradually increase the level of local content of the Timor.

- (b) "The June 1996 Programme"

2.33 The so-called June 1996 programme comprises a series of decrees issued in June 1996.

<sup>14</sup>Indonesia Exhibit 4.

<sup>15</sup>Indonesia Exhibit 41.



(1) Presidential Decree No. 42/1996

2.34 On 4 June 1996, Presidential Decree No. 42/1996 (“The Production of National Cars”) was issued.<sup>16</sup> This Decree No. 42/1996 stated that:

National cars which are made overseas by Indonesia workers and fulfil the local content stipulated by the Minister of Industry and Trade will be treated equally to those made in Indonesia.

In other words, National Cars in fully built-up form could be imported free of duty and luxury tax, if they were made by Indonesian personnel and fulfilled the local content requirements for the National Car.

2.35 This Decree also provided that this tax and duty exemption would be granted only once for a maximum period of one year, and would involve a total number of vehicles to be stipulated by the Minister of Industry and Trade. In Minister of Industry and Trade Decree No. 1410/MPP/6/1996 (30 June 1996)<sup>17</sup>, TPN was authorized to import 45,000 Timors pursuant to Decree No. 42/1996.

(2) Regulation No. 36/1996

2.36 Also on 4 June 1996, Indonesia issued Government Regulation No. 36/1996 (“The Amendment of Government Regulation No. 50 of 1994 on the Implementation of Law No. 8 of 1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as Amended by Law No. 11 of 1994, as Lastly Amended by Government Regulation No. 20/1996”).<sup>18</sup> Regulation No. 36/1996 made further revisions to the luxury tax on motor vehicles, which, as discussed, had been most recently revised on 19 February 1996, in Regulation No. 20/1996.

2.37 Regulation No. 36/1996 established the following luxury tax schedule:

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<sup>16</sup>Indonesia Exhibit 6.

<sup>17</sup>Indonesia Exhibit 13.

<sup>18</sup>Indonesia Exhibit 3.

Table 10  
Luxury Tax Rate Schedule

Type of Motor Vehicle	Luxury Tax Rate
passenger cars $\geq$ 1600cc. passenger cars with local content $\leq$ 60%. jeeps with local content $\leq$ 60%. buses with local content $\leq$ 60%.	35%
combis, minibuses, vans and pick-ups using diesel as fuel, with local content $\leq$ 60%.	25%
combis, minibuses, vans and pick-ups using gasoline as fuel with local content $\leq$ 60%.	20%
sedans and station wagons < 1600cc manufactured in Indonesia with local content > 60%. combis, minibuses, vans and pick-ups using gasoline or diesel as fuel, manufactured in Indonesia with local content with local content > 60%. buses manufactured in Indonesia. motorcycles < 250cc manufactured in Indonesia. national motor vehicles.	0%

(3) Decree No. 142/1996

2.38 As indicated, Presidential Decree No. 42/1996 permitted the “national motor vehicle” to be produced abroad for a period of one year and still receive the duty and tax benefits of the National Motor Vehicle programme, if the local content requirements for the National Car (20 per cent local content for the first year) were met and the car was produced by Indonesian personnel.

2.39 The Decree of the Minister of Industry and Trade No. 142/MPP/Kep/6/1996, issued 5 June 1996 (“The Production of the National Cars”)<sup>19</sup> established guidelines for meeting the local content requirement referred to in Decree 42/1996. Decree No. 142/1996 provides that “the production of national cars can be carried out overseas ... on the condition that Indonesian parts and components are used”, and then states further that “[t]he procurement of Indonesian-made parts and components shall be performed through the system of counter purchase of parts and components of motor vehicles by the overseas company carrying out the production and reexporting of national cars to Indonesia.” In addition, the decree states that “[t]he value of the counter purchase ... shall be fixed at the minimum of 25% (twenty-five per cent) of the import value of the national cars assembled abroad (C&F value).”

2.40 In other words, counter purchases by the overseas producer of the National Car of Indonesian motor vehicle parts and components worth at least 25 per cent of the C&F import value of the imported National Cars would satisfy the local content requirements for the National Car.

<sup>19</sup>Indonesia Exhibit 7.

(4) Audit of TPN's performance under Decree 142/1996

2.41 Indonesia has submitted a letter to the Panel dated January 1998, containing the results of an audit of TPN's compliance with the counterpurchase requirement of Decree No. 142/1996. The letter indicates that TPN was found in the audit not to have met the counterpurchase requirement.

3. The US\$690 million loan to TPN

2.42 The United States' claims include one additional measure, which it characterizes as a further component of the National Car Programme: a loan provided on 11 August 1997. According to the United States, at the direction of the Indonesian Government a consortium of four government-owned banks and twelve private banks decided to disburse US\$650 million in ten-year loans to TPN to carry out the national car project. The United States also asserts that one of the Government-owned banks involved previously had disbursed a US\$40 million bridging loan to TPN, bringing the total loan amount to US\$690 million. According to the United States, the loans reportedly will carry an annual interest rate of 3 per cent over the 3-6 month deposit rate, a maturity of 10 years, and a grace period of 3 years, and the four government-owned banks will provide one-half of the \$650 million loan.

2.43 On 25 February 1998, Indonesia notified the Subsidies Committee that, as of 21 January 1998, it had terminated all subsidies previously granted under the National Car programme. On 2 March 1998, Indonesia notified the Panel and requested the Panel to terminate the dispute settlement proceeding, at least as it relates to the 1996 National Car programme measures.

C. Notifications by Indonesia to WTO Committees

2.44 On 23 May 1995, Indonesia made a notification with respect to the 1993 Incentive System to the TRIMs Committee under Article 5.1 of the TRIMs Agreement (G/TRIMS/N/1/IDN/1). On 28 October 1996, Indonesia notified the TRIMs Committee that it was "withdrawing" its notification related to automobiles because it considered that its programme was not a TRIM (G/TRIMS/N/1/IDN/1/Add.1); on the same day Indonesia made a notification with respect to its 1993 Incentive System and its 1996 National Car programme to the SCM Committee (G/SCM/N/16/IDN).

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES<sup>20</sup>

A. Japan

3.1 **Japan** requests the Panel to find that:

- (a) the luxury sales tax exemption with regard to domestically produced National Cars pertaining to the February 1996 National Car Programme measures identified<sup>21</sup> is inconsistent with Article III:2 of GATT 1994, since imported automobiles are subject to luxury sales tax in excess of that applied to the like domestic products (i.e. National Cars);
- (b) the local content requirements with regard to domestically produced National Cars pertaining to the February 1996 National Car Programme measures identified are inconsistent with Article III:4 of GATT 1994, since the requirements accord to products

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<sup>20</sup>The descriptions in this section of the findings and recommendations requested by the parties are as they appear in the parties' submissions. These descriptions do not necessarily correspond to the parties' claims as identified in their requests for a panel.

<sup>21</sup>Decree Nos. 114/1993, 645/1993.

imported from Japan treatment less favourable than that accorded to like domestic products;

- (c) the local content requirements and the exemption from customs tariff and luxury sales tax pertaining to the February 1996 National Car Programme measures identified are trade related investment measures as stipulated in paragraph 1(a) of the Illustrative List annexed to the TRIMs Agreement, and are therefore inconsistent with Article 2 of the TRIMs Agreement;
- (d) the customs tariff exemption with regard to the import of automotive parts and components and the sales tax exemption pertaining to the February 1996 National Car Programme measures identified are inconsistent with Article I:1 of GATT 1994, since the exemptions are not accorded to the like products originating in all other members including Japan;
- (e) the exemption from customs tariff and sales tax granted under the extended National Car Programme of June 1996<sup>22</sup> solely to the completed automobiles originating in the Republic of Korea is inconsistent with Article I:1 of GATT 1994, since the exemption is not accorded to the like products originating in other Members including Japan;
- (f) the extended National Car Programme measures were not promptly published and have not been administered in a uniform, impartial and reasonable manner, thus being inconsistent with Articles X:1 and X:3(a) of GATT 1994.

3.2 **Japan** requests that the Panel recommend that Indonesia bring its measures into conformity with its obligations under GATT 1994 and the TRIMs Agreement.

B. European Communities

3.3 The **European Communities** requests the Panel to find that:

- (a) Indonesia violates the provisions of Article III:2, first sentence, by exempting from the luxury sales tax the sales of the following categories of motor vehicles:
  - (i) domestically manufactured motor cycles with engines of 250 cc or less;
  - (ii) combines, minibuses, vans and pick-ups using gasoline as fuel which are manufactured domestically and have a local content of more than 60 per cent;
  - (iii) combines, minibuses, vans and pick-ups using diesel oil as fuel which are manufactured domestically and have a local content of more than 60 per cent;
  - (iv) domestically manufactured buses;
  - (v) domestically manufactured sedans and stations wagons of less than 1,600 cc with a local content of more than 60 per cent;
  - (vi) National Cars assembled in Indonesia by pioneer companies; and

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<sup>22</sup>Presidential Decree No. 42/1996, Decree No. 142/1996.

- (vii) imported National Cars.
- (b) the following measures favour the “use” by Indonesian car manufacturers of domestic parts and components over “like” imported parts and components and are, accordingly, inconsistent with Article III:4 of GATT:
- (i) the exemption from the luxury sales tax of locally manufactured combines, minibuses, vans and pick-ups with more than 60 per cent local content;
  - (ii) the exemption from the luxury sales tax of locally manufactured sedans and stations wagons of less than 1,600 cc with more than 60 per cent local content;
  - (iii) the exemption from the luxury sales tax of National Cars assembled in Indonesia by pioneer companies meeting certain local content requirements;
  - (iv) the exemption from the luxury sales tax of National Cars assembled in Korea by “overseas producers” meeting certain counter-purchasing obligations;
  - (v) the grant of import duty relief to parts and components used in the assembly of motor vehicles (or of other parts and components for the assembly of motor vehicles) in Indonesia based on the finished vehicles (or the parts and components) meeting certain local content requirements;
  - (vi) the exemption from import duties for parts and components used for the assembly of National Cars in Indonesia by pioneer companies meeting certain local content obligations.
- (c) the following measures are inconsistent with Indonesia's obligations under Article I:1 of GATT:
- (i) the exemption from customs duties on imports of National Cars;
  - (ii) the exemption from the sales tax on luxury goods for imported National Cars;
  - (iii) the exemption from the sales tax on luxury goods for National Cars assembled in Indonesia; and
  - (iv) the exemption from customs duties on imports of parts and components for the assembly of National Cars in Indonesia.
- (d) the measures listed in paragraph b. above are also TRIMs inconsistent with Article III of GATT and, accordingly, that by applying those measures Indonesia is in violation of its obligations under Article 2.1 of the TRIMs Agreement.
- (e) the following incentives granted to PT TPN under the National Car Programme constitute "specific subsidies" within the meaning of Articles 1 and 2 of the SCM Agreement and cause "serious prejudice" to the interests of the Community in the sense of Article 5(c) of that Agreement:

- (i) customs duty relief for parts and components intended for assembly into National Cars;
- (ii) exemption from the luxury sales tax for National Cars;
- (iii) customs duty relief for National Cars imported from Korea.

C. United States

3.4 The **United States** requests the Panel to find that:

- (a) Indonesia's system of tariff and tax incentives under the 1993 Incentive System<sup>23</sup> and National Car programmes<sup>24</sup> and the government-directed \$690 million loan to TPN are inconsistent with Article III:4 of GATT 1994 and are not covered by Article III:8 of GATT 1994;
- (b) Indonesia's discriminatory application of the luxury sales tax is inconsistent with Article III:2, first sentence, of GATT 1994;
- (c) alternatively, Indonesia's discriminatory application of the luxury sales tax is inconsistent with Article III:2, second sentence;
- (d) Indonesia's exemption of CBU Kia Sephia sedans imported from Korea from import duties and the luxury sales tax violates Article I:1 of GATT 1994.
- (e) Indonesia's system of tariff and tax incentives under the 1993 Incentive System and National Car programmes and the government-directed \$690 million loan to TPN are inconsistent with Article 2 of the TRIMs Agreement;
- (f) Indonesia's grant of "national motor vehicle" benefits only to motor vehicles bearing a unique Indonesian trademark owned by Indonesian nationals discriminates against foreign-owned trademarks and their owners and is inconsistent with Articles 3, 20 and 65 of the TRIPS Agreement;
- (g) Indonesia has extended the scope of its tariff and tax subsidies in a manner inconsistent with Article 28.2 of the SCM Agreement.
- (h) Indonesia's subsidies under the National Motor Vehicle Programme have caused serious prejudice to the interests of the United States within the meaning of Articles 6 and 27 of the SCM Agreement;
- (i) Indonesia's subsidies under the National Motor Vehicle Programme have caused a threat of serious prejudice to the interests of the United States within the meaning of Articles 6 and 27 of the SCM Agreement.

3.5 The **United States** requests that the Panel recommend that Indonesia bring its measures into conformity with its obligations under GATT 1994, the TRIMs Agreement, the TRIPS Agreement, and the SCM Agreement.

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<sup>23</sup>Decrees No. 114/1993, 645/1993, 647/1993, 223/1995, 36/1997, and Regulation 36/1996.

<sup>24</sup>Decrees No. 82/1996, 31/1996, 42/1996, 36/1996, 142/1996, Regulations 20/1996 and 36/1996, and Presidential Instruction No. 2/1996.

3.6 The **United States** also requests that the Panel recommend, pursuant to Article 7.8 of the SCM Agreement, that Indonesia take appropriate steps to remove the serious prejudice and the threat of serious prejudice or withdraw its subsidies.

D. Indonesia

3.7 **Indonesia** requests the Panel to reject the complainants' assertions and find that the 1993 incentive programme and the 1996 National Car programme are allowable subsidies under the Subsidies Agreement and do not violate any provisions of GATT 1994, the TRIMs Agreement, or the TRIPs Agreement.

IV. REQUESTS FOR PRELIMINARY RULINGS

A. Participation of Private Lawyers

4.1 On 25 November 1997, Indonesia provided to the Panel a list of its delegation to the first meeting of the Panel with the parties. On 28 November 1997, the United States, in a letter to the Chairman of the Panel, noted that Indonesia's delegation list included several private lawyers, and objected to the participation of these non-governmental employees in meetings of the Panel. On 1 December 1997 and 3 December 1997, Indonesia submitted letters to the Chairman of the Panel, responding to the objection raised by the United States. At its first substantive meeting with the parties, the Panel heard arguments of the parties and made a ruling on this issue.<sup>25</sup>

1. Objection of the United States

4.2 The following are the arguments of the **United States** in support of its objection:

4.3 The issue of the participation of private lawyers in panel meetings was addressed by the panel in the Bananas case (WT/DS27/R/USA, adopted 25 September 1997, para. 7.10-7.12). In that case, following the objections of the complainants, the panel limited attendance at panel meetings to members of governments. In so ruling, the panel made the following observations, among others:

- Past practice in GATT and WTO dispute settlement has been not to admit private lawyers to panel meetings if any party objected to their presence.
- Because private lawyers may not be subject to disciplinary rules such as those that applied to members of governments, their presence in panel meetings could give rise to concerns about breaches of confidentiality.
- The admission of private lawyers to panel meetings, if it became a common practice, would not be in the interest of small Members as it could entail disproportionately large financial burdens for them.
- The panel had concerns about whether the presence of private lawyers would change the intergovernmental character of WTO dispute settlement proceedings.
- Limiting attendance at panel meetings to members of governments would not in any respect adversely affect the right of parties or third parties to meet and consult with their private lawyers in the course of panel proceedings, nor to receive legal or other advice in the preparation of written submissions from non-governmental experts.

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<sup>25</sup>See Findings, section XIV.A.1, for this ruling.

4.4 These observations of the Bananas panel are equally applicable to this Autos dispute. Moreover, while the Appellate Body ruled that private lawyers could participate in the Appellate Body hearing in Bananas, the Appellate Body carefully limited its ruling to proceedings of the Appellate Body, not panels, and took pains to note that it was not dealing with an appeal of the panel's ruling in Bananas concerning the participation of private lawyers in panel meetings. (WT/DS27/AB/R, adopted 25 September 1997, para. 11). While the United States does not agree with the Appellate Body's limited ruling, that ruling is distinguishable from the present case in that the entire Appellate Body process is a new process for which prior GATT practice, arguably, does not provide an appropriate guide.

4.5 However, the panel process is not new, and there is no basis at this time for the WTO to change its established practice in this area. If a change is to be made in WTO dispute settlement practice, such a change must be negotiated and agreed in the context of the review of the WTO dispute settlement rules and procedures scheduled to be completed by the end of 1998. A change of this magnitude would entail a fundamental alteration of the premises underlying WTO dispute settlement and its operation, and would erode the control of governments over what has been a well-functioning government-to-government process for the peaceful settlement of disputes.

4.6 Moreover, the fact that the private lawyers in question attended the consultations in the Autos dispute is neither relevant nor dispositive for purposes of this panel proceeding. Indonesia conditioned its agreement to consult on the presence of these individuals. Even then, however, there was an understanding between the United States and Indonesia that the private lawyers would not address the United States delegation, and that should they do so, the United States delegation would not respond. As a result, the private lawyers were limited to the role of communicating with their client.

4.7 Therefore, the United States objects to the participation of non-governmental employees in meetings of the Panel in the Autos dispute and requests the Panel to make a finding with respect to this matter prior to the 3 December 1997, meeting of the Panel with the parties.

## 2. Response of Indonesia

4.8 In its letter dated 1 December 1997, **Indonesia** made the following arguments:

4.9 The Government of the Republic of Indonesia has the sovereign right to determine the composition of its delegations to, and select its spokesmen at, all meetings of WTO bodies and organs. This sovereign right is based on the customary international law principle of the sovereign equality of states.

4.10 Moreover, it is recognized in the practice of international dispute tribunals, including the Appellate Body of the WTO. In upholding the right of Saint Lucia to include non-government legal counsel on its delegation for the Appellate Body hearing and to allow counsel to speak at the hearing in the EU Bananas proceeding, the Appellate Body stated:

4.11 On 15 July 1997, the Appellate Body notified the participants and third participants in this appeal of its ruling that the request by Saint Lucia would be allowed. The Appellate Body said the following:

... we can find nothing in the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), the DSU or the Working Procedures, nor in customary international law or the prevailing practice of international tribunals, which prevents a WTO Member from determining the composition of its delegation in Appellate Body proceedings. Having carefully considered the request made by the Government of Saint Lucia, and the responses dated 14 July 1997 received from Canada; Jamaica; Ecuador; Guatemala; Honduras;



Mexico and the United States, we rule that it is for a WTO Member to decide who should represent it as members of its delegation in an oral hearing of the Appellate Body.

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We note that there are no provisions in the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), in the DSU or in the Working Procedures that specify who can represent a government in making its representations in an oral hearing of the Appellate Body. With respect to GATT practice, we can find no previous panel report which speaks specifically to this issue in the context of panel meetings with the parties. We also note that representation by counsel of a government's own choice may well be a matter of particular significance - especially for developing country Members - to enable them to participate fully in dispute settlement proceedings.

WT/DS27/AB/R (9 September 1997) at paras. 10 and 12.

4.12 Thus, the Appellate Body fully rejected the bases and logic of the underlying panel report, upon which the United States bases its objection. In this regard, my Government wishes to reiterate, first, that the individuals in question are retained by the Government of the Republic of Indonesia and, obviously, are completely subject to its direction, not the other way around. Thus, the "intergovernmental character" of the panel process will not be disturbed by their participation. Indeed their participation is required to preserve the "intergovernmental character" of the process by helping to ensure that my Government is able to achieve its goals in the process. Second, as the United States well knows, these individuals are subject to the strict confidentiality requirements set forth under the United States legal system. Moreover, they are contractually bound to my Government to maintain the confidentiality of the proceeding. Will any of the other participants in the proceeding be so bound? If anything, the inclusion of respected private attorneys will reduce the breaches of confidentiality that occur in panel proceedings. Third, the Government of the Republic of Indonesia is perfectly capable of making independent financial decisions regarding contracting legal or other experts and any attempt by the United States to insert itself into this area is insulting and misplaced. This point, in particular, highlights the inappropriateness of the United States, as Indonesia's opponent in this proceeding, having any say whatsoever in Indonesia's composition of its defence team. Finally, the decision of the Appellate Body emphasizes the importance of full - not partial - participation by accredited counsel.

4.13 The United States ignores the logic of this decision and attempts to avoid its application to the instant proceeding, even though every rationale noted by the Appellate Body applies here in full. Moreover, the Appellate Body noted that the issue of private counsel participation before the Panel had not been appealed by a party to the EU Bananas dispute because the Member state which included the private attorney in its delegation, Saint Lucia, was a third party to the dispute and the issue had not been directly appealed by the Respondent. (The respondent in the EU Bananas dispute was, in any case, the European Communities which, like the United States and Japan, maintains an army of attorneys with WTO expertise and thus has no need for private assistance to defend its interests before the WTO.) The decision of the Appellate Body in the EU Bananas proceeding therefore should guide the Panel in rejecting the United States' objection.

4.14 The right to determine the composition of delegations to meetings with the Panel in dispute settlement proceedings is particularly important for developing countries like Indonesia. These WTO members do not have at their disposal specially trained and highly experienced corps of WTO legal experts. The only way Indonesia can obtain full and effective representation in this dispute is by retaining outside legal experts, which it has done. Effective legal representation, chosen by the party participating in the dispute is as necessary for the legitimacy of the WTO dispute settlement process as it

is for the legitimacy of any dispute settlement process. The United States' arguments to the contrary are absurd.

4.15 The United States cannot deny that under customary international law Indonesia has the sovereign right to compose its delegation to panel meetings in this dispute. The United States does not and cannot cite anything in the Marrakesh WTO Agreement, the DSU or the Working Procedures of this Panel that limits this sovereign right. Nor does or can the United States cite to any Panel decision or recommendation that limits the right and permits challenges to the credentials or qualifications of accredited delegates. All that the United States can do is to point to past GATT practice. The mere fact that previously no country has formally maintained its opposition to challenges to its sovereign right to compose its delegation cannot be the basis for extinguishing Indonesia's insistence on the exercise of that right now. This is particularly true because, unlike the old GATT regime, decisions by Panels (and the Appellate Body) under the DSU are legally binding and the basis for retaliation if not implemented. In short, Members did not deem the right to counsel so important when they could simply block a negative panel decision and be done with it.

4.16 In its letter dated 3 December 1997, **Indonesia** made the following arguments:

- (a) General principles of international law support Indonesia's sovereign right to select counsel of its choice and organize and present its defence

4.17 The principle of "sovereign equality of states" provides that all states are free to choose representation of their choice before international adjudicatory bodies or subsidiary organs of international organizations. This principle is an accepted rule of customary international law. Thus, Indonesia has an absolute right to compose its own delegations to meetings of international organizations, including WTO dispute settlement proceedings.

4.18 The United Nations International Law Commission (the ILC) expressly recognized the importance of the principle of sovereign equality of states in technical proceedings such as WTO dispute settlement. In his Fifth Report on Relations Between States and International Organizations, the Special Rapporteur explains the rationale for this principle as follows:

[T]he sending State should have a wider freedom of choice with respect to the members of its delegations to organs of international organizations and to conferences convened by such organizations [as compared with members of permanent missions]. One of the salient features of present-day international relations is the increasing number of subsidiary organs set up by international organizations to deal with very specialized matters of highly technical character which require the enlisting of the services of experts possessing the necessary training and experience ... . For these reasons it is highly desirable, if not indispensable, that the sending States should enjoy the widest possible freedom in the choice of the members of its delegations to such organs and conferences.<sup>26</sup>

4.19 The Report recognizes that a country may need to include outside experts in its delegation in order to deal effectively with the increasingly specialized nature of subject matters addressed by international fora. WTO dispute settlement proceedings are exceedingly specialized and complex proceedings that involve a wide range of technical trade, economic and legal issues that must be litigated under highly technical procedural rules and requirements. This is exactly the type of proceeding where the ILC declared that specialized expertise is indispensable.

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<sup>26</sup>See Yearbook of the International Law Commission, 1970, Vol. II, p. 19 (emphasis added).

(b) Practice before international adjudicatory bodies confirms Indonesia's right

4.20 The principle of sovereign equality of states is fully consistent with the practice of every major international dispute settlement tribunal and international organization. These practices support Indonesia's right to include outside private attorneys in its delegation to the WTO. Each of the following international dispute settlement tribunals and international organizations permits states complete freedom in composing their delegations:

Dispute resolution tribunals

- International Court of Justice;
- International Centre for Settlement of Investment Disputes;
- Permanent Court of Arbitration;
- European Court of Human Rights;
- Inter-American Court of Human Rights;
- United Nations Compensation Commission; and
- Iran-United States Claims Tribunal

Other international organizations

- United Nations;
- Food and Agriculture Organization;
- International Labour Office;
- International Telecommunication Union;
- United Nations Conference on Trade and Development;
- World Intellectual Property Organization; and
- Organization of American States.

4.21 In sum, no tribunal or organization (other than North American Free Trade Agreement in certain proceedings) limits in any way a state's decision to accredit outside counsel as members of its delegation. Nor does any limit the degree of counsel's involvement in a dispute proceeding. The absence of restrictions in all the major dispute resolution tribunals and other organizations is consistent with the general principle of customary international law that recognizes the sovereign right of countries to accredit representatives of their choosing to represent them in international fora.

(c) The WTO Appellate Body supports Indonesia's right

4.22 On 15 July 1997, the Appellate Body in the EU Banana Regime proceeding allowed outside counsel for the ACP States, not only to attend the oral proceedings but also to present the ACP States' legal case. The Appellate Body disagreed with the Panel's reasoning in denying outside counsel's participation in the Panel proceeding and concluded:

... we can find nothing in the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), the DSU or the Working Procedures [of the Panel], nor in customary international law or the prevailing practice of international tribunals, which prevents a WTO Member from determining the composition of its delegation in Appellate Body proceedings ... we rule that it is for a WTO Member to decide who should represent it as members of its delegation in an oral hearing of the Appellate Body.<sup>27</sup>

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<sup>27</sup>Report of the Appellate Body in the EU Banana Regime, para. 10.

4.23 In addition, we note that the Appellate Body recognized the importance of representation by counsel of a government's own choice not only in the Appellate Body proceedings, but also during the entire dispute settlement proceeding, including the Panel proceeding. Moreover, the Appellate Body emphasized the crucial nature of this right for developing countries, such as Indonesia, in particular. According to the Appellate Body:

We also note that representation by counsel of a government's own choice may well be a matter of particular significance - especially for developing-country Members - to enable them to participate fully in dispute settlement proceedings. Moreover, given the Appellate Body's mandate to review only issues of law or legal interpretation in panel reports, it is particularly important that governments be represented by qualified counsel in Appellate Body proceedings.<sup>28</sup>

4.24 The Appellate Body recognizes that each WTO Member may freely compose its delegation to the Appellate Body. We believe that the Appellate Body finding applies to Panel proceedings as well because nothing in the WTO agreements restricts a Member's right to compose its delegation in Panel proceedings.

(d) GATT past practice does not and cannot circumvent Indonesia's sovereign right

4.25 In earlier dispute settlement proceedings under the GATT, delegations were, in virtually every instance, composed solely of government representatives. This practice does not circumvent Indonesia's right to include outside counsel as accredited members of its dispute settlement delegation. The fact that in the past developing countries chose not to include outside counsel in their delegations (or were bullied by complainants such as the United States not to do so) does not block Indonesia from exercising its rights under international law to choose its representatives to the dispute proceeding. This right would be lost only if the WTO Agreement or the DSU limited who could be members of a delegation. As noted by the Appellate Body in the passage from the Bananas case quoted above, there is no such limitation. Further, as also recognized by the Appellate Body, customary international law and the practice of other international dispute settlement tribunals uniformly support a country's right to select the representatives of its choice. As a matter of international law, then, past GATT practice does not prevent Indonesia from accrediting outside counsel as members of its delegation.

4.26 Also, the change in the nature of GATT/WTO dispute settlement undercuts the importance of past GATT practice. Under the GATT, panel decisions (indeed, all stages of a proceeding) could be blocked by either party, including the losing party. Dispute settlement was viewed principally as part of the "diplomatic" process. Due largely to the insistence of the United States, the diplomatic process was replaced by a "judicial" process, in which the losing party cannot block a panel (or Appellate Body) decision.

4.27 Having expert counsel in a binding, "judicial" WTO proceeding is infinitely more important than it was in non-binding GATT proceedings. Because of the radical change in the dispute settlement system, prior GATT practice is not relevant. Thus, for practical reasons as well as under principles of international law, Indonesia's sovereign right to include outside counsel on its delegation is not affected by past GATT practice.

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<sup>28</sup>See Report of the Appellate Body in the EU Banana Regime, para. 12.

(e) Practical and equitable considerations mandate that Indonesia not be denied its right

4.28 As the Appellate Body has recognized, in order to participate on equal terms with Complainants and other countries with large corps of trade lawyers, Indonesia must be allowed to select its counsel for WTO dispute settlement proceedings. USTR, the European Communities and Japan each have a cadre of attorneys with substantial experience in WTO matters. In contrast, Indonesia has only a few attorneys with experience in trade disputes before the WTO. The language barrier adds another burden to Indonesia's effective representation because the WTO proceeding will be conducted in English, both with regard to written submissions and oral presentations.

4.29 The WTO will not be a meaningful and fair forum in which countries can resolve trade disputes unless the interests of all parties to the disputes are represented efficiently and effectively and in accordance with their wishes. Without the support of outside counsel, Indonesia's interests will not be adequately represented in this proceeding.

4.30 We refer the Panel and complainants to the writings of the eminent WTO scholars William Davey, John Jackson and Alan Sykes. In regard to what these three experts describe as the "basic problems" of developing countries in WTO dispute settlement proceedings, they conclude that developing countries such as Indonesia "clearly are not as able to use the dispute settlement system as developed countries".

4.31 Principles of international law and practices of all the major international dispute settlement tribunals and international organizations, including the WTO Appellate Body, support Indonesia's position to have counsel of its choice to represent its interests during the WTO proceedings. Complainants' objections to Indonesia's inclusion of outside counsel in its delegation to the WTO are groundless and contravene principles of international law and practices of international organizations and the spirit of equity in the WTO. Moreover, the objections comprise a litigation strategy designed to disadvantage Indonesia in the WTO proceeding. In this regard, complainant United States, in particular, employs the very device it states excluding outside counsel will preclude.

4.32 The Panel should ignore complainants' objections and recognize Indonesia's sovereign right to counsel. Any other decision, including any compromise, will taint the proceeding and, indeed, completely undermine the legitimacy of the WTO as a body for resolving disputes between developed nations with substantial WTO expertise and significant political and economic power and developing countries lacking such expertise and power.

4.33 At the first substantive meeting, **Japan** made the following arguments before the Panel:

4.34 Regarding the issue of the participation of private lawyers, Japan has some systemic concerns, in particular the following two:

- i) First, dispute settlement proceedings under the auspices of GATT/WTO have been supposed to be intergovernmental. The presence of private lawyers would change this intergovernmental character.
- ii) Second, since private lawyers may not be subject to disciplinary rules such as those applied to members of governments, Japan has some concerns about the breaches of confidentiality.

4.35 In this regard, Japan prefers the non-participation due to the preceding concerns, but Japan understands that it is the Panel who should decide on this issue. However, Japan believes that it would be essential for the Panel to ensure the observance of the general rules applied to the participants of the Panel, including confidentiality, in case the Panel allows their participation.

B. Preliminary Objection to the United States' Claims Regarding the \$US690 Million Loan to TPN

4.36 Indonesia raised a preliminary objection to the United States' claims with respect to the \$US690 million loan to TPN, on the basis that this loan was not within the Panel's terms of reference. On 3 December 1997, the Panel heard arguments and made a ruling on this issue.<sup>29</sup>

1. Objection by Indonesia

4.37 The following are **Indonesia's** arguments in support of this objection.

4.38 As a preliminary matter, Indonesia asks the Panel to rule that it will not examine the \$690 million loan discussed at great length by the United States. In its first submission, the United States argues that an August 1997 loan of \$690 million to Timor Putra Nasional is inconsistent with Article III:4 of the General Agreement and Article 2 of the TRIMs Agreement and is a specific subsidy that causes serious prejudice. The August 1997 loan should not be examined by the Panel because it was not raised in the 12 June 1997 request of the United States for the establishment of a panel (WT/DS59/6) or in the Panel's terms of reference.

(a) First, the loan was not raised in the Panel request or the Panel's terms of reference

4.39 Article 6.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the DSU) states that "[t]he request for the establishment of panel ... shall identify the specific measures at issue." In European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (9 September 1997) (para. 143 at p. 64), the Appellate Body examined Article 6.2 and stated:

Article 6.2 of the DSU requires that the claims ... must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending party and any third parties to know the legal basis of the complaint.

4.40 The terms of reference in the present dispute are the standard terms of reference in which the definition of the matter is supplied by Complainants' requests for establishment of a panel. Neither the United States, which now belatedly seeks to inject the loan into this proceeding, nor the other Complainants, identify the loan in their panel requests. The panel in United States-Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway, ADP/87 (27 April 1994) (at para. 336), concluded that:

a matter, including each claim composing that matter, could not be examined by a panel under the [General] Agreement unless that same matter was within the scope of, and had been identified in, the written statement or statements referred to or contained in its terms of reference.

(b) Second, the loan arose after the Panel was established

4.41 The Panel in United States-Restrictions on Imports of Sugar (22 June 1989), BISD 36S/331, concluded that a matter arising after the establishment of a panel is not within the scope of the panel proceeding. The Panel stated:

Since the matter raised by Australia [complainant] had arisen only after the establishment of the Panel by the Council ... , contracting parties had no reason to

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<sup>29</sup>See Findings, section XIV.A.2, for this ruling.

expect that the reallocation of sugar quotas among Caribbean countries [the matter] would be an issue before the Panel. The Panel therefore decided that this reallocation was not part of its mandate.<sup>30</sup>

Furthermore, in United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (para. 3.5.), the panel concluded that "its terms of reference [did] not permit it to examine 'any new measure which may come into effect during the Panel's deliberations'." Id. at para. 3.5.

(c) Third, the United States cannot "cure" its omission of the loan from its Panel request by discussing the loan in its first submission

4.42 In European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (9 September 1997), the Appellate Body stated that:

If a claim is not specified in the request for the establishment of a panel, then a faulty request cannot be subsequently "cured" by a complaining party's argumentation in its first written submission to the panel or in any other submission or statement made later in the panel proceeding.<sup>31</sup>

As did the United States here, in United States-Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil (19 June 1992), BISD 39S/128, Brazil made arguments in its first submission concerning issues not raised in consultations or in its request for the establishment of a Panel. The Panel rejected Brazil's arguments and concluded that the terms of reference were "limited to the matters raised by Brazil in its request for the establishment of this Panel".<sup>32</sup>

4.43 For the foregoing reasons, the Panel should rule that it will not examine any claim by the United States regarding the August 1997 loan.

## 2. Response of the United States

4.44 Indonesia argues that the Panel should not consider the \$690 million government-directed loan because it was not raised in the United States request for a panel. It is true that the loan was not identified in the United States request, because the loan had not yet been made.

4.45 However, there is precedent for panels taking a more flexible and dynamic approach to disputes than the rigid straitjacket advocated by Indonesia. In India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/R (issued 5 September 1997) ("Indian Mailbox") the panel rejected an Indian request to bar a United States claim because the claim had not been included in the United States request for a panel. Because the new claim of the United States in that case addressed the same "problem" identified in the United States request for a panel, the panel concluded that the new claim was within the panel's terms of reference.

4.46 Here, the United States clearly indicated in its request for a panel that the "problem" was the National Car Programme, which resulted in, among other things, the discriminatory treatment of imported auto parts and subparts and subsidies that caused serious prejudice to the interests of the United States. The \$690 million government-directed loan is merely the most recent component of the National Car Programme, a component that exacerbates the problem previously identified in the United States' request for a panel.

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<sup>30</sup>At para. 5.8 (emphasis added).

<sup>31</sup>At 64, para. 143 (second emphasis added).

<sup>32</sup>At para. 6.2.

4.47 This Panel demonstrated that it would not be bound by the mainstream of GATT dispute settlement practice when it decided to allow Indonesia's private counsel to participate in the meetings of the Panel. With respect to the admissibility of the \$690 million government-directed loan to TPN, the Panel should show similar flexibility by following the lead of the Indian Mailbox panel.

4.48 In the recent report in Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, the panel declined to make a preliminary ruling on a jurisdictional issue similar to the issue raised by Indonesia. Contrary to Indonesia's assertion, this was not because the panel lacked guidance on the issue, but because it is standard panel practice to defer decisions on such issues to the final panel report. These types of issue are not procedural, but instead are substantive. To resolve these issues, a panel is required to make findings of fact.

4.49 In this case, to resolve the issue raised by Indonesia, the Panel will have to make findings as to whether or not the \$690 million government-directed loan is merely one aspect of a single measure, the National Car Programme, or whether it is a separate measure in itself. This question implicates many other issues raised in this dispute, because Indonesia's defence concerning several claims of the Complainants is based on the proposition that the National Car Programme can be divided up into individual "programmes", some of which allegedly have expired.

4.50 The United States submits that the Panel should not prejudge the outcome of these issues one way or another by making a ruling on a preliminary objection, especially when standard practice is to defer such rulings to the final panel report.

#### C. Business Proprietary Information

4.51 Indonesia requested the Panel to require the United States to submit, prior to the first substantive meeting of the Panel with the parties, certain information characterized by the United States in its first submission as "business proprietary". The United States indicated in its first submission that it had further information in its possession that was relevant to its serious prejudice claims but that the information was "business proprietary" and the United States was reluctant to provide it to the Panel in the absence of "adequate procedures" to protect such information. At its first meeting with the parties, the Panel heard arguments and made a ruling with respect to this issue.<sup>33</sup>

##### 1. Request of Indonesia

4.52 The United States refers obliquely to confidential data in its possession which it claims would demonstrate serious prejudice and threat thereof if only the Panel process could be trusted with the data, which then would allow the United States to present it. (See Section VIII.B.) This presentation is inadequate. The United States has the burden of establishing serious prejudice on the basis of positive evidence and it cannot hide behind the claimed sensitivity of its "data."

4.53 The United States tactic raises issues of fairness, as well. The goal of the United States, apparently, is to allow itself to be "forced" to present the data in its second submission, to which, of course, the Government will have no opportunity to respond in its second submission.

4.54 This gamesmanship undermines the legitimacy of the Panel proceeding. The United States is well aware that the WTO - like the United States International Trade Commission and the United States Department of Commerce - has procedures to protect confidential data. Article 18.2 of the DSU designates all written submissions to the Panel as "confidential." According to Article 18.2:

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<sup>33</sup>See Findings, section XIV.A.3, for this ruling.



Members shall treat as confidential information submitted by another Member to the Panel or the Appellate Body which that Member has designated as confidential.

Article 18.2 also provides that, on request, a Member submitting confidential data shall “produce a non-confidential summary of the [confidential] information” contained in its written submission.

4.55 The United States, however, treats this proceeding as no-holds-barred litigation and, to secure an advantage, pretends that Article 18 does not exist, acting as though this is the first time the issue of confidentiality has arisen. The Panel should not countenance this attempt by a developed, experienced, sophisticated WTO Member to gain an unfair advantage over Indonesia. Rather, the Panel should require the United States to submit its confidential data immediately, prior to the 3-4 December 1997 hearing. The data should be available for review and comment by the legal experts hired and accredited by Indonesia and informative non-confidential summaries should be given to the Indonesian delegation. Moreover, Indonesia must be given an opportunity to review and respond fully to the data and to any additional United States argumentation based on it.

## 2. Response of the United States

4.56 The issue raised by Indonesia is much ado about nothing. Regarding business proprietary information, in its first submission the United States noted that it had additional information in its possession documenting the plans and projections of General Motors, Ford, and Chrysler with respect to the Indonesian motor vehicle market. The United States indicated that it was reluctant to provide such information to the Panel unless the Panel first established adequate procedures to protect such information. Indonesia claims that this legitimate desire to ensure the protection of business proprietary data constitutes an unfair tactic and that the protection of business proprietary data is adequately ensured by Article 18.2 of the DSU.

4.57 Article 18.2 of the DSU merely recognizes that confidential information should be treated as confidential, but in itself does not establish procedures for ensuring the protection of such information. Therefore, the United States was justified in being cautious with the information supplied to it by private companies.

4.58 Be that as it may, while the United States reserves its right to submit additional factual information in this proceeding, at this point, the United States does not intend to submit the business proprietary information we have been discussing. The information in question relates to the plans of United States auto-manufacturers to enter, or expand their presence in, the Indonesian passenger car market, plans that were cancelled in light of the introduction of the National Car Programme. The information included in the first United States submission summarizes that information in a non-confidential manner, and Indonesia has not disputed the accuracy of this data or the existence of the United States manufacturers' plans. Indeed, an attachment to Indonesia's first submission to the Panel corroborates this information and the existence of these plans. Therefore, there is no present need to submit this information, because the points that this information would corroborate are uncontested by Indonesia.

4.59 At no place in Indonesia's first written submission to the Panel does Indonesia contest the existence of the United States manufacturers' plans to enter, or expand their presence in, the Indonesian passenger car market. At the first meeting of the Panel, Indonesia announced, for the first time, that it does, indeed, contest the existence of these plans. If Indonesia plans to revise its defence by submitting rebuttal information of its own, then the United States, of course, reserves its own right to counter that information with information of its own.

4.60 Moreover, the United States notes the following statement of the Appellate Body in its report in the Bananas case: "There is no requirement in the DSU or in GATT practice for arguments on all

claims relating to the matter referred to the DSB to be set out in a complaining party's first written submission to the panel." (para. 145).

D. Request from Indonesia for Termination of the Panel with Respect to the National Car Programme

4.61 On 26 February 1998, **Indonesia** officially submitted to the Panel a copy of a letter from Indonesia to the Chairman of the SCM Committee, which letter Indonesia requested the Chairman of the Committee to consider as a formal modification of its notification of subsidies granted to the National Automobile Industry (G/SCM/N/16/IDN). This notification, to which were attached copies of the referenced decrees and regulations issued on 21 January 1998, states the following:

4.62 On 21 January 1998, the Government of Indonesia took the following actions:

- Presidential Decree No. 20/1998<sup>34</sup> revoked Presidential Decree No. 42/1996 (4 June 1996) and declared Presidential Instruction No. 2/1996 (19 February 1996) obsolete, thereby terminating the authority for further import duty and luxury tax exemption subsidies to producers of a national car.
- Minister of Industry and Trade Decree No. 19/MPP/Kep/1/1998<sup>35</sup> revoked (effective 2 February 1998) Minister of Industry and Trade Decree No. 31/MPP/SK/2/1996 (19 February 1996) and all departmental regulations issued pursuant to it to implement Presidential Instruction No. 2/1996.
- Minister of Industry and Trade Decree No. 20/MPP/Kep/1/1998<sup>36</sup> revoked (effective 2 February 1998) Minister of Industry and Trade Decree No. 142/MPP/Kep/6/1996 (5 June 1996), which had authorized production of national cars to be carried out overseas for a one-year period, in implementation of Presidential Decree No. 42/1996. (This decree already had terminated by its own terms.)
- Government Regulation No. 14/1998<sup>37</sup> amended Government Regulation No. 50/1994 (28 December 1994), as previously amended by Government Regulation No. 20/1996 (19 February 1996) and by Government Regulation No. 36/1996 (14 June 1996), so as to eliminate (effective 2 February 1998) the exemption of national cars from payment of the luxury sales tax.
- Minister of Finance Decree No. 19/KMK.01/1998<sup>38</sup> revoked (effective 2 February 1998) Minister of Finance Decree No. 404/KMK.01/1996 (7 June 1996), which had exempted national cars produced overseas (during the one-year period specified in Minister of Industry and Trade Decree No. 142/MPP/Kep/6/1996) from payment of the customs import duty. (This decree already had terminated by its own terms.)
- Minister of Finance Decree No. 20/KMK.01/1998<sup>39</sup> amended Minister of Finance Decree No. 36/KMK.01/1997 (21 January 1997) to delete (effective 2 February 1998) the authority to exempt parts and components for assembly or manufacture of national cars from payment of the customs import duty.

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<sup>34</sup>Indonesia Exhibit 51.

<sup>35</sup>Indonesia Exhibit 52.

<sup>36</sup>Indonesia Exhibit 53.

<sup>37</sup>Indonesia Exhibit 54.

<sup>38</sup>Indonesia Exhibit 55.

<sup>39</sup>Indonesia Exhibit 56.

4.63 On 27 February 1998, the Panel sent a communication to all parties concerning this subsidy notification received from Indonesia. The Panel asked Indonesia to inform the Panel what action, if any, Indonesia requested the Panel to take on the basis of the notification, and what Indonesia believed to be the legal implications of the notified revocations for the panel process. The Panel asked the complainants to respond to Indonesia's comments.

1. Request from Indonesia

4.64 **Indonesia** responded to the Panel as follows:

4.65 The Government of Indonesia believes that, given the actions it took on 21 January 1998 (as set out in our 25 February letter), the dispute settlement proceeding should be terminated, at least as it relates to the measures originally promulgated in 1996 to promote the National Car Programme.<sup>40</sup> We would hope that the three complaining parties would choose to withdraw their complaints. If they do not, though, the Panel should terminate the proceeding and issue a report limited to declaring that the matter was resolved through the abolition of the measures at issue.

4.66 As set out in Indonesia's letter of 25 February, the decrees and regulations issued by the Indonesian Government on 21 January revoked or amended all of the decrees, instructions and regulations implementing measures to promote the National Car Programme which allegedly were inconsistent with Indonesia's obligations under the General Agreement, the SCM Agreement, the TRIMs Agreement and the TRIPs Agreement. (In the two instances in which decrees were amended rather than revoked, the amendment abolished all measures in the decree that previously had benefited the National Car Programme.) All of the decrees, instructions and regulations cited in each of the complaining parties' request for establishment of a panel (at least, regarding the National Car Programme) were revoked (or amended in relevant part), and all of the measures to promote the National Automobile Industry which were thereby implemented ceased to be in effect.

4.67 Article 19.1 of the DSU provides that:

[w]here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. (Footnote omitted.)

4.68 Article 3.7 of the DSU confirms that this forward-looking remedy - elimination of an inconsistent measure - is the only WTO-consistent remedy. Therefore, even if the measures to promote the National Automobile Programme had been inconsistent with a provision of the WTO (which Indonesia does not accept), there is nothing further to remedy. Under such circumstances, it would be inappropriate for the Panel to do more than note the termination of the measures and declare that no determination is warranted as to the claimed WTO inconsistency of them.

4.69 Prior Panel decisions support the refusal to rule on an expired measure, as previously set out by Indonesia (See section VII.D(c)). In Thailand-Restrictions on Importation of and Internal Taxes on Cigarettes (7 November 1990), BISD 37S/200, prior to the panel's decision, Thailand issued regulations eliminating the discriminatory elements of two taxes. Even though the underlying authority to reimpose discriminatory taxes remained in effect, the panel concluded that the current regulations were consistent with Thailand's GATT obligations.

4.70 In the 1989 dispute regarding EEC-Restrictions on Imports of Dessert Apples (22 June 1987), BISD 36S/93, the EEC measures lapsed prior to the Panel's decision. Chile urged the panel to rule that

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<sup>40</sup>See Findings, section XIV.A.4, for the Panel's ruling on this request.

the EC should offer compensation since a ruling that the measures should be withdrawn would be meaningless. The panel refused to do so.

4.71 These prior panel decisions support the conclusion that, since the measures promoting the National Car Programme and their underlying legal authority have expired, the Panel should declare that no decision on the merits of the alleged inconsistency with WTO agreements is appropriate.

2. Response of Japan

4.72 **Japan** responded to the Panel as follows:

4.73 The Government of Indonesia expressed its hope that the complaining parties would withdraw the complaints. In addition, Indonesia argued that, if the complaining parties do not do so, the Panel should nevertheless terminate the proceeding and issue a report limited to declaring that the matter was resolved through the abolition of the measures at issue.

4.74 The Government of Japan finds it difficult to share the view of Indonesia. Japan still does not believe that a mutually satisfactory solution has been achieved. Unless such a mutually satisfactory solution is obtained between the parties, a panel is obliged to submit its findings to the DSB as described in Article 12:7 of the DSU. Article 12 of the DSU requires a panel to follow the procedures and not to unilaterally terminate the proceeding. In this regard, there are three elements Japan would particularly like to point out.

(a) It is still not clear whether the National Car Programme has been fully terminated

4.75 First, some parts of the decrees issued by the Indonesian Government are still unclear in their implications. For example, the decrees did not explicitly revoke the Presidential Decree No. 2/1996, which Japan believes is the most important basis for the National Car Programme, while declaring it "obsolete" instead.

4.76 Second, and more importantly, the Government of Japan has not been convinced that all the exemptions of import duties and luxury taxes have been terminated. As we all can recall, at the second Panel meeting, Indonesia explained that the Indonesian Government would request PT Timor to return the benefits already given to it, since it failed to meet the requirements of the June 1996 programme and the first year requirements of the February 1996 programme. Despite this statement, however, Japan has been informed that favourable treatment under the Programme in question might continue for Timor cars remaining stock, including unsold Korean made National Cars.

4.77 Japan is trying to gather further information from the Indonesian Government regarding these factual matters.

(b) The Government of Indonesia has not provided any assurances that it will not introduce the measures of the same nature as the National Car Programme, i.e. discriminatory measures to benefit specific domestic products

4.78 It should be noted that Indonesia in its letter of 2 March still denies the inconsistency of the National Car Programme with its obligations under the relevant provisions of the WTO Agreements. This, together with unclarity regarding the termination of the Programme makes it difficult for Japan to judge, at this stage, whether the Government of Indonesia has decided against introducing programmes of the same kind in the future.

(c) Even if measures are eliminated, a panel can and should rule on them

4.79 The Government of Japan is of the view that even if measures are eliminated, a panel still can and should rule on them. In fact, Japan has already discussed this issue before this Panel.

4.80 As already described more fully by Japan (See section X.B.3 and 4), Japan believes that it has been the usual practice of GATT/WTO panels to rule at least on measures that were effective at the time the panel's terms of reference were fixed, even if such measures later became ineffective before the panel rendered its ruling. "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system", as described in Article 3:2 of the DSU. In this respect, if a panel should not rule on this kind of occasion, a WTO Member might easily evade the WTO reviews.

4.81 Japan sincerely hopes that the Panel will continue to review this case.

3. Response of the European Communities

4.82 The **European Communities** responded to the Panel's request as follows:

4.83 For the reasons set out below, the European Communities disagree with Indonesia's demand and respectfully request the Panel to rule on all the claims within its terms of reference, including those concerning the 1996 National Car Programme.

4.84 The legal consequences of the measures enacted by Indonesia on 21 January 1998 are far from clear. For instance, Presidential Instruction No. 2/1996 has not been revoked but merely declared "obsolete" by Presidential Decree Number 20/1998. The precise implications of a declaration of "obsolescence" by what appears to be a norm of inferior rank are unclear. It is also unclear to the European Communities how, if at all, the measures of 21 January 1998 will apply to those cars imported from Korea which have not been sold yet.

4.85 In the European Communities' view, there is no good reason for the Panel to take any decision as regards these and other similar issues precipitately and on the basis of the limited information which has been made available by Indonesia. We consider that the Panel should complete its report in the normal fashion, and that the issues raised by Indonesia should be clarified and decided within the framework provided by Article 21 of the DSU. If the measures taken on 21 January 1998 already constitute appropriate implementation of the DSB recommendations in this case, Indonesia will find itself in the enviable position of not having to adopt any further implementing measures. On the other hand, if it was established in accordance with Article 21 of the DSU that such is not the case, the complainants would have access to the mechanisms provided in the DSU in case of non-compliance with the recommendations of the DSB.

4.86 Furthermore, it must be noted that the measures taken on 21 January 1998 do not provide for the reimbursement of the benefits already granted under the National Car Programme. As a result, those subsidies will continue to benefit future sales of National Cars. Accordingly, whether or not the measures adopted on 21 January 1998 are considered to have revoked effectively the National Car Programme, the Panel will be required to rule on the compatibility of those subsidies with the SCM Agreement.

4.87 Similarly, as admitted implicitly by Indonesia, the measures adopted on 21 January 1998, do not effect the 1993 Programme. Thus, again, the Panel, will in any event have to issue a report ruling on the claims regarding the 1993 Programme, whether or not the 1996 National Car Programme is deemed to have been effectively revoked.

4.88 Contrary to Indonesia's arguments, past practice supports the European Communities' request that the Panel rule on all the claims within its terms of reference. Under GATT 1947, several panels<sup>41</sup> considered measures that were no longer in force in cases where, as in the present dispute, the measures were still in force at the time the Panel was established.

4.89 This practice has continued under the WTO Agreement. In US - Standards for Reformulated Gasoline<sup>42</sup>, the Panel decided not to rule on a discontinued measure, but only because the measure had been terminated before the terms of reference were established and was unlikely to be renewed. In US - Measures affecting imports of Woven Wool Shirts and Blouses from India, the Panel decide that:

"in the absence of an agreement between the parties to terminate the proceedings, we think that it is appropriate to issue our final report regarding the matter set out in the terms of reference of this Panel in order to comply with our mandate [...] notwithstanding the withdrawal of the US restraint"<sup>43, 44</sup>

4.90 For the reasons set out above, the European Communities respectfully request the Panel to reject Indonesia's demand and to rule on all the claims within its terms of reference, including those relating to the 1996 National Car Programme.

#### 4. Response of the United States

4.91 The **United States** responded to the Panel's request as follows:

4.92 The United States does not concur in Indonesia's request.<sup>45</sup>

4.93 By way of background, by letter dated 25 February 1998, Indonesia informed the Chairman of the SCM Committee that Indonesia purportedly "had terminated all subsidies previously granted to the National Automobile Industry." Notwithstanding the fact that the deadline for submitting information and argument in this dispute closed on 30 January 1998, Indonesia provided copies of this letter, and the attachments thereto, to the Panel, the Chairman of the Dispute Settlement Body, and the complainants in this dispute.

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<sup>41</sup>See for instance the Panel Report on European Communities - Restrictions on Imports of Dessert Apples, Complaint by Chile, adopted on 22 June 1989, BISD 36S/93; the Panel Report on EEC - Restrictions on Imports of Apples, Complaint by the United States, adopted on 22 June 1989, BISD 36S/135; the Panel on United States - Prohibition of Imports of Tuna and Tuna Products from Canada, adopted on 22 February 1982, BISD 29S/91; the Panel Report on EEC - Restrictions on Imports of Apples from Chile, adopted on 10 November 1980, BISD 27S/98; and the Panel Report on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49.

The panel reports invoked by Indonesia do not support its position, as already demonstrated by Japan in its second submission to the Panel (see Section X.B.4).

<sup>42</sup>Panel Report on United States - Standards for Reformulated Gasoline, WT/DS2/R, adopted on 20 May 1996, para. 6.19.

<sup>43</sup>Panel Report on United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, adopted on 23 May 1997, WT/DS33/R, para.6.2.

<sup>44</sup>In Argentina - Certain measures affecting Imports of Footwear, Textiles, Apparel and Other Items (WT/DS56/R, at pp.83-86, on appeal) the Panel decided not to rule on a measure which was revoked after the circulation of the request for the establishment of a Panel but before the DSB agreed to the establishment of the Panel.

<sup>45</sup> The United States also does not concur in any termination of this proceeding with respect to the 1993 Programme, and notes that the measures notified by Indonesia to the SCM Committee do not affect the 1993 Programme.

4.94 In a communication dated 27 February 1998, the Panel requested that Indonesia inform the Panel by 2 March as to "what action, if any, it requests the Panel to take on the basis of this notification and why, and what it believes to be the legal implications of these revocations for the panel process." The Panel also requested the complainant parties in this dispute to respond to Indonesia's comments by 6 March.

4.95 At the outset, the United States must express some dismay that the Panel even has considered Indonesia's untimely submission. Having said that, however, the United States appreciates being afforded the opportunity to comment on Indonesia's request. For the reasons set forth below, the United States does not concur in Indonesia's request.

(a) The Measures at Issue Are Within the Panel's Terms of Reference

4.96 Indonesia's request relates only to "the measures to promote the National Automobile Programme."<sup>46</sup> Indonesia does not dispute that these measures are within the Panel's terms of reference. The only question is whether a Panel is free, notwithstanding its terms of reference, to decline to make a finding on measures within its terms of reference at the request of the responding party. The United States submits that a Panel may not.<sup>47</sup> The fact that the responding party claims that the measures have been withdrawn does not change this legal conclusion.

(b) Established GATT and WTO Panel Practice Is to Make Findings on Measures that Are Withdrawn Subsequent to the Establishment of a Panel's Terms of Reference

4.97 Even assuming, for purposes of argument, that the measures comprising the National Car Programme have been revoked and have ceased to have any legal or operational effect, Indonesia is not entitled to a termination of this dispute absent agreement by the complaining parties. Prior GATT and WTO practice dictates that a panel should make findings on discontinued measures covered by its terms of reference in situations where, as is the case here, a measure was in force at the time the panel was established.<sup>48</sup> This practice was most recently reaffirmed in United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/R, Report of the Panel, as modified by the Appellate Body, adopted on 23 May 1997, para. 6.2.

4.98 Indonesia's references to Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, DS10/R, Report of the Panel adopted on 7 November 1990, BISD 37S/200, and EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile, L/6491, Report of the Panel adopted on 22 June 1989, BISD 36S/93, are inapposite. With respect to Thai Cigarettes, Japan previously has demonstrated how that report does not support Indonesia's position.<sup>49</sup> Moreover, even if the Panel should not accept Japan's demonstration, Thai Cigarettes is an aberration from the mainstream of GATT and WTO practice.

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<sup>46</sup> See page 2 of 2 March 1998 letter from Indonesia to the Panel.

<sup>47</sup> Note that the Appellate Body has also spoken on the failure of a panel to make a finding on a measure within its terms of reference. In Japan - Taxes on Alcoholic Beverages (WT/DS8/AB/R), the Appellate Body stated that:

We note that the Panel's conclusions on "like products" and on "directly competitive or substitutable products" contained in paragraphs 7.1(i) and (ii), respectively, of the Panel Report fail to address the full range of alcoholic beverages included in the Panel's Terms of Reference. ... We consider this failure to incorporate into its conclusions all the products referred to in the Terms of Reference, consistent with the matters referred to the DSB in WT/DS8/5, WT/DS10/5 and WT/DS11/2, to be an error of law by the Panel. (Page 26)

<sup>48</sup> The parties previously have addressed this issue in connection with Indonesia's argument that the complainants' claims concerning the June 1996 measures are moot. (See section VII.E.3 and X.C).

<sup>49</sup> See Section X.B.4.

4.99 As for Dessert Apples, it directly contradicts Indonesia's position. In that case, the panel did make findings of GATT inconsistency with respect to measures that had expired after the panel's establishment. What the panel declined to do, and properly so, is recommend, as requested by Chile, that the EEC provide compensation.

(c) It Is Not Established that the Measures Have, in Fact, Expired

4.100 Assuming, for purposes of argument, that a panel may ignore its terms of reference and decline to make findings with respect to a measure that has expired subsequent to the panel's establishment, Indonesia has failed to establish that the measures that comprise the National Car Programme have expired. At best, the status of these measures remains unclear.

4.101 Looking at the measures from one perspective, and taking Indonesia at its word, the measures still have legal and operational effect with respect to products imported and sold prior to the revocation of those measures. According to Indonesia, the local content requirements of these measures, and TPN's failure to satisfy those requirements, continue to constitute the basis for seeking repayment by TPN of previously forgiven duties and taxes.<sup>50</sup> These measures will be the governing legal instruments should TPN challenge any Government demand for repayment of duties and taxes.

4.102 Looking at the measures from a different perspective, it is questionable whether the benefits conferred by the various legal instruments (as opposed to the legal instruments themselves) really have been withdrawn. Notwithstanding Indonesia's assurances to the Panel and the complainants, it was reported in February that TPN had requested that the Government of Indonesia provide a tax exemption for those Timor Kia Sephias that remain unsold.<sup>51</sup> The Government apparently was willing to consider TPN's request, because Indonesia's Minister of Industry and Trade was quoted as stating: "I am having discussions with the finance minister over whether these 15,000 cars will be exempted from the taxes like those imported with them."<sup>52</sup> It now appears that the Government, did, indeed, grant TPN's request, deciding "that the remaining 15,000 cars could maintain their tax exemptions."<sup>53</sup>

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<sup>50</sup> In a question to Indonesia, the United States described Indonesia's position as follows: "[A]ccording to Indonesia, TPN will have to reimburse the Government of Indonesia for import duties and luxury taxes that were exempted under Decree No. 42/96." Questions from the United States to Indonesia, 15 January 1998, page 1. The United States asked Indonesia to confirm whether this description was accurate. Id. Indonesia confirmed that this description was accurate. Answers of Indonesia to the 15 January 1988 Questions of the United States. Indonesia also stated to the Panel that the relevant Customs District Office "will issue a letter to TPN demanding payment of the customs import duties and luxury sales tax due by virtue of TPN's failure to satisfy the criteria of the National Car Programme for the first year." Importation, Enforcement and Effect of TPN's Non-Fulfillment, submitted by Indonesia on 30 January 1998.

<sup>51</sup> "Timor Car Project Has 'Moral Obligation' to Continue," Asia Pulse (19 Feb. 1998) (US Exhibit 41, p. 1).

<sup>52</sup> "Minister Asks Indonesian 'National Car' Maker to Evaluate Viability," Agence France Presse (19 Feb. 1998) (US Exhibit 41, p.2).

<sup>53</sup> "Indonesia Chief Falls Short on Promised Economic Reforms", New York Times (5 March 1998) (US Exhibit 41, pp. 3-5); see also "Indonesia Defends Car Tax Break," AP Online (5 March 1998) (US Exhibit 41, pp. 6-7); "Indonesia Dodging IMF Reform Demands...Again, Say Analysts", Agence France Presse (3 March 1998) (US Exhibit 41, pp. 8-10); and "Several IMF Conditions Go Unheeded in Indonesia", The Boston Globe (3 March 1998) (US Exhibit 41, pp. 11-14).



4.103 Moreover, in the statement quoted in the preceding paragraph, the Minister of Industry and Trade describes the issue as “whether these 15,000 [unsold] cars will be exempted from the taxes like those imported with them [i.e., the previously sold cars].” (Emphasis added). This suggests that, notwithstanding its prior assurances to the Panel and the complainants, Indonesia did not require TPN to reimburse the Government for luxury taxes owed on those cars that had been sold prior to the completion of the local content audit. In addition, it is now entirely unclear what has happened with respect to the forgone import duties owed on those cars that were sold and those that remain unsold.

4.104 Finally, it must be emphasized that none of the measures notified by Indonesia to the SCM Committee provides for the reimbursement of the subsidies already conferred under the National Car Programme. As previously demonstrated by the United States, these subsidies constitute “non-recurring” subsidies that will benefit future sales of cars produced by TPN, a point that Indonesia did not seriously dispute.<sup>54</sup> Thus, whether or not the measures notified by Indonesia to the SCM Committee can be considered as revoking the legal instruments that make up the National Car Programme, the Panel will be required to consider the subsidies conferred by these legal instruments in connection with the US and EC claims under the SCM Agreement.

(d) A Termination of the Dispute Would Diminish US Rights Under the DSU

4.105 It is axiomatic that rulings of panels “cannot add to or diminish the rights and obligations provided in the covered agreements.” Article 19.2, DSU. Pursuant to Article 1 and Annex 1 of the DSU, the DSU itself is a “covered agreement.” In the context of this case, under Article 21 of the DSU, the United States has the right to ensure that the National Car Programme is withdrawn and stays withdrawn or otherwise is brought into conformity with Indonesia’s WTO obligations. Under Article 22 of the DSU, the United States has the right to compensation or retaliation if these conditions are not fulfilled.

4.106 If the Panel were to grant Indonesia’s request and terminate the dispute settlement proceeding with respect to the National Car Programme, the Panel effectively would be depriving the United States of its rights under Articles 21 and 22 of the DSU. Because the Panel would not have made any findings that the measures were inconsistent with Indonesia’s WTO obligations, Indonesia arguably would be free at that point to reintroduce these measures, and the United States would have to commence an entirely new dispute settlement proceeding.

4.107 The evidence suggests that such a scenario is highly plausible. Newspaper reports indicate that subsidization of the National Car is continuing.<sup>55</sup>

4.108 Finally, the facts developed in this proceeding should make the Panel extremely sceptical of any claims by Indonesia that the discrimination against imports from the complainants and the subsidization of TPN under the National Car Programme have ended. Consider the following:

- The history of the National Car Programme, particularly the manner in which TPN was selected to be the producer of the National Car;<sup>56</sup>
- The obvious contradiction between Indonesia’s denial that the joint venture between TPN and Kia Motors was to be the producer of the National Car and all of the evidence to the contrary, including the third-party submission by Korea;<sup>57</sup>

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<sup>54</sup> See Sections VIII.B.2(b) and VIII.B.4(c).

<sup>55</sup> “IMF Effort Not Working, Suharto Tells Clinton”, The Washington Post (17 Feb. 1998) (US Exhibit 41, pp. 15-18). “Indonesia Chief Falls Short on Promised Economic Reforms”, New York Times (5 March 1998) (US Exhibit 41, pp. 3-5). “Indonesian Forest Fund Used for National Car: Camdessus”, Agence France Presse (21 Jan. 1998) (US Exhibit 41, p. 19).

<sup>56</sup>First Submission of the United States, 20 October 1997, paras. 34-80.

- The obvious contradiction between Indonesia's assertion that the Government of Indonesia played no role in the provision of the \$690 million loan to TPN and all of the evidence to the contrary and the fact that the IMF required *the Government* to revoke special credit privileges for the National Car Programme;<sup>57</sup>
- The obvious contradiction between Indonesia's assurance that TPN would be required to reimburse the Government for foregone customs duties and luxury taxes due in connection with the CBU Sephias imported from Korea and the evidence (described above) that the Government is *not* requiring reimbursement;
- The fact that Presidential Decree No. 20/1988 declares Presidential Instruction No. 2/1996 "obsolete" rather than "revoked"; and
- The fact that even in its letter of 2 March 1998, Indonesia continues to insist that the National Car Programme was not inconsistent with its WTO obligations. This indicates that Indonesia feels free to resurrect the measures in question when it determines that the time is ripe.

In short, the status of the National Car Programme remains unclear, and it is not (nor should it be) the Panel's task to predict the future based on the incomplete information available at this time. Instead, these are matters that are properly dealt with under Article 21 of the DSU. If it should turn out that the measures in question constitute adequate implementation of the recommendations by the DSB, Indonesia will have fulfilled its WTO obligations. However, should it be established under Article 21 that the measures in question do not constitute adequate implementation, the United States and the other complaining parties would still have their rights under Article 22.

(e) Conclusion

4.109 Both before and after this Panel was established, the United States sought a mutually acceptable solution with Indonesia of this matter. Indonesia refused, preferring to let the dispute settlement process run its course. It is now inappropriate for Indonesia to seek a termination of this dispute after the case has been fully briefed and argued.

4.110 Accordingly, for the foregoing reasons, the United States respectfully requests that the Panel deny Indonesia's request to terminate this dispute with respect to the National Car Programme.

V. CLAIMS UNDER ARTICLE III OF GATT 1994

A. Claims Under Article III:2, First Sentence of GATT 1994

1. Claims Raised by Japan

5.1 **Japan** claims that the National Car Programme of February 1996 violates Article III:2, first sentence of GATT 1994. (See Section III.A). The following are **Japan's** arguments in support of this claim:

5.2 One of the essential elements of Indonesia's National Car Programme is the discriminatory exemption from the sales tax on luxury goods (luxury tax) which would otherwise be levied on sales of National Cars. This privilege results in imposition of an internal tax on imported "like" automobiles in

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<sup>57</sup>See, e.g., Second Submission of the United States, 23 December 1997, Attachment A, para. 36, note 7.

<sup>58</sup>See, e.g., section VIII.A.2 (footnote 423); and IMF News Brief No. 98/2 (15 Jan. 1998) (US Exhibit 41, pp. 20-22).

excess of that applied to domestically produced National Cars, thus violating Article III:2, first sentence of GATT 1994.

- (a) Article III:2, first sentence requires that sales of imported products not be taxed at rates in excess of rates imposed on like domestic products

5.3 The first sentence of GATT Article III:2 provides that imported products:

"shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products."

Under the recent GATT/WTO precedents, Article III:2, first sentence has been applied in a straightforward manner:

"[T]he words of the first sentence require an examination of the conformity of an internal tax measure with Article III by determining, first, whether the taxed imported and domestic products are 'like' and, second, whether the taxes applied to the imported products are 'in excess of' those applied to the like domestic products."<sup>59</sup>

The National Car Programme meets both of these criteria.

- (b) Luxury tax is an internal tax

5.4 According to Indonesia's relevant laws and regulations, the sales tax on luxury goods is applicable to both domestically manufactured and imported automobiles.<sup>60</sup> The tax is collected from either domestic manufactures or importers, as the case may be.<sup>61</sup>

- (c) National Cars are domestic products

5.5 Under the relevant regulations<sup>62</sup>, National Cars (or National Motor Vehicles) must be "domestically produced by using facilities owned by national industrial companies or Indonesian statutory bodies with total share belonging to Indonesian citizens". The very language of the decree thus makes it clear the National Cars are domestic products. (See Section II.B.2).

- (d) National Cars and imported automobiles are "like" products

5.6 Regarding the legal test for determining "like" products, recent Appellate Body reports have repeatedly affirmed that:

"a determination of 'like products' for the purpose of Article III:2, first sentence, must be construed narrowly, on a case-by-case basis, by examining relevant factors including:

- (i) the product's end-uses in a given market,  
(ii) consumers' tastes and habits and

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<sup>59</sup> Report of the Appellate Body on Japan-Taxes on Alcoholic Beverages ("Japan-Alcoholic Beverage II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted on 4 October 1996 pp.18-19.

<sup>60</sup>Government Regulation No.36/1996 (Japan Exhibit 25). (See also Section II.B.2.)

<sup>61</sup>Decree of Minister of the Finance No.272/KNK.04/1995 (Japan Exhibit 24); Decree of the Ministry of Finance No. 647/KMK.04/1993 (Japan Exhibit 23).

<sup>62</sup>Decree of Minister of the Industry and Trade No.31/MPP/SK/2/1996 (Japan Exhibit 28).

(iii) the product's properties, nature and quality."<sup>63</sup>

5.7 However, in this present case, it is almost meaningless to discuss "likeness", because, even if vehicles identical in all aspects (including the end-uses, properties, nature and quality) with National Cars are manufactured abroad (for example, in Japan) and imported, they would still be treated differently from National Cars.

5.8 Moreover, foreign brand "like" products of National Cars (the Timor S515) actually are sold in the Indonesian auto market. As shown by the Table 11 below, the National Car - Timor Sephia sedans (1500cc) - are no different from other competitive products imported or assembled by other automakers in Indonesia. First, their common end-use in the Indonesian market is passenger transportation. Second, although consumers' brand preferences may exist, the products themselves are generally recognized to belong to the same "sedan" category. Indonesia may contend that the mere fact that the former vehicles are manufactured abroad makes them different (or that Indonesian consumers prefer domestic products, and thus, imported products are not regarded as "like" products of such domestic products). However, these arguments cannot prevail, since it would deny the fundamental principle of Article III.<sup>64</sup>

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<sup>63</sup> Report of the Appellate Body on Canada-Certain Measures Concerning Periodicals ("Canada - Periodicals"), WT/DS31/AB/R, adopted on 30 June 1997, pp. 19-20. Report of the Appellate Body on Japan- Alcohol Beverages II, p.19. See also Working Party Report on Border Tax Adjustment ("Border Tax Adjustment"), L/3464, adopted on 2 December 1970 (BISD 18S/97) para.18.

<sup>64</sup>In this connection, a panel report on Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, adopted on 10 November 1987 L/6216,(BISD 34S/83), stated that, [even if consumers prefer traditional Japanese shochu to vodka]"the traditional Japanese consumers habits with regard to shochu provided no reason for not considering vodka to be a 'like' product," since "the aim of Article III:2... could not be achieved if differential taxes could be used to crystallize consumer preferences for traditional domestic products." See para .5.7 of the Panel Report. Of course, it would be difficult to assume any wider difference between domestic automobiles and imported automobiles for Indonesian consumers than the difference between shochu and vodka for Japanese consumers.

Table 11  
Like Products

Company	P.T. Timor	Toyota	Mitsubishi	Honda	Suzuki
Brand	Timor S515i	Corolla	Lancer	Civic	Baleno SY 416
Category	Sedan	Sedan	Sedan	Sedan	Sedan
Engine displacement	1,500cc	1,600cc	1,600cc	1,600cc	1,600cc
Luxury Tax	0%	35%	35%	35%	35%
Price (1,000Rp) (March 1997)	36,400-36,900	68,300-71,800	65,000-72,000	71,160-74,860	44,750

(e) Imported products are taxed less favourably than "like" domestic products

5.9 As noted earlier, the category, or the concept of, "National Cars" consists, in principle, of domestic products. The regulation at issue accords the luxury tax exemption to this category of domestic products, thereby creating more favourable terms than imported products. In fact, paragraph (4) of Article 23 of Government Regulation No. 50/1994 on the Implementation of Law No.8/1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as amended by the Government Regulation No.20/1996 provides as follows:

"(4) National motor vehicles which are *domestically produced* by using trade marks created by relevant industrial companies themselves ... shall be granted government borne sales tax on luxury goods on their delivery." (*Italics added.*)<sup>65</sup>

On the other hand, under the February 1996 Programme, no imported motor vehicles qualify as the "National Cars" and all imported sedans are subject to 35 per cent luxury tax. [(See **Chart-3**)]\*\*

5.10 This mechanism deprives imported automobiles of an opportunity for tax exemption, which is available for domestic automobiles, precisely because they are imported products. To this extent, this case presents the same issue as a Panel faced in United States - Measures Affecting The Importation, Internal Sale and Use of Tobacco.<sup>66</sup>

5.11 In that case, all imported tobacco was subject to an internal tax (the Budget Deficit Assessment of "BDA"), but not all domestic tobacco was subject to the tax. The Panel found that "the BDA, as currently applied, provided less favourable treatment to imported tobacco than to like domestic tobacco."<sup>67</sup>

<sup>65</sup>Government Regulation No.20/1996 (Japan Exhibit 26); Government Regulation No.36/1996 (Japan Exhibit 25) which amended the former regulation but without relevant substantive changes.

<sup>66</sup> United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco ("United States - Tobacco"), DS44/R, adopted on 4 October 1994.

<sup>67</sup>*Id.* para.90. This panel further found that "an internal regulation which merely exposed imported products to a risk of discrimination ... constitutes, by itself, a form of discrimination, and therefore less favourable treatment within the meaning of Article III." (paras. 92-93, 95-98).

Quite similarly, at issue in this proceeding is tax exemption which is available for some domestic products (i.e., National Cars) but from which no imported products may benefit. Accordingly, imported like products are taxed less favourably than domestic products.

(f) Insignificant market share for imported sedans is not a defence

5.12 For various reasons, imported assembled sedans have earned only a fraction of the Indonesian market. The share of foreign passenger vehicles in the market was 0.28 per cent in 1994, 2.58 per cent in 1995 and 0.29 per cent in 1996.<sup>68</sup> However, previous Panels consistently have rejected a defence based on the insignificant economic consequence of imported products<sup>69</sup>, and there is no reason for this Panel to diverge from that clear precedent.

5.13 Indonesia admits all the facts necessary to establish a violation of GATT Article III:2. The first sentence of Article III:2 prohibits a WTO Member from subjecting imported goods to internal taxes in excess of those applied to like domestic products. Indonesia admits that:

- (1) "The Indonesian luxury tax is an internal tax"; and
- (2) "Under the February 1996 national car programme, the Government excuses [PT Timor] from payment of the luxury tax on the 1500cc Timor S515 ... while imposing the non-subsidized rate of 35 per cent on imports of like products." (See Section V.D.)

Therefore, Indonesia itself admits that it applies greater taxes on imported cars than it applies on like domestic products. No more need be said to establish a *prima facie* violation of the first sentence of Article III:2.

5.14 The Government of Japan continues to submit that the February 1996 Programme also violates the second sentence of Article III:2 (See Section V.B.1), but it considers that this point requires no more argumentation in light of Indonesia's admissions that it discriminates between National Cars and imported "like" automobiles.

5.15 Having admitted a *prima facie* violation of Article III:2, Indonesia raises as its only defence a series of related arguments intended to show that Article III:2 does not apply - despite its plain language - to tax discrimination of this kind. (See Section V.D.) Those arguments are meritless and should be rejected by the Panel. (See Section V.E.1.). Therefore, the February 1996 Programme violates Article III:2.

2. Claims Raised by the European Communities

5.16 The **European Communities** claims that Indonesia has violated its obligations under Article III:2, first sentence, by exempting from the Sales Tax on Luxury Goods the sales of the following categories of motor vehicles (See Section III.B):

- (1) domestically manufactured motor cycles with engines of 250 cc or less;
- (2) combines, minibuses, vans and pick-ups using gasoline as fuel which are manufactured domestically and have a local content of more than 60 per cent;
- (3) combines, minibuses, vans and pick-ups using diesel oil as fuel which are manufactured domestically and have a local content of more than 60 per cent;

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<sup>68</sup>Motor Vehicle Market Share 1992-1997 (Japan Exhibit 60).

<sup>69</sup>United States - Taxes on Petroleum and Certain Imported Substances, L/6175 adopted 17 June 1987, BISD 34S/136, para.5.1.9; United States - Tobacco, paras. 99-100.

- (4) domestically manufactured buses;
- (5) domestically manufactured sedans and stations wagons of less than 1,600 cc with a local content of more than 60 per cent;
- (6) National Cars assembled in Indonesia by Pioneer companies; and
- (7) imported National Cars.

5.17 The following are the **European Communities'** arguments in support of this claim:

5.18 GATT Article III:2, first sentence, provides that:

The products of the territory of any contracting imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly to like domestic products.

5.19 As confirmed by the Appellate Body in Japan - Alcoholic Beverages<sup>70</sup> and Canada - Certain Measures concerning Periodicals<sup>71</sup>, in order to establish whether an internal tax is applied in violation of Article III:2, first sentence, it is necessary to make two determinations:

- first, whether the taxed imported and domestic products are “like”; and
- second, whether the taxes applied to the imported products are “in excess of” those applied to the like domestic products.

5.20 Before making those two determinations, however, it must be ascertained whether the taxes in question constitute an “internal tax”.

(a) The Sales Tax on Luxury Goods is an “internal tax”

5.21 The Sales Tax on Luxury Goods is levied on the sale of both domestic and imported motor vehicles and not just “on” or “in connection” with the importation of motor vehicles, even if some categories of domestic motor vehicles are subsequently exempted therefrom. Accordingly, the Sales Tax on Luxury Goods has to be considered as an “internal tax” in the terms of Article III:2, and not as an import charge within the purview of GATT Articles II and VIII.

(b) Imported products are “like” the domestic products exempted from the tax

5.22 The term “like product” is not defined in the GATT 1994. In Japan - Alcoholic Beverages<sup>72</sup> and Canada - Certain Measures concerning Periodicals<sup>73</sup> the Appellate Body endorsed the basic approach set out in the 1970 Report of the Working Party on Border Tax Adjustment:

... the interpretation of the term [like product] should be examined on case-by-case basis.  
This would allow a fair assessment in each case of the different elements that constitute

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<sup>70</sup>Appellate Body Report on Japan - Alcoholic Beverages, WT/DS 8/AB/R, WT/DS 10/AB/R, WT/DS 11/AB/R, adopted 1 November 1996, pp. 18-19.

<sup>71</sup>Appellate Body Report on Canada - Certain Measures concerning Periodicals, WT/DS 31/AB/R, pp. 22-23.

<sup>72</sup>Appellate Body Report on Japan - Taxes on Alcoholic Beverages, WT/DS 8/AB/R, WT/DS 10/AB/R, WT/DS 11/AB/R, adopted 1 November 1996, p.20.

<sup>73</sup>Appellate Body Report on Canada - Certain measures concerning Periodicals, WT/DS 31/AB/R, p.21.

a similar product. Some criteria were suggested for determined, on a case-by-case basis, whether a product is “similar”: the product’s end uses in a given market; consumers’ tastes and habits, which change from country to country; the products properties, nature and quality.<sup>74</sup>

5.23 The tax exemptions provided by the measures in dispute are not based on any factor which affects of itself the properties, nature or quality of the products concerned or their end uses, nor consequently prevent the exempted products from being “like” the non-exempted products.

5.24 Exemptions (1) and (4) are based, only and exclusively, on the country of manufacture of the products.

5.25 Exemptions (2), (3) and (5) are also based on the country of manufacture of the products and, in addition, on their level of local content.

5.26 Exemption (6) applies to motor vehicles which fulfil the following three conditions:

- first, they must be National Cars manufactured by a Pioneer Company;
- second, they must have been manufactured in Indonesia; and
- third, the manufacturer must comply with certain local content requirements.

5.27 Exemption (7) is also based on three conditions:

- first, the cars must be National Cars manufactured by a Pioneer Company;
- second, they must have been manufactured with the “participation” of Indonesian nationals; and
- third, they must incorporate a certain percentage of “counter-purchased” parts and components exported from Indonesia.

5.28 For the purposes of exemption (6) and exemption (7) a motor vehicle is deemed to be a “National Car” if it satisfies the conditions enumerated in Article 1 of Decree 31/96, which provides that:

National vehicles shall be those which:

- (a) are domestically produced by using facilities owned by national industrial companies or Indonesian statutory bodies with total shares belonging to Indonesian citizens; and
- (b) use trade marks created by relevant industrial companies themselves and not yet registered by other parties in Indonesia and owned by Indonesian citizens; and
- (c) are developed with technology, designs and engineering on the basis of national capacity to be realized in phases.

5.29 Clearly, motor vehicles manufactured in Indonesia are not, by definition, “unlike” motor vehicles manufactured in the territory of any other Member.

5.30 Similarly, there is nothing which, a priori, makes Indonesian manufactured parts and components for the assembly of motor vehicles “unlike” Community manufactured parts and components.<sup>75</sup> It follows that motor vehicles with 61 per cent Indonesian made parts and components

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<sup>74</sup>Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para 18.

<sup>75</sup>In United States - Measures affecting Alcoholic and Malt Beverages, (adopted on 19 June 1992, BISD 39S/206, at para 5.22) the Panel found that the granting of tax exemptions and tax credits by the states of



do not, for that reason alone, cease to be “like” motor vehicles with 100 per cent Community content for the purposes of Article III:2, first sentence.

5.31 The additional criteria on which exemptions (6) and (7) for National Cars are based do not relate, directly or indirectly, to the characteristics of those cars but, instead, to the characteristics of the car manufacturers. As established by previous Panel Reports, differences in the producers’ characteristics which do not affect the products’ characteristics can never justify a different tax treatment of the products involved.

5.32 Thus, the Panel report on United States - Measures affecting Alcoholic and Malt Beverages, concluded that the granting of a tax credit for beer from small breweries but not for beer from large breweries infringed Article III:2, first sentence, whether or not this credit was also available in the case of imported beer because:

... beer produced by large breweries is not unlike beer produced by small breweries. Indeed the United States did not assert that the size of the breweries affected the nature of the beer produced or otherwise affected beer as a product ...<sup>76</sup>

5.33 This finding was invoked as a precedent by the subsequent Panel Report on United States - Standards for Reformulated and Conventional Gasoline, which in clear and unequivocal manner stated the principle that:

Article III:4 of the General Agreement deals with the treatment to be accorded to like products; its wording does not allow less favourable treatment dependent on the characteristics of the producer.<sup>77</sup>

5.34 Although this conclusion concerns Article III:4, the Panel made it clear that the same principle applied also to fiscal measures under Article III:2.

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Michigan, Ohio and Rhode Island only to wines produced using local ingredients was in violation of Article III:2, first sentence.

<sup>76</sup>Panel Report on United States - Measures affecting Alcoholic and Malt Beverages, adopted 19 June 1992, BISD 39S/206, at para 5.19

<sup>77</sup>Panel Report on United States - Standards for Conventional and Reformulated Gasoline, WT/DS 2/R, adopted 20 May 1996, para 6.11. The Panel went on to state the following (at paras 6.11 and 6.12):

The Panel noted that in the Malt Beverages case, a tax regulation according less favourable treatment to beer on the basis of size of the producer was rejected. Although this finding was made under Article III:2 concerning fiscal measures, the Panel considered that the same principle applied to regulations under Article III:4. Accordingly, the Panel rejected the United States argument that the requirements of Article III:4 are met because imported gasoline is treated similarly to gasoline from similarly situated domestic parties.

Apart from being contrary to the ordinary meaning of the terms of Article III:4, any interpretation of Article III:4 in this manner would mean that the treatment of imported and domestic goods concerned could no longer be assured on the objective basis of their likeness as products. Rather, imported goods would be subject to a highly subjective and variable treatment according to extraneous factors. This would thereby create great instability and uncertainty in the conditions of competition as between domestic and imported goods in a manner fundamentally inconsistent with the object and purpose of Article III

See also Panel Report on United States - Taxes on Automobiles, DS 31/R, unadopted, at paras 5.53-5.54.

5.35 In light of the foregoing, the European Communities submits that each of the following categories of goods should be considered as a single category of “like products” for the purposes of applying Article III:2, first sentence, in the present case:

- imported and Indonesian made motorcycles of 250 cc or less;
- imported combines, minibuses, vans and pick-ups and Indonesian made combines, minibuses, vans and pick ups, including those with a local content of 60 per cent or more;
- imported and Indonesian made buses;
- imported sedans and stations wagons of less than 1,600 cc and Indonesian made sedans and station wagons of less than 1,600 cc, including those with a local content of 60 per cent or more;
- imported motor vehicles and National Cars assembled in Indonesia by Pioneer Companies; and
- imported parts, components and raw materials for the assembly of motor vehicles and Indonesian made parts, components and raw materials, including those incorporated into imported National Cars.

(c) Imported motor vehicles are taxed in “excess of” domestic like motor vehicles

5.36 Imported motor vehicles are taxed “in excess of” domestic like products because they are always subject to the Sales Tax on Luxury Goods at a rate ranging from 20 per cent to 35, whereas like domestic products can benefit from exemptions (1) through (6).

5.37 The fact that some domestically made like products (namely, motor vehicles other than buses and motorcycles of less than 250 cc manufactured by non-Pioneer companies and with less than 60 per cent local content) are also subject to the Sales Tax on Luxury Goods does not preclude a violation of Article III:2, first sentence. As noted in the Panel Report on United States - Measures affecting Alcoholic and Malt Beverages:

The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a de minimis standard .... [T]he fact that only approximately 1.5 per cent of domestic beer in the United States is eligible for the lower tax rate cannot justify the imposition of higher internal taxes on imported Canadian beer than on competing domestic beer”.<sup>78</sup>

5.38 For the same reasons, it is irrelevant that some of the exemptions (e.g. exemption (5)) may in practice not have been applied yet due to the temporary lack of qualifying domestic production. As noted also in United States - Measures affecting Alcoholic and Malt Beverages:

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<sup>78</sup> Panel Report on United States - Measures affecting Alcoholic and Malt Beverages, adopted 19 June 1992, BISD 39S/206, para 5.6.

legislation mandatorily requiring the executive authority to take action inconsistent with the General Agreement would be inconsistent with Article III, whether or not the legislation were being applied.<sup>79</sup>

5.39 It is also without relevance that National Cars imported from Korea by PT TPN were exempted from the Sales Tax on Luxury Goods by Presidential Decree 42/96. There subsists a violation of Article III:2 because not all imported cars that are “like” the exempted domestic cars benefit from that exemption.

5.40 As put by the Panel Report on United States - Measures affecting the Importation, Internal Sale and Use of Tobacco:

"In accordance with the national treatment provisions of Article III:2 each pound of tobacco imported into the United States had to be accorded treatment no less favourable in respect of internal taxes than that accorded to like domestic products."<sup>80</sup>

5.41 By the same token, in the present case every single motor vehicle imported into Indonesia (and not just National Cars imported from Korea) should be accorded treatment “no less favourable” in respect of the Sales Tax on Luxury Goods than that granted in each case to the “most favoured” category of like domestic products.

(d) Imported parts and components are ‘indirectly’ taxed ‘in excess of’ like domestic parts, components and materials

5.42 Article III:2 prohibits not just “direct” discrimination against imported products but also any kind of “indirect” discrimination.

5.43 When the level of the tax applicable on a finished product is function of its local content level, imported parts and components are, as a result, subject “indirectly” to a tax which is in excess of that indirectly applied on domestic like parts and components. This form of indirect tax discrimination arises whether or not, in addition, there is also “direct” tax discrimination between the domestic and imported finished goods into which the parts and components are incorporated.

5.44 Confirmation of the above is provided by the Panel Report on EEC - Regulation on Imports of Parts and Components. In that case, the Panel found that the anti-circumvention duties imposed by the Community pursuant to its anti-dumping regulations on finished products assembled within the Community territory which did not meet certain local content requirements:

subject imported parts and materials indirectly to an internal charge in excess of that applied to like domestic products and [...] are consequently contrary to Article III:2 first sentence”.<sup>81</sup>

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<sup>79</sup>Id. at para 5.39. See also Panel Report on US - Taxes on Petroleum and Certain Imported Substances, adopted 17 June 1987, BISD 34S/136, para 5.2.2; and Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, adopted on 7 November 1990, 37S/200, 227, para 84.

<sup>80</sup>Panel Report on United States - Measures affecting the Importation, Internal Sale and Use of Tobacco, adopted on 4 October 1994, para 98. In support of this conclusion, the Panel referred to the “no-balancing” principle established with respect to Article III:4 by the Panel report on United States - Section 337 of the Tariff Act of 1930, adopted on 7 November 1989, BISD 36S/345, 387. This principle has been recently restated by the Panel report on United States- Standards for Conventional and Reformulated Gasoline, WT/DS 2/R, adopted 20 May 1996, at paras 6.14-6.15.

<sup>81</sup>Panel Report on EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990, BISD 37S/132 at para 5.9.

5.45 Exemptions (2) (3) (5) (6) and (7) are to be condemned under Article III:2, first sentence, the European Communities cites for the same reasons as the duties in the above case.

5.46 As shown above, exemptions (2) (3) (5) and (6) are “directly” discriminatory against imported motor vehicles in that they are available only for domestically produced motor vehicles. In addition, they discriminate “indirectly” against imported parts and components because, in order to qualify for the exemptions, domestic motor vehicles must incorporate a minimum percentage of locally made parts and components.

5.47 Exemption (7) does not discriminate “directly” against imported motor vehicles. To the contrary, it is an exemption reserved for certain imported motor vehicles. Nonetheless, exemption (7) infringes Article III:2, first sentence, because it is linked to a local content requirement and, therefore, discriminates “indirectly” against imported parts and components.

### 3. Claims Raised by the United States

5.48 The **United States** claims that Indonesia’s discriminatory application of the luxury tax (See Section III.C) is inconsistent with Article III:2, first sentence, of GATT 1994. The following are the **United States’** arguments in support of this claim.

5.49 Article III:2, first sentence, provides as follows:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.

5.50 Under Regulation No. 36/1996, motor vehicles produced or assembled in Indonesia with a local content in excess of 60 per cent, or national motor vehicles that satisfy the local content requirements of Decree No. 31/1996, are exempt from the luxury tax. However, imported CBU motor vehicles that are “like” their Indonesian-made counterparts are subject to the luxury tax, the precise amount of the tax depending on the type of motor vehicle.<sup>82</sup> Thus, the luxury tax on imported motor vehicles is “in excess of” the tax on like domestic motor vehicles that are exempt from the tax under Regulation No. 36/1996. As the Appellate Body stated in Japan - Taxes on Alcoholic Beverages, for purposes of Article III:2, first sentence, “[e]ven the smallest amount of ‘excess’ is too much”.<sup>83</sup> Here, the amounts are not small, but instead are the difference between 0 and 35 per cent.

### B. Claims Under Article III:2, Second Sentence of GATT 1994

#### 1. Claims Raised by Japan

5.51 **Japan** argues that “the National Car Programme” of February 1996 (See Section III.A) violates Article III:2, second sentence of GATT 1994. The following are **Japan’s** arguments in support of this claim:

5.52 Even if the National Car Programme did not violate Article III:2, first sentence, the National Car Programme still violates Article III:2, second sentence, which prohibits a Member country from

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<sup>82</sup>To reiterate, the applicable luxury tax rates under Regulation No. 36/1996 are: (1) 35 per cent for passenger cars and jeeps; (2) 25 per cent for light commercial vehicles (other than jeeps) that use diesel as fuel; and (3) 20 per cent for light commercial vehicles (other than jeeps) that use gasoline as fuel.

<sup>83</sup>WT/DS8/R, WT/DS10/R, WT/DS11/R, Report of the Appellate Body, adopted 1 November 1996, p. 24.

applying "internal taxes or other internal charges to imported or domestic products in a manner contrary to the principle set forth in paragraph 1."

5.53 A recent Appellate Body report has held that:

... three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:

(1) the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other;

(2) the directly competitive or substitutable imported or domestic products are "not similarly taxed"; and

(3) the dissimilar taxation of the indirectly competitive or substitutable imported domestic products is "applied ... so as to afford protection to domestic production".<sup>84</sup>

(a) National Cars and imported automobiles are "directly competitive or substitutable" products

5.54 **Japan** indicates that the same evidence presented in the context of its "like product" argument for its claim under Article III:2, first sentence (See Section V.A.1) supports its argument in the context of its claim under Article III:2, second sentence that National Cars are indistinguishable from imported automobiles.

(b) National Cars and imported automobiles are not "similarly taxed"

5.55 Since National Cars are exempted from the luxury tax while any imported sedans are subject to 35 per cent luxury tax, they are obviously not taxed "similarly".

5.56 Moreover, according to the Indonesia in its notification of subsidies, the luxury tax exemption constitutes a "subsidy". If National Cars and imported sedans are indeed similarly taxed within the margin of de minimis magnitude<sup>85</sup>, it is inconceivable how the tax exemption could constitute a "subsidy". Accordingly, by Indonesia's own admission National Cars and imported sedans are not similarly taxed.

(c) The tax exemption is accorded "so as to afford protection"

5.57 Indonesia has accorded the title of its Programme: "Development of the National Automobile Industry"<sup>86</sup> to the Presidential Instruction, which initiated the Programme. In addition to the Indonesian stated purpose of "the development of domestic motor vehicles in order that the national mobile industry can [quickly come] into being and can produce using brands created by itself", this objective is expressed unambiguously in "Elucidation on Government Regulation No. 36/1996", a supplementary legislative document for the government regulation granting tax exemption to National Cars.<sup>87</sup> It states:

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<sup>84</sup>Report of the Appellate Body on Japan - Alcoholic Beverages II, p.24. This three part test was affirmed by the Appellate Body Report in Canada - Periodicals, p.23.

<sup>85</sup>Report of the Appellate Body on Japan - Alcoholic Beverages II, pp.26-27. We discuss whether the characterization of a "subsidy" constitutes the valid defence in para. 3.501 - 3.521 below.

<sup>86</sup>Presidential Instruction No.2/1996 (Japan Exhibit 8).

<sup>87</sup>Government Regulation No.36/1996 (Japan Exhibit 25).

[I]t is necessary to support the domestic automotive industry in order to further promote its growth particularly in the face of global competition. One of the methods which can be added is the provision of a tax incentive in the form of exception from the imposition of sales tax on luxury goods.... (Emphasis added.)

5.58 "Objective" factors surrounding the tax exemption testify to its "protective" character as well.<sup>88</sup> As we have already discussed, the share of imported passenger automobiles has been insignificant for a variety of reasons which are unrelated to competitiveness of foreign products. To grant an additional advantage to domestic production in this environment would do nothing more than add a layer of "insulation" to the Indonesian market.

## 2. Claims Raised by the United States

5.59 The **United States** claims that Indonesia's discriminatory application of the luxury tax is inconsistent with Article III:2, second sentence, of GATT 1994. The following are the **United States'** arguments in support of this claim:

5.60 As argued in Section V.A.(3) the exemption from the luxury tax under the National Car Programme violates Article III:2, first sentence, of GATT 1994. Should the Panel find otherwise, it is nevertheless the case that this exemption constitutes a violation of Article III:2, second sentence, which prohibits a Member from applying "internal taxes or other internal charges to imported or domestic products in a manner contrary to the principle set forth in paragraph 1".<sup>89</sup>

5.61 In Japan Liquor II, the Appellate Body set forth the following test for establishing a violation of Article III:2, second sentence:<sup>90</sup>

... [T]hree separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:

- (1) the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other;
- (2) the directly competitive or substitutable imported and domestic products are "not similarly taxed"; and

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<sup>88</sup>Report of the Appellate Body on Japan - Alcoholic Beverages II, pp.27-31; Report of the Appellate Body on Canada - Periodicals, pp31-32.

<sup>89</sup>In its request for the establishment of a panel in this case, the United States did not limit its claim under Article III:2 to the first sentence of that provision. In its first submission to the Panel, however, the United States limits its arguments to Article III:2, first sentence, based on the belief that there can be no serious disagreement that the tax incentives under the National Car programme discriminate against imported passenger cars that are "like" domestic passenger cars. Based on its interpretation of Indonesia's arguments submitted as of the end of the first meeting of the Panel, the United States does not believe that Indonesia has contested the fact that, insofar as Article III:2 is concerned, the products in question are "like products". However, in anticipation that Indonesia may revise its arguments at this stage of the proceeding, the United States addresses its claim under Article III:2, second sentence.

<sup>90</sup>Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, page 25 (italics in original). The Appellate Body subsequently affirmed this test in Canada - Certain Measures Concerning Periodicals, WT/DS31/AB/R, Report of the Appellate Body adopted 30 July 1997, page 23.

- (3) the dissimilar taxation of the directly competitive or substitutable imported domestic products is "applied ... so as to afford protection to domestic production".

5.62 All of the elements required by Article III:2, second sentence, as interpreted by the Appellate Body, are present in this case. First, there is ample evidence that the Timor Kia Sephia is "directly competitive or substitutable" with imported passenger cars. Second, the difference between a tax rate of zero and a tax rate of 35 per cent clearly constitutes non-similar taxation.

5.63 Finally, the tax exemption is accorded "so as to afford protection". The Elucidation on Government Regulation No. 36/1996, the instrument that actually confers the tax exemption, states that the purpose of the exemption is to "support the domestic automotive industry in order to further promote its growth particularly in the face of global competition".<sup>91</sup> Moreover, the very size of the tax differential makes it clear that the dissimilar taxation was applied "so as to afford protection".<sup>92</sup>

C. Claims Under Article III:4 of GATT 1994

1. Claims Raised by Japan

5.64 **Japan** claims that the local content requirements for the National Cars and their parts and components under the February 1996 programme (See Section III.A) violate Article III:4 of GATT 1994. The following are **Japan's** arguments in support of these claims:

5.65 The manufacturer of the National Cars (i.e., so called "pioneers") receive the following two substantive competitive benefits:

- (1) it may import automotive parts and components used in the assembly of National Cars duty free; and
- (2) purchasers of such National Cars pay no luxury tax, in comparison to the 20 per cent- 35 per cent luxury tax that would normally apply.

These benefits are conditioned on the attainment of the following levels of local content:

- At the end of first year, the local content rate of more than 20 per cent;
  - At the end of second year, the local content rate of more than 40 per cent;
  - At the end of third year, the local content rate of more than 60 per cent.
- (a) Article III:4 of GATT 1994 requires each WTO Member to guarantee equality of competitive opportunity between domestic goods and imported goods

5.66 GATT Article III:4 provides as follows:

The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

5.67 In Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, the panel found:

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<sup>91</sup>US Exhibit 10.

<sup>92</sup>Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, page 32.

the requirement of Article III:4 to accord imported products treatment no less favourable than that accorded to domestic products was a requirement to accord imported products competitive opportunities no less favourable than those accorded to domestic products.<sup>93</sup>

5.68 The test for compliance with GATT Article III:4 is two-fold. First, are the imported and domestic goods in question "like products"? Second, have the imported products received treatment "less favourable" than the domestic like product? Therefore, interpretation of Article III:4 in the context of the present dispute boils down to the following two elements:

- (1) whether or not imported automotive parts and components and domestic automotive parts and components are "like" products; and
  - (2) whether imported automotive parts and components are accorded less favourable treatment than domestic like products, in view of the local content requirements.
- (b) Imported parts and components and domestic parts and components are "like" products

5.69 Relevant factors in determining whether or not imported automotive parts and components and domestic automotive parts and components are "like products" may be constructed on a case-by-case basis by examining relevant factors including:

- (i) the product's end-uses in a given market,
- (ii) consumers' tastes and habits, and
- (iii) the product's properties, nature and quality.<sup>94</sup>

5.70 Domestic automotive parts and components and automotive parts and components from Japan are regarded as a single product for use in the assembly of automobiles, and thus it is practically unnecessary to discuss the "like" products issue further in this present case. Automotive parts and components are identical in all respects (including the end-uses, properties, nature and quality) with domestic ones may be imported from abroad.

5.71 Imported automotive parts and components from Japan and other WTO Members are "like" domestic parts and components that may be used in the assembly of National Cars. The only distinction that the Indonesia has made relevant under the Programme is not whether imported or domestic parts and components differ in any physical respect, but where they originate. Thus, imported and domestic parts and components are "like products" under Article III:4.

- (c) Imported parts and components are accorded less favourable treatment than domestic like products in two respects

5.72 Only parts and components that originate in Indonesia contribute to the satisfaction by a National Car producer of the local content requirement upon which Indonesia has conditioned the duty free treatment of the remaining imported parts and components used to assemble the National Car and the luxury tax exemption on National Cars.

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<sup>93</sup>Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, DS21/R, adopted on 18 February 1992 (BISD 39S/27) para.5.5.

<sup>94</sup>Working Party Report on Border Tax Adjustment, para.18; Report of the Appellate Body on Japan - Alcoholic Beverages II, p.19; Report of the Appellate Body on Canada - Periodicals, pp.19-20.



- (1) The import duty exemption on automotive parts and components used in the assembly of National Cars conditioned upon the attainment of certain levels of local content accords advantages to domestic automotive parts and components not available to imported like products

5.73 WTO/GATT panels have consistently found that requirements to purchase domestic products to obtain an advantage violate Article III:4. The EC-Bananas III case, a WTO panel quoted and reaffirmed the following description by the 1994 GATT panel on EC-Bananas II regarding the scope of Article III:4:

previous panels had found consistently that this obligation applies to any requirement imposed by a contracting party, including requirements 'which an enterprise voluntarily accepts in order to obtain an advantage from the government (EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990 (BISD 37S/132), para. 5.21).' In the view of the Panel, a requirement to purchase a domestic product in order to obtain the right to import a product at a lower rate of duty under a tariff quota is therefore a requirement affecting the purchase of a product within the meaning of Article III:4.<sup>95</sup>

5.74 The Bananas III finding reinforces firmly established GATT precedent (e.g. the 1958 panel report on Italian Discrimination Against Imported Agriculture Machinery<sup>96</sup> and the 1984 report on Canada - Administration of the Foreign Investment Review Act ("FIRA")<sup>97</sup>).

5.75 On the basis of their domestic origin, Indonesian automotive parts and components receive treatment substantially more favourable than do even identical automotive parts and components imported from Japan and other WTO Members. In particular, only parts and components that originate in Indonesia contribute to the satisfaction by a National Car producer of the local content requirement upon which Indonesia has conditioned the import duty (and further luxury tax) exemption. In other words, Indonesia's National Car Programme established local content targets that automakers must satisfy in order to obtain a sliding scale of duty preferences, thereby favouring the purchase of domestic over imported like products for purposes of automobile production. The plain language of Article III:4, as applied in the EC - Bananas III and other cases (including the FIRA and Italian Agriculture Machinery cases) leaves no doubt that such an arrangement violates Article III:4.

- (2) The luxury tax exemption on sales of National Cars conditioned upon the attainment of certain levels of local content accords advantages to domestic automotive parts and components not available to imported like products

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<sup>95</sup>EEC-Import Regime for Bananas, DS38/R, para. 146, 11 February 1994 (not adopted)("EC - Bananas II"), as quoted and adopted by the WTO panel in EC - Regime for the Importation, Sale and Distribution of Bananas ("EC - Bananas III"), WT/DS27/R/USA, paras. 7.179 and 7.180.

<sup>96</sup>See the 1958 panel report on Italian Discrimination Against Imported Agriculture Machinery, which concluded that Italian government credits for the purchase of domestically-produced machinery "might adversely modify the conditions of competition between the domestic and imported products" in violation of Article III:4. (BISD 7S/60, para. 12, adopted on 23 October 1958).

<sup>97</sup>See 1984 report on Canada - Administration of the Foreign Investment Review Act ("FIRA"), in which the panel found that "requirements to buy from Canadian suppliers are inconsistent with Article III:4." (BISD 30S/140, para. 5.10, adopted on 7 February 1984.) In particular, the *FIRA* panel noted that the coverage of "requirements" under Article III:4 included "undertakings," even if voluntary, to purchase domestic products if: "once they were accepted [such undertakings] became part of the conditions under which the investment proposals were approved, in which case compliance could be legally enforced." (para. 5.4)

5.76 On the basis of their domestic origin, Indonesian automotive parts and components receive treatment substantially more favourable than do even identical automotive parts and components imported from Japan and other WTO Members.

5.77 The conditioning of the luxury tax exemption on a local content requirement affords protection to domestic automotive parts and components because it promotes the sale of National Cars over other domestically assembled sedans that contain a greater proportion of imported parts. Such less favourable luxury tax treatment of imported products relative to a domestic like product stands in clear violation of Article III:4 precisely in the same way as the import duty exemption discussed in the preceding section.

## 2. Claims Raised by the European Communities

5.78 The **European Communities** claims that the following measures (See Section III.B) applied by Indonesia are inconsistent with Article III:4 of GATT 1994 because they favour the “use” by Indonesian car manufacturers of domestic parts and components over “like” imported parts and components:

- (1) the exemption from the Sales Tax on Luxury Goods of locally manufactured combines, minibuses, vans and pick-ups with more than 60 per cent local content;
- (2) the exemption from the Sales Tax on Luxury Goods of locally manufactured sedans and stations wagons of less than 1,600 cc with more than 60 per cent local content;
- (3) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Indonesia by Pioneer companies meeting certain local content requirements;
- (4) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Korea by “overseas producers” meeting certain counter-purchasing obligations;
- (5) the grant of import duty relief to parts and components used in the assembly of motor vehicles (or of other parts and components for the assembly of motor vehicles) in Indonesia based on the finished vehicles (or the parts and components) meeting certain local content requirements; and
- (6) the exemption from import duties for parts and components used for the assembly of National Cars in Indonesia by Pioneer Companies meeting certain local content obligations.

5.79 The following are the **European Communities's** arguments in support of these claims:

5.80 Article III:4 of GATT provides in pertinent part that:

The products of the territory of any contracting party imported into the territory of any contracting party shall be accorded treatment no less favourable than that accorded to the products of national origin in respect of all laws, regulations and requirements affecting their internal .... use.

5.81 In order to rule on this claim, the Panel is required by the wording of Article III:4 to make the following determinations:

- first, whether the measures at issue are “laws, regulations or requirements”;
- second, whether they “affect the internal use” of parts and components for the assembly of motor vehicles;

- third, whether imported parts and components are “like” domestic parts and components; and
- fourth, whether the measures afford “less favourable treatment” to imported parts and components.

(a) The measures at issue are “laws, regulations or requirements”

5.82 The measures at issue are contained in generally applicable Presidential Instructions, Government Regulations and Decrees of the Minister of Finance and of the Minister of Industry and Trade. Therefore, they are “laws or regulations” within the meaning of Article III:4.

5.83 The measures are “voluntary” in the sense that car manufacturers are not under a legal obligation to use local parts and components and that failure to comply with the local content targets set by the measures only entails the loss of the tax and tariff benefits linked thereto. This, however, does not have the consequence of placing the measures outside the purview of Article III:4.

5.84 Previous Panels have made clear that III:4 does not apply only to “mandatory” measures. Where compliance with a certain measure is necessary in order to secure an advantage or benefit, such measure may also be covered by Article III:4. As noted by the Panel Report on EEC - Regulation on Imports of Parts and Components:

... the comprehensive coverage of ‘all laws, regulations or requirements affecting’ [emphasis added by the Panel] the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, such as those examined by the FIRA Panel .... but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute ‘requirements’ within the meaning of that provision.<sup>98</sup>

5.85 The “advantage” in question may consist of a benefit granted in respect of an import measure, such as for instance a tariff exemption. Thus, in EC - Regime for the Importation, Sale and Distribution of Bananas the Panel found that a requirement to purchase domestic bananas in order to obtain the right to import bananas at a lower duty rate under a tariff rate quota was a requirement affecting the internal purchase of a product within the meaning of Article III:4.<sup>99</sup>

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<sup>98</sup>Panel Report on European Communities - Regulation on imports of Parts and Components, adopted on 16 May 1990, 37S/132, 197, para 5.21.

This principle has been consistently followed by other Panels. Thus, the Panel Report on Italian discrimination against Imported Agricultural Machinery (adopted on 23 October 1958, BISD 7S/60, 64, para 12) found that an Italian law providing especial credit terms to farmers for the purchase of agricultural machinery conditional on the purchase by the farmers of Italian machinery was contrary to Article III:4. Similarly, the Panel Report on EEC - Payments and subsidies paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins (adopted on 25 January 1990, BISD 37S/86, 124-125) concluded that the payment by the Community of subsidies to the processors of oilseeds who purchased oilseeds of Community origin was contrary to Article III:4.

<sup>99</sup>See e.g. Panel report on EC - Regime for the Importation, Sale and Distribution of Bananas, adopted 25 September 1997, WT/DS 27/R/USA, paras. 7.179 and 7.180. On appeal, this finding has been upheld by the Appellate Body (WT/DS 27/AB/R, adopted 25 September 1997, at para 211).

- (b) The measures "affect the internal use" of parts and components for the assembly of motor vehicles

5.86 For a measure to “affect” the use of parts and components for motor vehicles, it does not have to regulate directly those products. It only has to affect the conditions of competition between domestic and imported parts and components. In the words of the Panel Report on Italian Discrimination Against Imported Agricultural Machinery:

... The selection of the word ‘affecting’ would imply [...] that the drafters of the Article intended to cover in [Article III:4] not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market.<sup>100</sup>

5.87 The measures in dispute “affect” the internal use of automotive parts and components because they “modify adversely the conditions of competition” between domestic and imported parts and components by giving to the Indonesian car manufacturers tax and tariff incentives for using local parts and components instead of imported like parts and components.<sup>101</sup>

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<sup>100</sup>Panel Report on “Italian Discrimination against Imported Agricultural Machinery”, adopted on 23 October 1958, 7S/60, 64, para 12.

<sup>101</sup>That the purpose of the measures at issue is to increase the use of local parts and components at the expense of imported parts is not only obvious from the structure and design of the measures but has been openly acknowledged by the Indonesian authorities.

Thus, the only recital of Decree 645/93 reads as follows:

“Considering that to increase the efficiency of the motor - vehicle assembling industry, the parts and accessories industry thereof, and in the framework of saving foreign exchange as well as increase domestic production, it is deemed necessary to regulate relief of import duty on importation of certain parts and accessories for assembling purposes” [emphasis added]

The recital of Decree 223/95 amending Decree 645/93 is even less ambiguous in this respect:

“considering that with a view to increase the volume of local contents used in the industry of automotive assembly and the industry of automotive parts and accessories, as well as within the framework of economising on foreign exchange and enhancing the utilisation of domestic products it is necessary to improve...” [emphasis supplied].

A similar statement is found in the first recital of Government Regulation 36/96:

“Considering that in an effort to motivate development in the car industry to expand the use of domestic car components, it is deemed necessary to provide facilities of Sales Tax on certain goods considered as Luxury, on the transfer of certain motor vehicles ” [emphasis supplied]

More recently, the “policy objective” of the measures at issue has been defined in the following terms in Indonesia’s notification under Article XVI:1 of GATT 1994 and Article 25 of the SCM Agreement as

“to support development of the domestic automotive industry, including increased use of domestically produced components” [emphasis supplied] (G/SCM/N/16/IDN)

(c) Imported parts and components and domestic parts and components are “like” products

5.88 The mere fact of being manufactured in Indonesia does not of itself confer upon Indonesian made parts and components any specific characteristics, properties, nature or quality which makes them “unlike” parts and components made in the Community.

(d) The measures at issue give “less favourable treatment” to imported parts and components

5.89 The measures at issue afford “less favourable treatment” to imported parts and components because the use of those parts does not entitle Indonesian car manufacturers to the same tax and tariff benefits as the use of like domestic parts. As a result, whenever both Community made parts and components and Indonesian made parts and components can be obtained on the same conditions, the Indonesian car manufacturers will give preference to the purchase or internal production of Indonesian made parts and components over the importation of Community made ones.

(e) Local content requirements have already been found contrary to Article III:4 of GATT

5.90 Local content requirements similar to the ones under consideration have already been found to be inconsistent with Article III:4 of GATT by previous Panels.

5.91 In the 1984 case concerning Canada’s Foreign Investment Review Act (“FIRA”), the Panel found that the undertakings given to the Canadian Government by certain foreign investors to, *inter alia*, purchase goods of Canadian origin in specified amounts or proportions afforded “less favourable treatment” to like imported products and were therefore contrary to Article III:4.<sup>102</sup>

5.92 Local content requirements have also been found contrary to Article III:4 by the 1990 Panel Report on EC - Regulation on Imports of Parts and Components. In that case, the Panel concluded that, by making the suspension of anti-circumvention proceedings initiated in accordance with the Community’s anti-dumping regulations against the subsidiaries of Japanese companies established in Community territory conditional upon the investigated companies giving an undertaking to limit the use of Japanese parts and materials, without imposing similar limitations on the use of like domestic products, the latter were given more favourable treatment in violation of Article III:4.<sup>103</sup>

(f) The TRIMs Agreement confirms that the measures are incompatible with Article III:4 of the GATT

5.93 The TRIMs Agreement has confirmed beyond doubt that local content requirements such as the ones under consideration are inconsistent with Article III:4 of GATT. Indeed, the Illustrative List of TRIMs annexed to that Agreement reads in relevant parts as follows:

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those [...] compliance with which is necessary to obtain an advantage, and which require:
  - (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source [...] in terms of a proportion of volume or value of its local production.

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<sup>102</sup>Panel report on Canada - Administration of the Foreign Investment Review Act, adopted on 7 February 1984, BISD 30S/140, paras 5.4-5.12.

<sup>103</sup>Panel report on EEC - Regulation on Imports of Parts and Components, adopted on 16 May 1990, BISD 37S/132, paras 5.19-5.21.

5.94 The measures in dispute fall squarely within point 1 (a) of the Illustrative List and are therefore contrary to GATT Article III:4.

3. Claims Raised by the United States

5.95 The **United States** claims that Indonesia's system of tariff and tax incentives and the government-directed \$690 million loan to TPN (See Section III.C), all of which are contingent upon the use of domestic automotive parts, are inconsistent with Article III:4 of GATT 1994 and are not covered by Article III:8(b) of GATT 1994. The following are the **United States'** arguments in support of these claims:

(a) Summary of the measures

5.96 Imported automotive parts, as well as imported subparts, face discrimination once they arrive in Indonesia. Indonesia offers several incentives to purchasers and users of automotive parts and subparts that are intended to encourage the use of Indonesian-made parts and subparts. These incentives can be summarized as follows:

(1) Import duty incentives

5.97 Under Decree No. 645/1993, as amended by Decree No. 223/1995, the import duty rate on imported automotive parts and subparts decreases as the local content of the finished product (either a motor vehicle or a motor vehicle part) increases.<sup>104</sup> If the degree of local content exceeds a certain threshold (60 per cent in the case of passenger cars, 40 per cent in the case of light commercial vehicles, and 40 per cent in the case of subparts of passenger cars and light commercial vehicles), imports may enter duty-free. (See Tables 6 and 7)

5.98 In addition, under the National Motor Vehicle programme, Article 4(2) of Decree No. 645/1993, as amended by Article 1 of Decree No. 82/96, exempts "[i]mports of parts and equipment of motor vehicles for assembling purposes or manufacture of national motor vehicles which fulfil the required local contents stipulated by the Minister of Industry and Trade ... ." As set forth in Article 3(1) of Decree No. 31/1996, in order to receive national motor vehicle benefits, the local content rates shown in Table 8 must be achieved.

5.99 Finally, under Article 1 of Presidential Decree No. 42/1996, national motor vehicles produced abroad were allowed to be imported free of the 200 per cent Indonesian tariff on CBU passenger cars if such cars "fulfill[ed] the local content requirements as stipulated by the Minister of Industry and Trade"; i.e., if they satisfied the local content rates of Decree No. 31/1996 set forth in the preceding paragraph. Thus, TPN was allowed to import CBU Kia Sephia sedans from Korea without having to pay the 200 per cent tariff on finished passenger cars. TPN was allowed to do so only because, as a participant in the joint venture to assemble a "national motor vehicle", it was subject to the local content schedule set forth in Decree No. 31/1996.

(2) Tax incentives

5.100 Under Decree No. 647/1993, passenger cars and jeeps were subject to a luxury tax of only 20 per cent, provided that their local content exceeded 60 per cent. Otherwise, the luxury tax for these motor vehicles was 35 per cent. Regulation No. 20/1996 established a more complex luxury tax schedule, although the distinguishing feature of the schedule continued to be that the luxury tax rate decreased as the rate of local content increased. Finally, Regulation No. 36/1996 increased the degree of discrimination inherent in Indonesia's luxury tax structure by establishing a luxury tax rate of 0 per cent

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<sup>104</sup>Decree No. 223/1995 replaced the incentive schedule originally contained in Decree No. 645/1993.

for national motor vehicles and motor vehicles with a local content greater than 60 per cent. Under Regulation No. 36/1996, the following luxury tax schedule currently exists:

Table 12  
Luxury Tax Relief

Type of Motor Vehicle	Luxury Tax Rate
passenger cars $\geq$ 1600cc passenger cars with local content $\leq$ 60% jeeps with local content $\leq$ 60%	35%
light commercial vehicles (other than jeeps) using diesel fuel with local content $\leq$ 60%	25%
light commercial vehicles (other than jeeps) using gasoline with local content $\leq$ 60%	20%
passenger vehicles < 1600cc manufactured in Indonesia with local content > 60% light commercial vehicles (diesel or gasoline) With local content > 60% national motor vehicles	0%

Under this schedule, all passenger vehicles and light commercial vehicles (with the exception of passenger cars with a cylinder capacity greater than or equal to 1600cc) are exempt from the luxury tax provided that the local content of the vehicle exceeds 60 per cent. Thus, the incentive to use domestic, rather than imported, automotive parts is even greater. And, of course, national motor vehicles are subject to their own local content schedule, as set forth in Decree No. 31/1996.

(3) The government-directed \$690 million loan

5.101 Finally, there is the government-directed \$690 million loan to TPN. This loan conferred an advantage on TPN because of (1) the concessional terms of the loan; and (2) in the absence of this intervention by Indonesia, TPN would not have been able to obtain such a loan due to its own financial situation, the financial situation of its partner, Kia Motors, and the overall clamp down on lending by the Indonesian Government. In addition, the evidence is overwhelming that Indonesia ordered the consortium of government-owned banks and private banks to provide the loan because of TPN's status as a participant in the production of a "national motor vehicle". TPN's status, in turn, was contingent upon satisfaction of the local content requirements for a "national motor vehicle" set forth in Decree No. 31/1996.

5.102 The most recent component of the National Motor Vehicle programme was introduced on 11 August 1997, when a consortium of four government-owned banks and twelve private banks decided to disburse US\$650 million in ten-year loans to TPN to carry out the national car project.<sup>105</sup> Although the twelve private banks have not been identified in full, the four government-owned banks reportedly are Bank Dagang Negara (BDN), Bank Expor Impor, Bank Rakyat Indonesia, and Bank Tabungan Negara.<sup>106</sup> BDN previously had disbursed a US\$40 million bridging loan to TPN, bringing the total loan amount to US\$690 million. The loans reportedly will carry an annual interest rate of 3 per cent

<sup>105</sup> "16 Banks to Lend \$690 Million for Timor Car Project", *Jakarta Post*, 12 August 1997 (US Exhibit 14, pp. 161-162).

<sup>106</sup> *Id.*

over the 3-6 month deposit rate, a maturity of 10 years, and a grace period of 3 years.<sup>107</sup> The four government-owned banks would provide one-half of the \$650 million loan.<sup>108</sup>

5.103 The circumstances surrounding this loan indicate that the loan was provided at the express direction of the Government of Indonesia, and that but for the Government's involvement, TPN never would have obtained the loan.

5.104 On 21 April 1997, nine economics ministers were instructed by the President to coordinate efforts to implement the car programme.<sup>109</sup> This group was given a mandate to ensure that the Kia Timor venture has a local content of 60 per cent by 1999.<sup>110</sup> The President's directive apparently resulted, among other things, in a directive from the Minister of National Development Planning that "All government bodies and state-owned companies should purchase the Timor when they need new sedans".<sup>111</sup>

5.105 In May, the Coordinating Minister for Economy and Finance announced that Indonesia had "ordered" 13 banks to lend US\$1.3 billion to TPN.<sup>112</sup> The private banks hesitated to do so, but were eventually persuaded to do so.<sup>113</sup> Even after being persuaded, the private banks would agree to provide no more than one-half of the financing.

5.106 In addition, the decision to grant the \$690 million loan package came at a time when Indonesia, due to the depreciation of the rupiah and overly aggressive lending by banks, was clamping down on credit and cancelling large projects, thereby making the loan to TPN all the more extraordinary.<sup>114</sup> Indeed, the President of Indonesia, in his state of the nation address, announced "that all projects that were not a national priority would be shelved given the 'new realities' facing the country".<sup>115</sup> As a

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<sup>107</sup> Id.

<sup>108</sup> Id.

<sup>109</sup> "RI to Finish Car Programme by '99", The Jakarta Post, 23 April 1997, p. 1 (US Exhibit 14, pp. 105-107).

<sup>110</sup> "Timor in Trouble at WTO and at Home", Business Times (Singapore), 25 June 1997 (US Exhibit 14, pp. 143-145).

<sup>111</sup> "Timor Faces Rough Road at WTO; Indonesia's Government Promises to Back Vehicle Project", The Nikkei Weekly, 23 June 1997, p. 23 (US Exhibit 14, pp. 140-142).

<sup>112</sup> "Analysts Warns [sic] About Loans for Timor Car", Jakarta Post, 13 August 1997, p. 1 (US Exhibit 14, pp. 163-165).

<sup>113</sup> "Indon Banks May Land in the ER", Business Times (Singapore), 15 August 1997, p. 7 (US Exhibit 14, pp. 166-169); see also "Indonesia Company: Suharto Clan's Business Activities", EIU Viewswire, 28 July 1997 (US Exhibit 14, pp. 154-157) ("This year the government twisted bankers' arms to procure a \$690m loan to finance [TPN's] assembly plant."). Apparently, while the Government of Indonesia initiated the "national motor vehicle" programme, it lacked the money to pay for it. Therefore, the involvement of private lenders was necessary. "BRI Not Under Pressure to Support Nat'l Car Programme," ANTARA - The Indonesian National News Agency, 13 June 1997 (US Exhibit 14, pp. 136-137). Moreover, international banks had refused to lend to TPN. "Bumpy Road Ahead for Motoring Plan", South China Morning Post, 8 June 1997, p. 7 (US Exhibit 14, pp. 132-135).

<sup>114</sup> As one commentator noted of the decision to grant the \$690 million loan, "The move appears to contradict government policy to clamp down on credit growth." "Jakarta Plans New 'National' Car", Financial Times (London), 7 May 1997, p. 4 (US Exhibit 14, pp. 110-111).

<sup>115</sup> "Timor Car Project Not to Be Rescheduled in Face of Currency Crunch" Agence France Presse, 20 August 1997 (US Exhibit 14, pp. 170-171); see also "Timor Car Project Won't Be Rescheduled", Jakarta Post, 21 August 1997 (US Exhibit 14, pp. 172-173), in which it was reported that:

President Soeharto, in his National Day Address last Saturday, called on the business community to select projects for implementation carefully in view of the currency upheaval currently confronting the economy. Soeharto said the government and business should review their investment projects to ascertain which should be given top priority and which should be postponed.



result, according to the Coordinating Minister for Economy and Finance, the Government "took stock of projects according to their scale of priority. Obviously, high priority programmes will not be axed".<sup>116</sup> However, when asked by reporters whether the Timor car project would be rescheduled, the Coordinating Minister responded that "the term 'national' classifies it as a high priority project".<sup>117</sup> This followed an earlier statement by the Coordinating Minister that "Everyone must support the [national car] programme".<sup>118</sup>

5.107 Likewise, the Minister of Industry and Trade was reported as declaring that, because the Timor car project was a national project, it would not be rescheduled despite the rupiah plunge that prompted the rescheduling of other major projects.<sup>119</sup> This followed earlier statements by Government officials stressing the critical importance of the Kia Timor project:

"The government, as the facilitator, will provide whatever assistance they need, either in construction, licensing or other aspects of the industry."<sup>120</sup>

"We have to support the programme from all sides so the project can be finished as soon as possible."<sup>121</sup>

"The government has money to spend. And, naturally, it is in the government's interest to use that money for priority programmes, particularly a national programme".<sup>122</sup>

5.108 Banking sources indicated that Bank Indonesia, the central bank, would provide subsidized liquidity credit of up to 70 per cent of the funds needed for the car project.<sup>123</sup> In summarizing the decision to grant the \$690 million loan package, one economist characterized the loans as "special credit which 'seemed to be endorsed by the central bank'".<sup>124</sup> However, an editorial in The Jakarta Post best captured the situation:<sup>125</sup>

Given the power of the government, and in view of the "national" label put on the Timor car programme, those banks will have no other choice but to give the required loans, at the great risk of suffering bad credit.

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See also, "Indonesia: Jakarta Pledges to Cut Big Projects", Financial Times (USA) (17 September 1997) <<http://www.usa.ft.com/hippocampus/v4514e.htm>> (US Exhibit 15, pp. 3-4).

<sup>116</sup> "Ministers Review Projects Rescheduling", Business Daily, 8 September 1997 (US Exhibit 14, pp. 174-175).

<sup>117</sup> Id.

<sup>118</sup> "13 Banks Ordered to Finance Timor Car Project", The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114).

<sup>119</sup> "National Car Programme Not Affected by Currency Crisis", ANTARA - The Indonesian National News Agency, 10 September 1997 (US Exhibit 14, pp. 176-178).

<sup>120</sup> "RI to Finish Car Program by '99", The Jakarta Post, 23 April 1997, p. 1 (US Exhibit 14, pp. 105-107).

<sup>121</sup> "Government Agencies Urged to Buy Timor Nat'l Car", ANTARA - The Indonesian National News Agency, 5 June 1997 (US Exhibit 14, pp. 129-131).

<sup>122</sup> "Govt Offices to Be Obligated to Buy Timor Car", The Jakarta Post, 4 June 1997, p. 1 (US Exhibit 14, pp. 126-128).

<sup>123</sup> "13 Banks Ordered to Finance Timor Car Project" The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114).

<sup>124</sup> "Analysts Warn About Loans for Timor Car" Jakarta Post, 13 August 1997 (US Exhibit 14, pp. 163-165).

<sup>125</sup> Quoted in "Indonesia 'National' Car Stalls" International Herald Tribune, 27 May 1997, p. 17 (US Exhibit 14, pp. 123-125).

5.109 Indeed, newspapers reported that the Governor of Bank Indonesia (the Indonesian central bank) was opposed to state banks granting a large loan to TPN.<sup>126</sup> However, the Governor reportedly was forced to approve the deal following a meeting with the President.<sup>127</sup>

5.110 Finally, all indications are that TPN was not perceived as a sound credit risk, and that the decision to grant the US\$690 million loan package was based on something other than commercial considerations. Reportedly, some of the private banks involved were willing to immediately write off any credit they would give to TPN.<sup>128</sup> Some analysts regarded the decision “as a double standard and a violation of prudent banking principles.”<sup>129</sup> Other analysts were more specific<sup>130</sup>:

Economist Faisal Basri from the University of Indonesia and automobile analyst Suhari Sargo doubted [TPN’s] capacity to repay the debts in view of the small sales target set by the company. “An annual sales target of 40,000 vehicles per annum is too small to reach a break-even point,” Faisal was quoted by Antara as saying. Faisal also doubted whether the US\$690 million loans would be sufficient for [TPN] to develop a manufacturing industry with a minimum local content of 60 per cent, as required by the government. Analyst Suhari foresaw a financial burden of at least US\$170 million a year for [TPN] simply to install and service the debts beginning in 2000. “This amount will be equivalent to 15,000 cars. That’s very hard for [TPN] because it has to produce and sell 150,000 vehicles a year to get a 20 per cent profit margin, ... .” He said between 30,000 and 50,000 sedans were sold each year, or 15 per cent to 20 per cent of the country’s total automobile market.

5.111 Moreover, the Kia Timor project was in so much trouble that the Government of Indonesia finally wound up “roping in two leading domestic automakers, PT Astra International and PT Indomobil.”<sup>131</sup> Indomobil was charged with assembling the Timor Kia Sephias, while the Government asked Astra to participate by supervising the construction of assembly facilities and the nation-wide distribution of the cars.<sup>132</sup>

5.112 To make matters worse, and the decision to grant the loan package even more questionable, the decision was made in light of the fact that TPN’s partner, Kia, was in extremely perilous financial condition. Kia was responsible for putting up US\$400 million to build the assembly plant.<sup>133</sup> On 15 July 1997, the Kia Group was placed under control of a bankruptcy protection committee by bankers

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<sup>126</sup> “Indonesian National Car Marker to Get Loans from State Banks”, Agence France Presse, 29 April 1997 (US Exhibit 14, pp. 108-109); see also “Minister Says Indonesia to Slash Credit to National Car”, Agence France Presse, 14 May 1997 (US Exhibit 14, pp. 119-120); “Indonesia Preparing Team to Defend Nat’l Car Policy at WTO”, ANTARA - The Indonesian National News Agency, 9 May 1997 (US Exhibit 14, pp. 115-118); and “Jakarta Plans New ‘National’ Car”, Financial Times (London), 7 May 1997, p. 4 (US Exhibit 14, pp. 110-111).

<sup>127</sup> Id. See also “13 Banks Ordered to Finance Timor Car Project”, The Jakarta Post, 7 May 1997, p.12 (US Exhibit 14, pp. 112-114).

<sup>128</sup> “13 Banks Ordered to Finance Timor Car Project”, The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114).

<sup>129</sup> “Indonesia Tries to Head Off Bank Crisis” The Nikkei Weekly, 4 August 1997, p. 20 (US Exhibit 14, pp. 158-160).

<sup>130</sup> “Analysts Warn About Loans for Timor Car”, Jakarta Post, 13 August 1997 (US Exhibit 14, pp. 163-165).

<sup>131</sup> “Astra, Indomobil Roped in to Speed Up Timor Car Project” Business Times (Singapore), 16 May 1997, p.1 (US Exhibit 14, pp. 121-122). One source described TPN’s manufacturing plans as “currently in disarray”. Id.

<sup>132</sup> Id. Astra’s decision to “help” did not come as a surprise to some observers, because Astra is 9.3 per cent owned by the Nusamba Group, an investment company controlled by three foundations controlled by the President. Id.

<sup>133</sup> “A Furious Flap Over Favoritism”, Business Week, 8 July 1996, p. 14 (US Exhibit 14, pp. 92-95).

concerned about the company's debt of nearly US\$11 billion.<sup>134</sup> On 22 July 1997, South Korean banks refused to meet the full funding requested by the Kia Group, and demanded that Kia executives surrender management control.<sup>135</sup> Subsequently, on 22 September 1997, the main units of the Kia Group, including Kia Motors, filed for special court protection "in a last-ditch attempt to prevent South Korea's eighth-largest conglomerate from being dismantled and its management ousted by bank creditors."<sup>136</sup>

5.113 Finally, in October 1997, Indonesia appealed to the International Monetary Fund and the World Bank for help in the face of a 32 per cent decline in the rupiah since August 1997.<sup>137</sup> However, notwithstanding this crisis, and notwithstanding calls for further budget cuts, newspapers reported that "[t]he government has ruled out cuts in the controversial national car programme ..."<sup>138</sup>

- (b) The tariff and tax incentives and the government-directed \$690 million loan are inconsistent with Article III:4

5.114 Article III:4 states the following:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5.115 Indonesia's tariff and tax incentives for automotive parts and subparts and the provision of the \$690 million loan are openly discriminatory and are in plain contravention of Article III:4 of GATT 1994. First, they each constitute regulations or requirements that "affect" the sale, purchase, transportation and distribution of imported and domestic automotive parts and subparts. Second, imported automotive parts and subparts are "like" domestic automotive parts and subparts. Third, the tariff and tax incentives and the \$690 million loan discriminate against imported automotive parts and subparts.

- (1) The tariff and tax incentives and the government-directed \$690 million loan are regulations or requirements that affect the internal sale, etc. of automotive parts and subparts

5.116 Indonesia's tariff and tax incentives are "regulations" or "requirements" that affect the internal sale, offering for sale, purchase, distribution or use of automotive parts and subparts in Indonesia. Manufacturers or assemblers of motor vehicles (or motor vehicle parts) pay a lower duty on imported parts (or subparts) if the finished motor vehicle (or the finished part) satisfies local content targets

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<sup>134</sup> "S. Korea Bankruptcy Panel Takes Control of Kia", Los Angeles Times, 16 July 1997 (US Exhibit 14, pp. 146-148); see also "South Korea: Emergency Loans Give Breathing Space to Carmaker Kia", Financial Times (London), (16 July 1997 (US Exhibit 14, pp. 149-150); and "Koreans Place Kia Motors Under Bankruptcy Shield" New York Times, 16 July 1997 (US Exhibit 14, pp. 151-153).

<sup>135</sup> "South Korea: Banks Refuse Full Funding of Kia Rescue", Financial Times (23 July 1997) <<http://www.usa.ft.com/hippocampus/7f12a.htm>> (US Exhibit 15, pp. 1-2).

<sup>136</sup> "Kia: Debt-Hit Motor Group Seeks Court Protection", Financial Times (USA) (23 September 1997) <<http://www.usa.ft.com/hippocampus/v47d5a.htm>> (US Exhibit 15, p. 5).

<sup>137</sup> "Indonesia: IMF Urged to Back Rescue", Financial Times (USA) (13 October 1997) <<http://www.ft.com/hippocampus/v50cd6.htm>> (US Exhibit 15, pp. 8-9).

<sup>138</sup> "Indonesia: Fund Managers Urge Government to Cut Budget Deep", Financial Times (USA) (11 October 1997) <<http://www.ft.com/hippocampus/v5074c.htm>> (US Exhibit 15, pp. 6-7).

decreed by the Government. As such, the various Indonesian measures clearly create an incentive for manufacturers or assemblers to purchase domestic parts or subparts, as opposed to imported parts or subparts.

5.117 Moreover, while “a determination of whether there has been a violation of Article III:4 does not require a separate consideration of whether a measure ‘afford[s] protection to domestic production’”<sup>139</sup>, it is worth recounting that Indonesia has made no secret of the fact that the purpose of the various measures is to protect the domestic automotive parts industry. The preamble to Decree No. 114/1993 (which establishes the local content thresholds for the 1993 programme) states that the objective of the measure is “supporting and encouraging the development of the automotive industry and/or the component industry ...”. Likewise, the Elucidation to Regulation No. 20/1996 (which established luxury tax incentives) states that the purpose of the regulation was “to speed up the achievement [of] the national motor vehicle industry using local components ...”. The Elucidation to Regulation No. 36/1996 is to the same effect. Most recently, in its notification to the SCM Committee, Indonesia stated that the objective of both the 1993 and National Motor Vehicle programmes was the “increased use of domestically produced components”.<sup>140</sup>

5.118 In the Screwdriver panel report, the panel recognized that requirements that an enterprise voluntarily accepts to gain government-provided advantages are nonetheless “requirements”<sup>141</sup>:

The Panel noted that Article III:4 refers to “all laws, regulations or requirements affecting (the) internal sale, offering for sale, purchase, transportation, distribution or use”. The Panel considered that the comprehensive coverage of “all laws, regulations or requirements affecting” the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, ... but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute “requirements” within the meaning of that provision ... .

5.119 Indonesian producers or assemblers of motor vehicles (or motor vehicle parts) that seek to take advantage of the tariff and tax incentives offered by the Government must satisfy the local content targets of the relevant measures. These targets are requirements - or regulations - within the meaning of Article III:4.

5.120 These tariff and tax incentives also clearly “affect” the sale of imported automotive parts and subparts, because they provide a clear incentive to an Indonesian manufacturer or assembler to augment its purchases of Indonesian-made parts. For example, a manufacturer or an assembler of motor vehicles can obtain a complete exemption from tariffs on imported parts and the luxury tax on finished motor vehicles if the local content of the vehicle exceeds 60 per cent. In the case of a producer of a “national motor vehicle”, such as Kia Timor, the target is even lower; 20 per cent local content in the first year. These incentives directly affect (and it is their stated purpose to affect) the competitive conditions under which automotive parts and subparts are sold to manufacturers and assemblers. Therefore, these incentives “affect” the sale of automotive parts subparts in Indonesia.<sup>142</sup>

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<sup>139</sup> “European Communities - Regime for the Importation, Sale and Distribution of Bananas”, Report of the Appellate Body, WT/DS27/AB/R, adopted 25 September 1997, para. 216 (emphasis in original).

<sup>140</sup>G/SCM/N/16/IDN (13 January 1997), pp. 3 and 4.

<sup>141</sup>“EEC - Regulation on Imports of Parts and Components”, L/6657, adopted on 16 May 1990, BISD 37S/132, 197, para. 5.21 (emphasis in original). See also “Canada - Administration of the Foreign Investment Review Act”, L/5504, adopted on 7 February 1984, BISD 30S/140, 158, para. 5.4.

<sup>142</sup>See “Italian Agricultural Machinery”, L/833, adopted 23 October 1958, BISD 7S/60, 64, para. 12 (“... [T]he text of paragraph 4 referred ... to laws and regulations and requirements affecting internal sale, purchase, etc., and not to laws, regulations and requirements governing the conditions of sale or purchase. The selection of the word ‘affecting’ would imply, in the opinion of the Panel, that the drafters of the Article

5.121 As for the \$690 million loan to TPN, this loan is no different in kind from the special credit facilities that were condemned by the panel in Italian Agricultural Machinery. TPN received the government-directed loan because of its status as a participant in the Kia Timor joint venture to produce a “national motor vehicle”. Kia Timor achieved its status because of its commitment to satisfy the local content requirements of Decree No. 31/1996. As such, the loan, just as much as the tariff and tax incentives, adversely modifies the conditions of competition between domestic and imported automotive parts and subparts on the Indonesian market.

(2) Domestic and imported automotive parts and subparts are “like products”

5.122 Although there obviously are hundreds, if not thousands, of individual parts that go into a finished motor vehicle, for purposes of Article III:4, imported automotive parts and subparts are “like” automotive parts and subparts made in Indonesia. Domestic and imported products share the same physical characteristics and commercial uses. Thus, while a clutch and a shock absorber may differ from each other, a domestic and imported clutch are “like” each other, just as a domestic and imported shock absorber are “like” each other. In Indonesia, however, the Government discriminates against the imported clutch and shock absorber by providing incentives that favour the purchase and use of their domestic counterparts.

(3) Indonesia’s tariff and tax incentives and the government-directed \$690 million loan to TPN provide less favourable treatment to imported automotive parts and subparts

5.123 Indonesia imposes progressively lower import duties on imported automotive parts and subparts based on the local content of the finished motor vehicle or the finished part. Similarly, Indonesia exempts sales of motor vehicles from the luxury tax if the local content of the vehicle exceeds 60 per cent. Finally, the Indonesian government directed a consortia of banks to extend special credit facilities, in the form of a \$690 million loan, to TPN in order to enable the joint venture in which it is the predominant partner, Kia Timor, to produce a “national motor vehicle” that will satisfy local content targets. Each of these measures accords manifestly less favourable treatment to imported automotive parts and subparts in comparison to their domestically-made counterparts, and each of these measures is calculated to place imported products at a competitive disadvantage by creating an incentive for Indonesian manufacturers or assemblers of motor vehicles or motor vehicle parts to use Indonesian-made parts or subparts. Indeed, Indonesia has made no secret of the fact that the express purpose of this discriminatory treatment is to increase the use of Indonesian-made parts. Indonesia’s discriminatory measures constitute precisely the type of protectionist regulatory measures that Article III:4 condemns.

(c) Indonesia’s discriminatory tariff and tax incentives and the government-directed \$690 million loan do not constitute a direct subsidy to domestic producers within the meaning of Article III:8(b)

5.124 Indonesia’s discriminatory tariff and tax incentives and the government-directed \$690 million loan do not constitute “the payment of subsidies exclusively to domestic producers” within the meaning of Article III:8(b), because domestic producers of automotive parts or subparts do not receive subsidy payments. In the case of tariff incentives that favour the use of domestic automotive parts, the subsidies go to domestic producers or assemblers of motor vehicles in the form of lower (or no) import duties on imported automotive parts.<sup>143</sup> In the case of tariff incentives that favour the use of domestic automotive subparts, the subsidies go to domestic producers or assemblers of automotive parts in the form of lower

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intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market.” (Emphasis in original).

<sup>143</sup>In the case of Presidential Decree No. 42/1996, the subsidy took the form of an exemption from the 200 per cent tariff on imports of completely built-up Kia Sephia sedans.

(or no) import duties on imported subparts. In the case of tax incentives that favour the use of domestic automotive parts, the subsidies go to domestic producers or assemblers of motor vehicles in the form of an exemption from the luxury tax.<sup>144</sup> Finally, in the case of the government-directed \$690 million loan, TPN received the loan in its capacity as a producer of the “national motor vehicle” and as user of parts.<sup>145</sup> As such, these discriminatory measures do not constitute payments exclusively to Indonesian producers of automotive parts (or subparts); rather, they modify the conditions of competition between domestic and imported products in contravention of Article III:4.

5.125 Article III:8(b) states:

The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

5.126 A series of GATT 1947 panel reports have interpreted Article III:8(b) very narrowly to hold that the only subsidies subject to exclusion from the national treatment obligations of Article III are those subsidies that are paid exclusively to domestic producers. Thus, for example, credit facilities provided to purchasers<sup>146</sup>, and not producers, and payments whose benefits could be partially retained by processors<sup>147</sup>, have been found not to qualify under Article III:8(b).

5.127 Of particular relevance is the panel report in the Italian Agricultural Machinery case. In that case, the Italian Government provided special credit facilities to purchasers of Italian agricultural machinery. In finding these facilities to be in violation of Article III:4, and not excluded by Article III:8(b), the panel “agreed . . . that . . . the provisions of paragraph 8(b) would not be applicable to this particular case since the credit facilities provided under the Law were granted to the purchasers of agricultural machinery and could not be considered as subsidies accorded to the producers of agricultural machinery.”<sup>148</sup> With respect to the Indonesian subsidies at issue here, these subsidies are provided to the purchasers of automotive parts (or, in some cases, subparts) and cannot be considered as subsidies accorded to the producers of automotive parts (or subparts).

D. General response by Indonesia to claims Under Article III of GATT 1994 - SCM Agreement prevails

5.128 **Indonesia** makes a general response to all of the claims raised by the complainants, including those under Article III, by arguing that the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) is the *lex specialis*, and prevails, for review of the 1993 and 1996 subsidy programmes, which Indonesia, as a developing country, is permitted to maintain. In addition, **Indonesia** responds specifically to the claims under Article III:4 regarding the tariff measures, by arguing that these are border measures and voluntary measures and thus not governed by Article III. (See Section V.F.1.) **Indonesia** also responds specifically to all of the claims (including those under Article III) made with

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<sup>144</sup>Under Regulation No. 36/1996, there are no gradations in terms of local content rates. If local content exceeds 60 per cent, the vehicle is exempt from the luxury tax. If not, the vehicle is subject to the luxury tax based on the rate applicable to the vehicle type. In the case of a “national motor vehicle,” the applicable local content rate varies by year.

<sup>145</sup>At the risk of repetition, TPN received the government-directed loan due to its status as a participant in the Kia Timor joint venture to produce the “national motor vehicle.” Kia Timor’s status, in turn, was based on its obligation to satisfy specific local content targets under Decree No. 31/1996.

<sup>146</sup>Italian Agricultural Machinery, L/833, adopted 23 October 1958, BISD 7S/60, 64, para. 16.

<sup>147</sup>“European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins”, L/6627, adopted on 25 January 1990, BISD 37S/86, para. 137.

<sup>148</sup> BISD 7S/60, 64, para. 14.

respect to the June 1996 measures by arguing that those measures have expired. (See Section X.A.) The following are **Indonesia's** general responses to the Article III claims raised.

1. The SCM Agreement is the *lex specialis* for review of the 1993 and 1996 subsidy programmes, which Indonesia, as a developing country, is permitted to maintain

5.129 The provisions of the SCM Agreement prevail over those of the General Agreement in the instant dispute because they are more specific to subsidies. Sinclair<sup>149</sup> describes *lex specialis* as "the concept that a specific norm of conventional international law may prevail over a more general norm".<sup>150</sup> *Lex specialis* is "widely supported in doctrine"<sup>151</sup> and extends back to Grotius.<sup>152</sup> "Among agreements that are equal in respect to the qualities mentioned, that should be given preference which is more specific and approaches more nearly to the subject in hand: for special provisions are ordinarily more effective than those that are general".<sup>153</sup> Furthermore, GATT panels have recognized *lex specialis*. For example, the Panel in EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile examined the restrictive measures at issue in the context of Article XIII instead of Article I because, if found, Article XIII was *lex specialis*.<sup>154</sup>

5.130 The 1993 and 1996 subsidy programmes are out of the scope of the provisions of the General Agreement. *Generalia specialibus*, which is related to *lex specialis*, "does not merely involve that general provisions do not derogate from specific ones, but also, or perhaps as an alternative method of statement, that a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of a general provision dealing with the category of subject to which that matter belongs, and which therefore might otherwise govern it as part of that category".<sup>155</sup>

5.131 Because the SCM Agreement addresses subsidies in a manner far more specific than the General Agreement, it is *lex specialis* for this dispute.

5.132 Complainants seek to mask their inability to prove that the two Indonesian programmes still in effect (the 1993 incentive programme and the February 1996 national car programme) are causing adverse effects to their interests. They unsuccessfully attempt to do so by asserting that the programmes are inconsistent with Article III of the GATT 1994 (as well as Article I of GATT 1994 and Article 2 and the Illustrative List of the TRIMs Agreement).<sup>156</sup> Their attempts fail. Both programmes are subsidy measures and so the SCM Agreement (as well as GATT Article XVI) is the *lex specialis*. Unlike many other WTO agreements, the SCM Agreement provides substantial special and differential treatment for developing countries like Indonesia. The 1993 and February 1996 subsidy programmes fully conform

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<sup>149</sup>Sir Ian Sinclair, K.C.M.Q., Q.C., Bencher of the Middle Temple, Member of the International Law Commission, Associate member of the Institut de Droit International, Sometime Legal Advisor to H.M. Foreign and Commonwealth Office.

<sup>150</sup>Ian Sinclair, *The Vienna Convention on the Law of Treaties* 96 (2nd ed. 1984).

<sup>151</sup>Ian Sinclair, *The Vienna Convention on the Law of Treaties* 96 (2nd ed. 1984) (citing Y.B. of the Int'l L. Commission (1976-II), 120).

<sup>152</sup>Wilfred Jenks, *The Conflict of Law-Making Treaties*, 1953 Brit. Y.B. Int'l L. 446.

<sup>153</sup>Book II, Cap. XVI, sec. xxix (1): translation by Kelsey in *Classics of International Law* edition, vol. ii (1929) 428. cited in Wilfred Jenks, *The Conflict of Law-Making Treaties*, 1953 Brit. Y.B. Int'l L. 446.

<sup>154</sup>EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile (22 June 1989), BISD 36S/93, 133, para. 12.28.

<sup>155</sup>Gerald Fitzmaurice, *The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Other Treaty Points*, 1957 Brit. Y.B. Int'l L. 236 (second emphasis added). Sir Gerald Fitzmaurice, K.C.M.Q., Q.C., was Legal Advisor to the Foreign Office.

<sup>156</sup>As will be discussed, the third Indonesian programme subject to complaint--established by the June 1996 decrees and regulations--is no longer in effect. By its terms it expired 30 June 1997 and has not been (and will not be) renewed.

to Indonesia's obligations, as a developing country, under the SCM Agreement. The Panel, therefore, should dismiss all three complaints.

(a) The 1993 incentive programme grants an exemption from or reductions in import duties and the luxury tax available to all companies in the automotive industry

5.133 In June 1993, the Government recognized that its existing policy of seeking to have manufacturers and assemblers of automobiles and automotive components, subcomponents and parts produce their products in Indonesia was unsuccessful. The Government therefore created a new policy, the 1993 Incentive Programme. Under the programme, manufacturers and assemblers are free to source wherever they wish (in Indonesia or abroad). The Government, however, grants exemptions from or reductions in import duties and the luxury tax for companies that choose to source specified percentages of their parts and components in Indonesia.

5.134 Decree of the Minister of Industry No. 114/M/SK/6/1993 (9 June 1993) granted incentives in the form of exemption from or reduction in import duties to automotive component producers and assemblers that purchase Indonesian parts and components.<sup>157</sup> Since 21 January 1997, pursuant to Decree of the Minister of Finance No. 36/KMK.01/1997, the import duty on major components has ranged from 65 per cent for producers and assemblers who source less than 20 per cent of their parts and components domestically to 0 per cent for those who source more than 60 per cent domestically.<sup>158</sup> For subcomponents and parts, the duty ranges from 25 per cent for those who source less than 20 per cent domestically to 0 per cent for those who source more than 40 per cent domestically.

5.135 At present, pursuant to Decree of the Minister of Finance No. 272/KMK.04/1995 (28 June 1995), the luxury tax rate is 20 per cent for domestically produced sedans of 1600cc or less and domestic content of more than 60 per cent; it is 35 per cent for other sedans.<sup>159</sup>

(b) The February 1996 National Car Programme grants import duties and luxury tax exemptions to producers of a National Car

5.136 Instruction of the President No. 2/1996 (19 February 1996) establishes the national car programme and directs the Minister of Finance to grant exemption from import duties regarding imported parts and components and from payment of luxury tax to companies designated as producers of a national car.<sup>160</sup> The exemption from import duties currently is implemented by Article 4 of Decree of the Minister of Finance No. 36/KMK.01/1997 (21 January 1997) and the exemption from the luxury tax is implemented by Government Regulation No. 36/1996 (4 June 1996).<sup>161</sup>

5.137 Decision of the State Minister for the Mobilization of Investment Funds No. 02/SK/1996 (5 March 1996) designated Timor Putra Nasional (TPN) to produce a national car.<sup>162</sup> Under Decree of the Minister of Industry and Trade No. 31/MPP/SK/2/1996 (19 February 1996), TPN's receipt of the import duty and luxury tax exemptions is conditioned on, among other things, the sourcing of at least 20 per cent of the national car's parts and components domestically at the end of the first year, at least 40 per cent at the end of the second year and at least 60 per cent at the end of the third year. The programme effectively terminates in the third year.<sup>163</sup>

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<sup>157</sup>See Indonesia Exhibit 8. The schedule of incentives granted has been amended several times since 1993.

<sup>158</sup>See Indonesia Exhibit 9.

<sup>159</sup>See Indonesia Exhibit 10.

<sup>160</sup>See Indonesia Exhibit 1.

<sup>161</sup>See Indonesia Exhibit 9 and 3, respectively.

<sup>162</sup>See Indonesia Exhibit 5.

<sup>163</sup>See Indonesia Exhibit 2.



- (c) The Government's grant of exemptions and reductions in import duties and the luxury tax to certain manufacturers and assemblers of automobiles and automotive parts is a subsidy

5.138 Articles 1 and 2 of the Subsidies Agreement define specific subsidy. They provide in relevant part that "a subsidy shall be deemed to exist if ... there is a financial contribution by a government" where:

- "government revenue that is otherwise due is foregone or not collected" (Article 1.1(a)(i)(ii)); and
- a benefit is thereby conferred that is "specific to an enterprise or industry or group of enterprises or industries" (Article 2.1).

5.139 Under the 1993 incentive programme, the Government forgoes or does not collect revenue that is otherwise due by granting an exemption from or reduction in the rate of import duties on automotive parts and components. Thus, there is the requisite financial contribution by the Government. As will be discussed in the next subsection, the subsidy falls under the provisions of Article 3 of the Subsidies Agreement. Thus, by virtue of Article 2.3 of that Agreement, there is the requisite specificity.<sup>164</sup>

5.140 The same is true with regard to the February 1996 national car programme. It exempts companies designated by the Government as producers of a national car from the payment of either import duties on automotive parts and components or the luxury tax. The Government, therefore, forgoes or does not collect revenue otherwise due from specific enterprises.

5.141 Because both programmes indisputably provide subsidies, the SCM Agreement is the *lex specialis* and the WTO conformity of the programmes must be assessed pursuant to the provisions of only this Agreement.

- (d) Article 27.3 of the SCM Agreement permits Indonesia, as a developing country, to maintain the subsidies granted under the 1993 and February 1996 programmes

5.142 Entitlement to the subsidies granted under both the 1993 and February 1996 programmes and the level of the subsidy granted to each recipient depends upon the percentage of locally sourced parts and components in a particular car model or automotive component. Therefore, these subsidies technically fall within the scope of Article 3.1(b) as "subsidies contingent (whether solely or as one of several other conditions) upon the use of domestic over imported goods".

5.143 Indonesia is a developing country. Accordingly, Indonesia is within the ambit of Article 27.3 of the Subsidies Agreement, which provides that "[t]he prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years ... from the date of entry into force of the WTO Agreement [i.e., until 1 January 2000]." Instead, the provisions of Articles 5 to 7 regarding "actionable subsidies" apply. (See Section VIII.B.2(c)). No Complainant has, as required by Article 6, demonstrated by positive evidence that the Indonesian auto subsidies result in "serious prejudice" to its interests. (See Section VII.B). Therefore, the Panel should: (1) rule that the subsidies provided by Indonesia under the 1993 and February 1996 programmes are consistent with Indonesia's obligations under the Subsidies Agreement; and (2) because the Subsidies Agreement is the *lex specialis*, dismiss all three complaints.

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<sup>164</sup>The United States Government officially has recognized that the 1993 programme is a subsidy programme. In its April 1997 report entitled Indonesia's Automotive Market Summary, the US Department of Commerce declared that "[t]his policy [the February 1996 national car programme] represents a net increase in the amount of subsidy paid under the system". (Emphasis added.) See Indonesia Exhibit 11.

- (e) Introduction of the February 1996 subsidy programme was not inconsistent with Indonesia's obligations under the SCM Agreement

5.144 **Indonesia** further asserts that Indonesia's introduction of the February 1996 programme was consistent with its obligations under Articles 27.3 and 28.2 of the Subsidies Agreement. These arguments are set forth in detail in Section VIII.C, which covers the claim raised by the **United States** under Article 28 of the SCM Agreement, and **Indonesia's** responses to this claim.

2. Indonesia's luxury tax subsidies to the automotive industry are governed by the disciplines of the SCM Agreement and not by Article III of the GATT 1994

5.145 This is the first dispute involving the relationship between the WTO Agreement on Subsidies and Countervailing Measures and Article III of the General Agreement.<sup>165</sup> Prior to the entry into force of the WTO Agreements, no international legal definition of subsidy existed. There was no all-encompassing structure of remedies applicable to subsidies. Subsidy disciplines applied only to a small number of GATT Contracting Parties and there was no over-arching WTO agreement governing the relationship of the substantive agreements. Thus, there was no basis for claiming that the Tokyo Round Subsidies Code was *lex specialis* in instances such as those presented in this dispute. This all changed with the entry into force of the WTO. Subsidies are governed by and subject to the disciplines of the Subsidies Agreement, not Article III of the General Agreement.

- (a) Both the 1993 incentive programme and the February 1996 National Car Programme subsidize certain automobile producers by granting reduced luxury tax

5.146 The luxury tax rate for sedans (passenger vehicles) is 35 per cent.<sup>166</sup> Decree No. 272 implements the 1993 Incentive Programme. Article 2(1) sets a subsidized luxury tax rate of 20 per cent for domestically produced sedans with an engine capacity of less than 1600cc and with local content of greater than 60 per cent. Also, the Government forgoes collection of 15 per cent of the generally applied 35 per cent luxury tax rate with respect to those enterprises producing automobiles meeting these criteria. Therefore, the measure is a specific subsidy within the meaning of Articles 1.1(a)(1)(ii) and 2 of the Subsidies Agreement.

5.147 With respect to producers of a national car, Instruction of the President No. 2/1996 (19 February 1996)<sup>167</sup> and its implementing regulations and decrees declare that the 35 per cent luxury tax is "borne by the Government." Thus, the February 1996 programme also provides a subsidy within the meaning of Article 1.1(a)(1)(ii) of the Subsidies Agreement that is specific within the meaning of Article 2.<sup>168</sup>

- (b) Subsidies are governed by and subject to the disciplines of the SCM Agreement

5.148 Articles 3 through 9 of the SCM Agreement set out the disciplines applicable to different types of subsidies and the remedies applicable to each type. All subsidies fall into one of three categories - prohibited, actionable or non-actionable. Two types of subsidies are prohibited by virtue of Article 3.1 - subsidies contingent upon export performance and subsidies contingent upon the use of domestic over imported goods. Four types of subsidies are non-actionable: subsidies which are "not specific within

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<sup>165</sup>Canada did not argue that its "funded" postal rates for certain periodicals was a subsidy under the terms of, and subject to the disciplines of, the Subsidies Agreement. This is a crucial distinction between the instant dispute and Canada-Certain Measures Concerning Periodicals, WT/DS31/R (14 March 1997).

<sup>166</sup>See Decree of the Minister of Finance No. 272/KMK.04/1995 (28 June 1995) at Indonesia Exhibit 10.

<sup>167</sup>See Indonesia Exhibit 1.

<sup>168</sup>The United States also argues that the August 1997 loan is inconsistent with Article III:4 of the General Agreement. However, as demonstrated above, the loan is not within the Panel's Terms of Reference and so should not be examined.

the meaning of Article 2" (Article 8.1(a)); assistance for certain research activities (Article 8.2(a)); assistance to disadvantaged regions (Article 8.2(b)); and assistance to promote adaptation to new environmental requirements (Article 8.2(c)). All subsidies which are neither prohibited under Article 3 nor non-actionable under Article 8 are actionable and are governed by Articles 5 through 7 of the SCM Agreement. Thus, all subsidies are covered. If they are one of the two subsidies identified in Article 3 they are prohibited. If they are one of the four identified in Articles 8, they are non-actionable. If they are specific subsidies within the meaning of Articles 1 and 2 but are not among the subsidies identified in Articles 3 or 8, then they fall into the residual category of actionable subsidies.

5.149 The SCM Agreement also sets out in detail the remedies applicable to the three categories of subsidies. For developed country WTO Members, the remedy applicable to the two types of subsidies identified in Article 3.1 is the mandate to "withdraw the subsidy without delay" (Article 4.7). The only prerequisite for such a mandate is the proven existence of a prohibited subsidy. The complaining party is not required to plead or prove any adverse effects. For all WTO Members, subsidies that meet the criteria of Article 8 are, as the term indicates, non-actionable. They are generally permissible and are not subject to remedial action.

5.150 For the residual category of actionable subsidies, including those not prohibited for developing countries by virtue of Article 27, a complaining party must establish both the existence of a subsidy within the meaning of Articles 1 and 2 and adverse effects to its interests through the use of that subsidy (Article 5). Where both the subsidy and the adverse effects are established, the remedy is that the developing country Member "shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy" (Article 7.8). In other words, the remedy is to eliminate the harm to the trade interests of the complaining Member. The subsidizing country can choose to do so by eliminating the measure, but it is not required to do so. Its only obligation then is to eliminate the adverse effects.

5.151 By virtue of the special and differential treatment provided by Article 27, the prohibitions of Article 3.1 do not apply to developing country WTO Members (Articles 27.2 and 27.3). Accordingly, the Article 7 remedy provisions applicable to actionable subsidies apply instead of the remedial provisions of Article 4 (Article 27.7). The effect is that, as here (because Indonesia is a developing country), Complainants must plead and prove not only the existence of one of the two types of subsidies identified in Article 3.1<sup>169</sup>, but also that the subsidy alleged has caused adverse effects to their interests (Article 5).

5.152 In sum, the remedy where both the subsidy and the adverse effects are proven is the remedy applicable to actionable subsidies - the adverse effects of the subsidy shall be removed. The subsidizing developing country can choose to do so by eliminating the measure but it also has the option of maintaining the measure and taking action to eliminate the adverse effects.

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<sup>169</sup> Both the 1993 and February 1996 programmes impose the type of local content eligibility requirements contemplated by Article 3.1(b). The June 1996 programme does not, but is irrelevant because it already has ended.

- (c) General rules of treaty interpretation preclude finding that a subsidy permissible under the SCM Agreement is proscribed by Article III of the GATT 1994

5.153 Under general rules of treaty interpretation, one must give meaning and effect to all terms of a treaty. As properly recognized by the WTO Appellate Body: "An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".<sup>170</sup> Therefore, Article III:2 of the General Agreement cannot control this dispute because, if it did, the entire SCM Agreement would be reduced to inutility.

5.154 Under Article III:2 no imported product shall be subject to an internal tax in excess of that applied to a like domestic product. Article 3.8 of the WTO Dispute Settlement Understanding codifies long-standing GATT practice that infringement of an obligation of the General Agreement such as that of Article III:2 is considered *prima facie* to constitute a case of nullification or impairment. In other words, the covered practice is proscribed and the complaining party need not plead or prove adverse trade effects.<sup>171</sup>

5.155 The Indonesian luxury tax is an internal tax. Under the 1993 Incentive Programme, passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60 per cent are obliged to pay a subsidized luxury tax of only 20 per cent if they are produced in Indonesia, while the imported like product (imported passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60%) are subject to the non-subsidized luxury tax rate of 35 per cent. Under the February 1996 national car programme, the Government excuses TPN from payment of the luxury tax on the 1500cc Timor S515 (which meets the applicable local content level) while imposing the non-subsidized rate of 35 per cent on imports of like products. (There is no ban on imports of small-engine-capacity sedans that would be "like" the Timor. However, Complainants have the burden of proving that there actually are such imports because, if they do not do so, they fail to prove "serious prejudice" with respect to the "actionable" subsidization by Indonesia of the luxury tax rate for certain domestic sedans.)

5.156 If Article III:2 applied, then no more would need to be established. Complainants would not have to plead or prove that they have suffered adverse trade effects by reason of the subsidized luxury tax rates. Despite the Subsidies Agreement, which permits actionable subsidies to be maintained unless they are proven to cause adverse trade effects, the measure--indeed all such actionable subsidies - would be proscribed under Article III:2 of the General Agreement merely upon a showing of discrimination due to a subsidy. Such a holding would render meaningless the provisions of the Subsidies Agreement relating to actionable subsidies.

5.157 In this dispute the issue is limited to Article III:2 and tax subsidies.<sup>172</sup> However the same interpretational problem would arise with respect to virtually all subsidies other than subsidized import duties and other border charges. The purpose of most subsidies is to provide financial assistance to a targeted industry or a small group of industries. By their very nature and by design, subsidies discriminate against producers of like products (both domestic and imported) that do not receive the subsidy. To the extent that a subsidy is not provided to an imported product (which is the case in virtually every subsidy ever granted), then it does not provide national treatment. Accordingly, one

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<sup>170</sup>United States - Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R (20 May 1996) (p.23) footnote omitted). See also Japan - Taxes on Alcoholic Beverages, WT/DS/AB/R (4 October 1996) (p. 12); DSU, Article 3.2.

<sup>171</sup>In its Uruguay Round TRIMs submission of 6 February 1989, the United States recognized that certain GATT provisions (e.g., Article I) proscribe practices, while others (e.g., Article VI) remedy adverse trade effects (MTN.GNG/NG12/W/14 at pp. 12-13). GATT Article XVI and the Subsidies Agreement, like GATT Article VI, remedy trade effects of actionable subsidies.

<sup>172</sup>The import duty subsidies relate to border measures, not to internal laws subject to Article III:4 of the General Agreement. This renders much of Complainants' argumentation irrelevant.

cannot give meaning and effect to the framework of the Subsidies Agreement requiring proof of adverse trade effects as to actionable subsidies if Article III of the General Agreement and its national treatment principle is applied.

5.158 The importance of the existence of a legal definition of subsidies and an all-encompassing structure of remedies is evident by contrasting the subsidies provisions applicable to goods with those applicable to services. In its Explanatory Note on the Scheduling of Initial Commitments in Trade in Services<sup>173</sup> (intended to assist countries in preparing their services commitments in the Uruguay Round), the GATT Secretariat stated:

Article XVII [national treatment] applies to subsidy-type measures in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines" to counter the distortive effects caused by subsidies. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article. Subsidy-type measures are also not excluded from the scope of Article II (MFN). An exclusion of such measures would require a legal definition of subsidies which is currently not provided for under the GATS.

5.159 The GATS contains no "legal definition of subsidies", and so the GATS requirements regarding national treatment (which permit scheduling a limitation on the obligation) apply. In the goods area, there is a legal definition in the SCM Agreement, thereby warranting exclusion of subsidies from application of the national treatment obligation of GATT Article III.

5.160 The only conceivable interpretation of the relationship of subsidies and Article III of the General Agreement that would not reduce the SCM Agreement to redundancy or inutility is that subsidies which meet the criteria of Articles 1 and 2 of the SCM Agreement are governed by and are subject to the disciplines of only the SCM Agreement. Actionable subsidies (including Article 3.1 subsidies which are actionable for developing countries by virtue of Article 27) require proof of adverse trade effects. That requirement cannot be subverted merely by arguing that the subsidy violates Article III of the GATT 1994 by denying national treatment.

(d) The proper interpretation of Article III:8(b) of the GATT 1994 supports the view that Article III does not override the SCM Agreement

5.161 In Canada-Certain Measures Concerning Periodicals, WT/DS31/AB/R (30 June 1997), the Appellate Body discussed and ruled upon Article III:8(b). The facts of the dispute show that Canada did not argue that its funded postal rates programme was a subsidy under the criteria of Articles 1 and 2 of the Subsidies Agreement and, therefore, was subject to the disciplines and remedies of only that Agreement. Rather, Canada argued simply that its practice was excused (i.e., not subject to any discipline or remedies) by virtue of Article III:8(b) of the General Agreement.

5.162 The United States disagreed, arguing that the transfer of funds from one government entity to another did not fulfil the condition of Article III:8(b) regarding "the payment of subsidies exclusively to domestic producers." The Panel sided with Canada. The finding of the Panel with which the Appellate Body disagreed and which it reversed was:

Thus, we do not find that Canada Post retains any economic benefits from the "funded" rate scheme it applies to certain Canadian periodicals. The payment of the subsidy is made "exclusively" to Canadian publishers that qualify for the scheme. Since

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<sup>173</sup>MTN.GNS/W/164 (3 September 1993) at p. 6 (emphasis added).

Article III:8(b) explicitly recognizes that subsidies exclusively paid to domestic producers are not subject to the national treatment rules of Article III, including those under Article III:4, we find that Canada's "funded" rate scheme on periodicals can be justified under this provision.<sup>174</sup>

5.163 In analysing the Appellate Body's discussion, one must consider the following facts. The Appellate Body was ruling on whether the government paid a subsidy exclusively to domestic producers and it was doing so in a dispute in which both parties focused solely on the General Agreement. The Appellate Body was not asked to decide and it did not address the question presented in this dispute, which is whether a subsidy permissible under the SCM Agreement (except to the extent it is proven to cause adverse trade effects) can still be proscribed as a violation of the national treatment principle of Article III of the General Agreement.

5.164 With this in mind, let us analyze the text, drafting history, context, and object and purpose of Article III:8(b). The Chairman of the Working Party that examined the provision that became Article III:8(b) explained the purpose of and need for the provision as follows:

This provision had been added to the Geneva draft [of the ITO Charter] because it was felt that if subsidies were paid on domestic and not on imported products it might be construed that Members were not applying the "national treatment" rule.<sup>175</sup>

At the Havana Conference, the Report of the Sub-Committee that examined Article 18 of the draft ITO Charter (the predecessor of Article III of the General Agreement) stated:

This sub-paragraph [Article III:8(b)] was redrafted in order to make it clear that nothing in Article 18 could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 would override the provisions of Section C of Chapter IV [on Subsidies.]<sup>176</sup>

Previous GATT panel reports addressing Article III:8(b) have focused on the first portion of this quotation from the Havana Reports. However, neither they nor the Appellate Body in Canada-Periodicals focused on or analyzed the portion emphasized above.

5.165 The panel report most relevant to this dispute is United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206.<sup>177</sup> There, the panel, as quoted by the Appellate Body in Canada-Periodicals, stated:

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<sup>174</sup>WT/DS31/R (14 March 1997) (para. 5.44).

<sup>175</sup>E/CONF.2/C.3/A/W.49, p. 2.

<sup>176</sup>Report of Committees and Principal Sub-committees, United Nations Conference on Trade and Employment, held at Havana, Cuba from 21 November 1947 to 24 March 1948, ICITO I/8 (September 1948) at 66, para. 69 (emphasis added).

<sup>177</sup>Two other reports discussing Article III:8(b) are not of value in this dispute because they address whether a subsidy was indeed paid exclusively to domestic producers, a fact not at issue in this dispute. Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60; and European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (25 January 1990), BISD 37S/86. The US erroneously claims that the requirement set out in Italian Machinery is not met with regard to what they term Indonesia's tariff and tax incentives for automotive parts and subparts. (See Section V.E.3(b)). As discussed in the next section of this submission, subsidized customs import duties are border measures, not internal measures, and therefore are not within the scope of Article III. The luxury tax subsidy applies to assembled automobiles and is provided exclusively to the

Article III:8(b) limits therefore the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer like his foreign competitors must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.<sup>178</sup>

The full import of this statement is clear from the following finding of the United States-Measures Affecting Alcoholic and Malt Beverages Panel:

The words "payment of subsidies" refer only to direct subsidies involving a payment, not to other subsidies such as tax credits or tax reductions.<sup>179</sup>

5.166 One must note, however, that United States Alcoholic Beverages was decided prior to the completion of the Uruguay Round negotiations and, therefore, under the then-existing GATT regime. The Tokyo Round Subsidies Code did not contain an all-encompassing definition of subsidies. Its membership was limited to those Contracting Parties who chose to adhere and the relationship of the Code to the GATT was not expressed and was subject to differing views. Further, because the GATT and the Code were separate legal instruments, provisions of one could not be raised and analyzed by a panel in a dispute involving the other.

5.167 All of that changed with the entry into force of the WTO Agreements. Article 1 of the SCM Agreement identifies four types of subsidies: (i) direct transfer of funds; (ii) forgoing of revenue otherwise due; (iii) provision of goods or services at non-market prices; and (iv) payment to a funding mechanism directed by a private body. Only the first type is a "direct subsidy." All Members of the WTO adhere to both the General Agreement and the SCM Agreement and both agreements are integral parts of the Agreement Establishing the World Trade Organization (see Article II.2 thereof). Finally, dispute settlement panels are mandated to address the relevant provisions of all WTO agreements cited by the parties to a dispute. (Article 7.2 of the Dispute Settlement Understanding.)

5.168 Under these circumstances, general rules of treaty interpretation require rethinking the scope of Article III:8(b). Under the WTO, "the payment of subsidies" language in Article III.8(b) must refer to all subsidies identified in Article 1 of the SCM Agreement, not merely to the subset of "direct" subsidies. This interpretation, and only this interpretation, avoids rendering the SCM Agreement meaningless. Under this interpretation, any and all subsidies provided exclusively to domestic producers are not governed by the national treatment principle of Article III of the General Agreement (which by definition they could not meet). Rather, subsidies that fall within the scope of Articles 1 and 2 of the SCM Agreement and that are actionable under Articles 5 and 6, are subject only to the disciplines of Article 7 of the SCM Agreement and, even then, only if they cause adverse effects to the interests of other Members.

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producers or assemblers, thereby fulfilling the criterion set out in Italian Machinery. United States-Measures Affecting the Importation, Internal Sale and Use of Tobacco (12 August 1994), DS44/R, also is not relevant. There, the complaining parties sought unsuccessfully to use Article III:8(b) to argue that United States producers (but not importers) benefitted from a subsidy derived from the proceeds of an internal tax which was not within the scope of Article III:8(b) but was in violation of Article III:2.

<sup>178</sup>BISD 39S/206 (para 5.10 at p. 272)(emphasis added).

<sup>179</sup>Id. at p. 271-72, para. 5.8 (emphasis added).

- (e) In a conflict between the SCM Agreement and Article III of the GATT 1994, the SCM Agreement Prevails

5.169 The "General interpretative note to Annex 1A" of the Agreement Establishing the World Trade Organization states:

In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization (referred to in the agreements in Annex 1A as the "WTO Agreement"), the provision of the other agreement shall prevail to the extent of the conflict.

The Report of the Panel in European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA (22 May 1997), defines "conflict" as follows:

As a preliminary issue, it is necessary to define the notion of "conflict" laid down in the General Interpretative Note. In light of the wording, the context, the object and the purpose of this Note, we consider that it is designed to deal with (i) clashes between obligations contained in GATT 1994 and obligations contained in agreements listed in Annex 1A, where those obligations are mutually exclusive in the sense that a Member cannot comply with both obligations at the same time, and (ii) the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits .

However, we are of the view that the concept of "conflict" as embodied in the General Interpretative Note does not relate to situations where rules contained in one of the Agreements listed in Annex 1A provide for different or complementary obligations in addition to those contained in GATT 1994. In such a case, the obligations arising from the former and GATT 1994 can both be complied with at the same time without the need to renounce explicit rights or authorizations. In this latter case, there is no reason to assume that a Member is not capable of, or not required to meet the obligations of both GATT 1994 and the relevant Annex 1A Agreement. (Emphasis added; footnote omitted.)

5.170 If the Panel were to conclude that it cannot reconcile the coverage and disciplines of the SCM Agreement and Article III of the General Agreement (either by reason of general rules of treaty interpretation or through interpretation of Article III:8(b)), then a "conflict" would exist between the Subsidies Agreement and Article III of the General Agreement. By virtue of the General Interpretative Note, the provisions of the Subsidies Agreement would prevail.

5.171 The SCM Agreement permits Indonesia, as a developing country, to subsidize the luxury tax rate unless those subsidies are proven to cause adverse trade effects. Article III of the GATT 1994, on the other hand, would proscribe these subsidies on the ground that they denied national treatment under the terms of Article III:2. Adverse trade effects would not need to be proven. In other words, the SCM Agreement explicitly permits what Article III of the GATT 1994 would prohibit. Indonesia's obligations under the two provisions would be mutually exclusive. One simply could not apply the general prohibition of Article III:2 and, at the same time, provide Indonesia its explicit rights under the SCM Agreement regarding the proof of adverse effects. This falls squarely within the definition of "conflict" in the General Interpretative Note. Hence, the provisions of the SCM Agreement (an "Annex 1A Agreement") would prevail over Article III of the General Agreement.

5.172 Article III:4 of GATT 1994 also conflicts with the SCM Agreement insofar as it prohibits measures which the SCM Agreement does not prohibit. Take, for example, a law that provides assistance to an industry in a disadvantaged region (meeting the requirements Article 8.2(b) of the SCM



Agreement) or other "greenlight" subsidies. This subsidy is permitted by the SCM Agreement, but would violate Article III:4, if it applied. A similar conflict arises in the instant case, where the SCM Agreement, as Indonesia has demonstrated, permits the measures which complainants argue violate Article III:4. Also, even if complainants were correct, a conflict would exist and only the SCM Agreement would apply.

(f) The SCM Agreement defines subsidies and sets out all of the rights and obligations pertaining to them

5.173 Articles 1 through 9 of the SCM Agreement comprehensively set out the definitions of, disciplines on and remedies for subsidies. The SCM Agreement covers all subsidies. If a subsidy is one of the two types of subsidies identified in Article 3, it is a prohibited subsidy. If a subsidy is one of the four types of subsidies identified in Article 8, it is a non-actionable subsidy. If a subsidy is specific within the meaning of Article 2, but neither prohibited under Article 3 nor non-actionable under Article 8, it falls into the residual category of actionable subsidies.

5.174 Also, the Subsidies Agreement covers all remedies for subsidies, with Article 27 providing special and differential treatment of developing country Members. If a subsidy is a prohibited subsidy, a complainant must prove the existence of a prohibited subsidy and the remedy is that the Member "withdraw the subsidy without delay" (Article 4.7). If a subsidy is an actionable subsidy, including an otherwise prohibited subsidy granted or maintained by a developing country, a complainant must prove the existence of a subsidy within the meaning of Articles 1 and 2 and adverse effects to the complainant's interests through the use of that subsidy (Article 5). The remedy is that the Member "shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy." (Article 7.8). Procedures and remedies for certain non-actionable subsidies are set forth at Article 9.

(g) The definition of "subsidy" in the SCM Agreement is all-encompassing, contrary to the United States assertion

5.175 To support its argument that the definition of subsidy in the SCM Agreement is not all-encompassing, the United States cites Article 1.1 of the SCM Agreement as stating that the definition is "[f]or the purpose of this Agreement".

5.176 First, the United States' attempt to use this language to confine the definition ignores the fact that all WTO agreements are part of a unitary whole. The SCM Agreement is part of the family of WTO agreements. Article II:2 of the Agreement Establishing the World Trade Organization states that "[t]he agreements and associated legal instruments included in Annexes 1, 2 and 3 ... are integral parts of this Agreement, binding on all Members." Prior to the entry into force of the WTO Agreements, no international legal definition of subsidy existed. There was no all-encompassing structure of definitions, disciplines and remedies, and the Subsidies Code applied to only a small number of GATT Contracting Parties. With the entry into force of the WTO agreements, the SCM Agreement's definition of subsidy became the sole definition of subsidy for the family of WTO agreements.

5.177 Second, the United States fails to (and cannot) provide an alternative definition of subsidy. Finally, the measures at issue clearly fall within the definition of "subsidy" set out at Articles 1.1(a)(1)(ii) and 2 of the SCM Agreement. (See Sections V.D.1 and VIII.A.1 and 2).

(h) Article VI:5 of the GATT 1994 Is Irrelevant and Serves to Limit a Complainant's Unilateral Remedy

5.178 The United States cites GATT Article VI:5 to support its argument that the SCM Agreement was not intended to be the exclusive remedy against measures that can be characterized as subsidies. (See Section V.E.3) However, Article VI:5 is irrelevant to this case. It has nothing to do with whether a

subsidy can be granted by the host country (i.e., whether the obligations of Article III of the General Agreement apply as well as those of the SCM Agreement) or, for that matter, with subsidies at all. Rather, it prevents the authorities of an importing country from double counting when imposing duties under domestic anti-dumping or countervailing duty laws.<sup>180</sup>

- (i) The United States' interpretation of Article 32.1, footnote 56, of the SCM Agreement is flawed

5.179 The United States cites footnote 56 of Article 32 of the SCM Agreement as indicating that the drafters did not intend for the Agreement to be the exclusive remedy against measures within the Agreement's definition of subsidy (See Section V.E.3), and thus there is no "conflict" between the SCM Agreement and the General Agreement. This interpretation is incorrect. Article 32.1 and footnote 56 were taken verbatim from the Tokyo Round Subsidies Code, in which they appear as Article 19.1 and footnote 38. A companion article and footnote appear in the Tokyo Round Anti-Dumping Code. Only the reference to "dumping", as opposed to "subsidy", differs.<sup>181</sup> Thus, it is clear that the drafters of the Tokyo Round Codes considered that these articles and their footnotes applied to actions by authorities of importing countries under domestic countervailing duty or anti-dumping laws. In this context "other relevant provisions" of the General Agreement refers to other permissible actions by importing authorities, such as safeguard actions under Article XIX of the General Agreement, which are "appropriate" when the conditions for application of that remedy are satisfied.

5.180 There are two additional reasons why the United States' argument is flawed. First, the United States' argument ignores the significance of the words "relevant" and "where appropriate" in footnote 56:

This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate. (Emphasis added.)

The United States ignores the very text it seeks to interpret. Other GATT provisions are not "relevant" and, moreover, action under other GATT provisions is not "appropriate" and therefore is precluded, because the measures at issue are clearly covered by the SCM Agreement, which also provides remedies for them.

5.181 Second, Article 32.1 itself states:

No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement. (Emphasis added; footnote omitted.)

The words "as interpreted by this Agreement" confirm the supremacy of the SCM Agreement in defining and providing remedies for subsidies.

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<sup>180</sup>In situations in which the granting of a subsidy leads to an export price that is below "normal value" (the comparable price for the like product when destined for consumption in the home country's market), the authorities of the importing country could, absent Article VI:5, impose both anti-dumping and countervailing duties. Article VI:5 prevents this.

<sup>181</sup>The text of Article 16.1 of the Anti-Dumping Code and footnote 16 follow (with differing text, from Article 19.1 and footnote 38 of the Subsidies Code, included within brackets).

Article 16.1: "No specific action against dumping of exports from another Party [a subsidy of another signatory] can be taken except in accordance with the provisions of the General Agreement, as interpreted by this Agreement."

Footnote 16: "This is not intended to preclude action under other relevant provisions of the General Agreement, as [where] appropriate."

- (j) Indonesia's right, as a developing country, to maintain domestic-content subsidies is subject only to Indonesia's obligation not to cause serious prejudice to a like product.

5.182 Because Indonesia is a developing country Member, "[t]he prohibition of paragraph 1(b) of Article 3 shall not apply ... for a period of five years ... from the date of entry into force of the WTO Agreement [i.e., until 1 January 2000]" to its domestic-content subsidies (Article 27.3). Instead, Articles 5 through 7 apply. No Complainant has, as required by Article 6, demonstrated by positive evidence that the domestic-content subsidies result in "serious prejudice" to a like product. (See Section VIII.B.)

- (k) The application to this dispute of Article III of the GATT 1994, as complainants advocate, would render the SCM Agreement meaningless

5.183 If Article III:2 were to proscribe actionable subsidies that are not proven to cause adverse effects, the provisions of the Subsidies Agreement regarding actionable subsidies would be rendered meaningless.

- (l) Virtually all subsidies are intended to, and actually do, benefit only domestic products

5.184 Under the SCM Agreement, with regard to an actionable subsidy, a complainant must prove both the existence of a subsidy within the meaning of Articles 1 and 2 and adverse effects to the complainant's interests through the use of that subsidy (Article 5). In contrast, according to Article 3.8 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) as well as long-standing GATT practice, a measure infringing upon Article III:2 of the General Agreement is proscribed outright. Under Article III:2, an imported product shall not be subject to an internal tax in excess of that applied to a like domestic product. A complainant need not prove adverse effects to its interests resulting from that measure.

5.185 By definition, subsidies discriminate against like products, both domestic and imported, that do not receive the subsidy. To the extent that a subsidy is not provided to an imported product, which is virtually always the case, the subsidy would violate the national treatment requirement of Article III if that obligation were applicable.

- (m) Under complainants' interpretation, Indonesia's luxury tax subsidies would be condemned solely because of their discriminatory nature and the European Communities and United States would not have to show serious prejudice

5.186 The subsidy provided under the 1993 Incentive Programme benefits passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60 per cent. In contrast, imported passenger sedans with an engine capacity of less than 1600cc and an Indonesian content of more than 60 per cent are subject to a non-subsidized luxury tax rate that is in excess of the subsidized rate. Under the February 1996 National Car Programme, a 1500cc Timor S515 that meets the applicable local content level is not subject to the luxury tax, whereas a similar imported car would be subject to a non-subsidized luxury tax rate in excess of the subsidized rate.

5.187 If Article III:2 were applied instead of the SCM Agreement, Indonesia's luxury tax subsidies would be condemned solely because of their inherently discriminatory nature. The European Communities and the United States would not have to meet the SCM Agreement's requirement of proving serious prejudice.

- (l) Conversely, Indonesia's interpretation does not render Article III useless, as complainants maintain, but confines it appropriately

5.188 Indonesia's interpretation that subsidies that meet the criteria of Articles 1 and 2 of the SCM Agreement are governed solely by the SCM Agreement is the only reasonable interpretation of the relationship between subsidies and Article III that would not render crucial provisions of the SCM Agreement meaningless. Moreover, contrary to Complainants' assertions, Indonesia's interpretation does not render Article III useless, but confines Article III to its appropriate sphere.

- (1) A "conflict" exists - Article III of the General Agreement and the SCM Agreement are mutually exclusive and cannot be applied simultaneously; the obligations of the SCM Agreement are not additional, supplementary or complementary to Article III of the GATT 1994

5.189 According to the Panel in European Communities-Regime for the Importation, Sale and Distribution of Bananas, a "conflict" exists when:

- (i) mutually exclusive GATT 1994 and Annex 1A Agreement obligations clash; and
- (ii) a rule in one agreement prohibits what a rule in another agreement explicitly permits. Obligations are mutually exclusive when a Member cannot comply with both obligations at the same time.<sup>182</sup>

5.190 A "conflict" does not exist when rules in an Annex 1A Agreement provide for different or complementary obligations in addition to those in GATT 1994 because the Annex 1A and GATT 1994 obligations "can both be complied with at the same time without the need to renounce explicit rights or authorizations."<sup>183</sup>

5.191 Contrary to the assertions of the European Communities and Japan (See Sections V.E.1 and 2), Indonesia's GATT 1994 and SCM Agreement obligations are mutually exclusive because they cannot "both be complied with at the same time without the need to renounce [the] explicit right[] or authorization[]" to maintain the subsidies at issue absent serious prejudice to a like product. Furthermore, Article III would "prohibit" what the SCM Agreement "permits". The SCM Agreement specifically does not prohibit developing countries from granting a subsidy involving differential internal tax treatment on products. On the other hand, Article III:2 of GATT 1994 prohibits such differential tax treatment on products. Thus, a conflict clearly exists in the instant case.<sup>184</sup>

5.192 In Bananas III, the Panel specifically addressed the type of conflict which exists in the instant case in an example dealing with the relationship between Article XI and the Agreement on Textiles and Clothing (ATC):

Article XI:1 of GATT 1994 prohibits what Article 2 of the ATC permits in equally explicit terms. It is true that Members could theoretically comply with Article XI:1 of

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<sup>182</sup>European Communities-Regime for the Importation, Sale and Distribution of Bananas (22 May 1997), WT/DS27/R/USA, 321, para. 7.159.

<sup>183</sup>Id., at para 7.160 (emphasis added).

<sup>184</sup>The European Communities and Japan also argue that the Subsidies Agreement does not explicitly authorize or permit Indonesia to apply discriminatory measures prohibited by Article III. As discussed, the measures at issue are not prohibited by Article III. The European Communities emphasizes the word "explicitly", implying that the Subsidies Agreement is not explicit enough. Yet the Subsidies Agreement is explicit enough that the EC itself admits that "Indonesia is ... authorised to grant 'subsidies' under certain conditions." Those conditions are the absence of serious prejudice to a like product and they are met in the instant case.

GATT, as well as with Article 2 of the ATC, simply by refraining from invoking the right to impose quantitative restrictions in the textiles sector because Article 2 of the ATC authorizes rather than mandates the imposition of quantitative restrictions. However, such an interpretation would render whole Articles or sections of Agreements covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A which were negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994.<sup>185</sup>

5.193 Contrary to Japan's assertion (See Section V.E.1(3)(c)), the relationship between Article III and the SCM Agreement is analogous to the relationship between Article XI and the ATC - a conflict exists regardless of whether Indonesia "could theoretically comply with" both Article III and the SCM Agreement "simply by refraining from invoking the right" to maintain the subsidies at issue absent serious prejudice to a like product. This is because the SCM Agreement "authorizes rather than mandates" maintenance of such subsidies. Finding that a conflict does not exist "would render" the provisions of the SCM Agreement regarding actionable subsidies "meaningless."

5.194 Furthermore, such a finding would "run counter to the object and purpose" of the SCM Agreement. Special and differential treatment of developing country Members is one of the objects and purposes of the Subsidies Agreement as evidenced by Article 27, which details that treatment, and by the language of Article 27.1 ("Members recognize that subsidies may play an important role in economic development programmes of developing country Members.").

5.195 The Panel in Bananas III recognized that "many agreements listed in Annex 1A ... were negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994." Indonesia's right to maintain the subsidies at issue absent serious prejudice to a like product is precisely this type of right. It "differ[s] substantially from those of the GATT 1994" and it is part of the compromise negotiated between the developed and the developing countries.

5.196 The DSU prohibits the diminishment of Indonesia's right to maintain the subsidies at issue absent serious prejudice to a like product. "Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." (DSU Article 3.2.) Furthermore, the DSU not only prohibits the nullification or impairment of Indonesia's benefits, it prohibits the impedance of an objective of the Subsidies Agreement expressed in Article 27.1 ("Members recognize that subsidies may play an important role in economic development programmes of developing country Members"). "All solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements ... shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements" (DSU Article 3.5).

5.197 The United States wrongly criticizes the Panel in Bananas III and Indonesia for not fully supporting the proposition that a conflict exists if obligations are not mutually exclusive. (See Section V.E.3). First, as discussed above, the obligations are mutually exclusive. Furthermore, the negotiating history of the SCM Agreement supports the view that a conflict exists where a "right" granted by one Agreement is "precluded" by a provision in another Agreement. Annex 1A Agreements, including the SCM Agreement, were "negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994."<sup>186</sup> The opposite view, as discussed above,

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<sup>185</sup> European Communities-Regime for the Importation, Sale and Distribution of Bananas (22 May 1997), WT/DS27/R/USA, 321, n. 403 (emphasis added).

<sup>186</sup> See European Communities-Regime for the Importation, Sale and Distribution of Bananas (22 May 1997), WT/DS27/R/USA, 321, n. 403.

“would render whole Articles or sections of Agreements covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A.”<sup>187</sup>

- (2) Paragraph 8(b) of Article III of the GATT 1994 is inapposite, except clarifying that Article III applies to discriminatory internal taxes on like products

5.198 Article III applies to discriminatory internal taxes on like products. The import duty subsidies are border measures, not internal measures, and therefore are outside the scope of Article III. (See Section V.F.1). The luxury tax subsidy is provided exclusively to producers or assemblers of automobiles and therefore is allowed under Article III:8(b) and is in accordance with Italian Discrimination Against Imported Agricultural Machinery.<sup>188</sup> The European Communities’s and Japan’s arguments regarding the interpretation of Article III:8(b) in United States-Measures Affecting Alcoholic and Malt Beverages<sup>189</sup> and Canada-Certain Measures Concerning Periodicals<sup>190</sup> are addressed in Section V.D.2. Moreover, even if the Panel finds that the luxury tax subsidy is not allowed under Article III:8(b), there is still no like product in the instant case. In quoting the report of the Sub-Committee of the Havana Conference, the European Communities itself recognizes that there must be a like product. Article III:8(b) was redrafted “in order to make it clear that nothing in Article [III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes.”<sup>191</sup>

- (m) Complainants’ assertion that the SCM Agreement cannot be *lex specialis* because, if it were, generally available and Article 8 subsidies would not be constrained, is incorrect

5.199 The example made by the United States (See Section V.E.3(a)(2)) involves differential internal taxation subject to Article III and is irrelevant to the instant case. The import duty subsidies are not internal measures (See Section V.F.1.), the luxury tax subsidy is allowed under Article III:8(b) and there are no like products involved in the instant case.

- (n) Even if the United States example were relevant, the point the United States seeks to advance is incorrect as a matter of law-the SCM Agreement addresses generally available and other Article 8 subsidies

5.200 Articles 1 through 9 of the SCM Agreement are comprehensive and explicit in setting out the definitions of, disciplines on and remedies for subsidies. The absence of an SCM Agreement remedy for non-specific subsidies, such as the one described by the United States, does not indicate that the SCM Agreement fails to provide an all-encompassing structure of remedies. Instead, this absence is part of that all-encompassing structure of remedies. The detail and explicitness of the remedy provisions of the SCM Agreement indicate that this result was intended by the drafters. In particular, the remedy provisions of Article 9 clearly do not apply to non-specific subsidies (Article 8.1(a)), only to other non-actionable subsidies (Article 8.1(b)). In any event, the United States example is irrelevant in the instant case because the measures at issue are actionable subsidies.

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<sup>187</sup> See *id.*

<sup>188</sup> Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60.

<sup>189</sup> United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206.

<sup>190</sup> Canada-Certain Measures Concerning Periodicals (30 June 1997), WT/DS31/AB/R.

<sup>191</sup> Report of Committees and Principal Sub-committees, United Nations Conference on Trade and Employment, held at Havana, Cuba from 21 November 1947 to 24 March 1948, ICITO I/8 (September 1948) at 66, para. 69 (emphasis added).

- (o) Japan's and the United States' claims that Indonesia's measures violate Article III:2, second sentence are incorrect

5.201 Japan's and the United States' claims that Indonesia's measures violate Article III:2, second sentence are incorrect. The SCM Agreement is *lex specialis* and, in the alternative, insofar as a conflict exists, controls the resolution of this dispute, including claims under Article III:2.

- (p) Japan's view that Indonesia's argument renders the General Interpretative Note meaningless is incorrect

5.202 Japan argues that "Indonesia's '*lex specialis*' theory would render the General Interpretative Note completely unnecessary and would severely weaken the GATT's fundamental obligations". (See Section V.E.1). Japan has mischaracterized Indonesia's position.

5.203 Indonesia's *lex specialis* argument does not "render the General Interpretative Note completely unnecessary." Rather, Indonesia's argument is supported by the General Interpretative Note. Because a "conflict" exists, the General Interpretative Note mandates that the provisions of the Subsidies Agreement "prevail to the extent of the conflict." Nor do any of Indonesia's arguments "severely weaken the GATT's fundamental obligations." As discussed above, Indonesia's interpretation that subsidies that meet the criteria of Articles 1 and 2 of the SCM Agreement are solely governed by the SCM Agreement is the only reasonable interpretation of the relationship between subsidies and Article III that would not render the SCM Agreement meaningless. This interpretation does not "severely weaken" Article III, but confines Article III to its appropriate sphere.

- (q) Parts and components are not "indirectly" taxed in excess of like domestic goods

5.204 Parts and components are not "indirectly" taxed in excess of "the like domestic goods". First, there are hardly any "like" parts and components. Second, importers of these parts and components continue to pay the tax in a direct manner and in the amounts and at the rates they have been paying for years. Not receiving benefits received by another company does not at all, either directly or indirectly, increase the tax on parties that do not receive the benefit.

E. Rebuttals to Indonesia's general response to the claims raised under Article III of GATT 1994

1. Rebuttal arguments of Japan

5.205 The following are **Japan's** arguments rebutting Indonesia's general defence to the claims raised under Article III of GATT 1994:

5.206 Indonesia argues that GATT Article III does not apply to this dispute. That view is wrong, however.

5.207 Regarding the luxury tax exemption, while Indonesia has not made other counter-arguments, such as those it has made concerning the import duty exemption. Therefore, it is undisputed that the local content requirement, at least in connection with the luxury tax exemption, constitutes a *prima facie* violation of GATT Article III:4 by treating domestic parts and components more favourably than like imports and the only question is whether the application of GATT Article III:4 to the luxury tax exemption is denied by virtue of the SCM Agreement.

5.208 Indonesia argues that its measures in question are actionable subsidies under the SCM Agreement, and specifically that they are subsidies contingent on the use of domestic products that would be prohibited by SCM Article 3.1(b) but are made actionable instead by virtue of Article 27.3. There is no dispute that Indonesia's discriminatory tax policies fall within the SCM Agreement's

definition of "subsidy" and they are actionable on a transitional basis under part III of the SCM Agreement. The only implication of this analysis is that, under the SCM Agreement, such subsidies are subject to the remedial provisions stipulated by Article 7, just like other subsidies including tax exemptions on domestic products actionable under the SCM Agreement, instead of Article 4, which provides the extremely expeditious procedures for prohibited subsidies. Therefore, the issue is whether the national treatment obligations of GATT Article III also apply to actionable subsidies.

5.209 Indonesia further argues that the national treatment obligations of GATT Article III do not apply to actionable subsidies, regardless of their nature, contending that such subsidies are governed solely by the SCM Agreement. In order to support that position, Indonesia mentioned four main arguments in its First Submission: the SCM Agreement is the *lex specialis* for "subsidies" within its definition; applying GATT Article III:2 to "subsidies" would reduce the SCM Agreement to inutility; GATT Article III and the SCM Agreement "conflict" with each other; and GATT Article III:8(b) should be "re-thought" in light of the SCM Agreement.

5.210 None of Indonesia's arguments have merit. Both GATT Article III and the SCM Agreement are applicable to the National Car Programme, there is no "conflict" between them, and GATT Article III prohibits the Indonesian measures. To accept Indonesia's argument, that is, to fail to apply GATT Article III:2 to "subsidies" would render one of the GATT's core provisions meaningless. Under Indonesia's interpretation, discriminatory imposition of internal taxes would be allowed in the name of "subsidy", but that would deprive Article III:2 of all life and purpose, because its sole function is to prohibit the discriminatory imposition of internal taxes. The following discussion demonstrates the flaws in the arguments made by Indonesia to support its incorrect theory of the relationship between GATT Article III and the SCM Agreement.

(a) Indonesia's *lex specialis* argument does not have any merit

5.211 Indonesia argues that "[t]his dispute involves subsidies and so is governed by the [SCM] Agreement, and not by the [GATT] or the [TRIMs Agreement]". Indonesia further argues that the SCM Agreement "is the *lex specialis* and the WTO conformity of the programmes must be assessed pursuant to the provisions of only this Agreement". (See Section V.D.)

(1) Indonesia's *lex specialis* argument is unsupported

5.212 Indonesia's *lex specialis* argument lacks any legal foundation. Indonesia essentially concedes this by failing in its First Submission to cite a single textual provision in support of its assertion that only the SCM Agreement applies to discriminatory tax breaks and other subsidy measures. This failure is unsurprising, of course, because there simply is no WTO rule that provides for specific agreements, such as the SCM Agreement, to apply to the complete exclusion of general WTO obligations, such as national treatment. The lack of textual support alone is enough to reject Indonesia's position<sup>192</sup>, but it is only compounded by the further absence from Indonesia's arguments of any citation to the drafting history, a Panel decision, or even a treatise in its support.

(2) Indonesia's *lex specialis* argument is wrong

5.213 Indonesia's *lex specialis* argument is also wrong. It is inconsistent with the text of the WTO Agreements.

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<sup>192</sup>See Vienna Convention on the Law of Treaties, art. 31; See also, United States - Standards for Reformulated and Conventional Gasoline ("US - Gasoline"), WT/DS2/AB/R, adopted on 20 May 1996, pp. 16-17.



5.214 As mentioned, no WTO rule provides for specific agreements to apply to the complete exclusion of general WTO obligations. To the contrary, the WTO Agreements expressly provide for a different - and much narrower - rule of law. Specifically, the General Interpretative Note to Annex 1A of the Agreement Establishing the WTO (the "General Interpretative Note") provides:

In the event of a conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A [of the WTO Agreement], the provision of the other agreement shall prevail to the extent of the conflict.

5.215 The existence of the General Interpretative Note thoroughly undermines Indonesia's *lex specialis* argument. The General Interpretative Note explicitly specifies the consequences if a "conflict" should arise between the GATT and certain other agreements, including the SCM Agreement, and it provides for preemption only "to the extent of the conflict." But if the SCM Agreement were the *lex specialis* that applied to the complete exclusion of the GATT, as Indonesia argues, then no "conflict" could ever occur between the two. It is obvious that the WTO Membership, by adopting the General Interpretative Note, formally acknowledged the possibility of "conflict". Thus, the General Interpretative Note, by its very existence, disproves Indonesia's *lex specialis* theory.

5.216 In addition, Indonesia's theory is disproved by the existence of footnote 56 to the SCM Agreement, which specifies that the SCM Agreement does not "preclude action under other relevant provisions of GATT 1994, where appropriate." As with the General Interpretative Note, footnote 56 definitively shows that the SCM Agreement does not apply to the complete exclusion of the GATT.<sup>193</sup>

5.217 Indonesia asserts that the SCM Agreement creates the "sole definition of subsidy for the family of WTO Agreements". However, there is no reason to ignore the plain language of Article 1.1 of the SCM Agreement, which expressly states that the definition is "for the purpose of this Agreement". One should interpret that article in good faith in accordance with the ordinary meaning to be given to its terms, as the Vienna Convention guides us to do.

5.218 Indonesia also claims its "right as a developing country to maintain domestic-content subsidies" absent serious prejudice to a like product. As mentioned already, the measures in question are not prohibited under the SCM Agreement, but made actionable on a transitional basis by virtue of SCM Article 27.3. However, this does not mean that developing countries are granted rights for exemption not only from SCM Article 3.1(b) but also from all other WTO provisions, including GATT Article III. In the context of discriminatory imposition of internal taxes, the measures in question are at the same time subject to GATT Article III.

(3) Indonesia's *lex specialis* argument has seriously damaging implications for the WTO system

5.219 If adopted, Indonesia's *lex specialis* argument would create loopholes in the GATT large enough to undermine the WTO's fundamental purpose of trade liberalization. In Indonesia's view of the WTO system, sanitary measures, technical standards, and entire categories of other measures would be largely exempted from the GATT and other general WTO disciplines. This result would occur, perversely, despite the facts that such measures were undeniably subject to the GATT before the Uruguay Round and that the clear purpose of the Uruguay Round was to strengthen - not weaken - multilateral disciplines.

5.220 The damage to the WTO system that would result from adoption of Indonesia's *lex specialis* argument is well illustrated by this case, since it would excuse Indonesia's violations of GATT

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<sup>193</sup>Vienna Convention on the Law of Treaties, art. 26.

Articles I:1, X:1, and X:3, although nothing about the SCM Agreement comes anywhere close to waiving the MFN obligation, excusing Indonesia's failure to publish its programmes, or allowing it to administer its programmes unreasonably and partially.

(b) The SCM Agreement would not be reduced to inutility by Article III:2 of GATT

5.221 As noted by the Appellate Body and previous Panels, under general rules of treaty interpretation, one must give meaning and effect to all terms of a treaty and must not "adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."<sup>194</sup> Indonesia invokes this principle in an attempt to prove that GATT Article III:2 does not apply to the National Car Programme, contending that application of Article III:2 would reduce the entire SCM Agreement to inutility. (See Section V.D.2). That argument is not only wrong, but backwards, and it should be rejected.

5.222 In fact, the SCM Agreement will continue to impose a variety of substantive and procedural disciplines on subsidies and countervailing measures regardless of the applicability of GATT Article III:2. There exist various subsidies which are subject to the SCM Agreement and are not proscribed by GATT Article III:2. For example, exempting domestic enterprises from certain internal taxes or charges, such as registration taxes, would not violate GATT Article III:2, when those taxes or charges are not applied in connection with imported products. However, such measures still fall into the scope of Article 1(a)(1)(ii) and Article 2.1 of the SCM Agreement and therefore these measures are subject to the disciplines of the SCM Agreement to their fullest extent.

5.223 Further, the SCM Agreement is not meaningless, even though GATT Article III, as a whole, applies to subsidies. The text of GATT Article III supports this observation, because the "subsidies" covered by GATT Article III:8(b) are not prevented by GATT Article III, but they may still be subject to the provisions of the SCM Agreement. Thus, it is plainly wrong to say that the SCM Agreement would be reduced to inutility if the Panel rules that GATT Article III:2, or the entire GATT Article III, applies to this case.

5.224 By contrast, GATT Article III:2 would be reduced to inutility if one accepted Indonesia's view of the SCM Agreement. Under that view, SCM Article 27.3 grants developing country Members a licence to impose discriminatory taxes on imported goods in clear contravention of GATT Article III:2. That view would further lead to an absurd conclusion that even developed country Members could engage in such discriminatory taxation, provided only that such discrimination was not contingent on the use of domestic over imported products, since nothing in the SCM Agreement prohibits such kinds of subsidies. It should be apparent that Indonesia's approach would eviscerate GATT Article III:2. All discriminatory internal taxation that had previously been regarded as violations of GATT Article III:2 would be suddenly recast as "subsidies" exempt from GATT Article III:2 disciplines. There would be no GATT Article III:2, because its sole function is to prohibit discriminatory internal taxes and they would all be exempt from its disciplines. The reasoning of the US - Malt Beverages Panel is exactly on point; that Panel rejected an argument like Indonesia's, declaring that "such an interpretation would virtually eliminate the prohibition in Article III:2 of discriminatory internal taxation by enabling contracting parties to exempt all domestic products from indirect taxes."<sup>195</sup>

5.225 Thus, the Appellate Body's warning that WTO provisions cannot be construed in a manner that deprives them of all force and effect precludes giving the SCM Agreement such a broad construction as

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<sup>194</sup>Appellate Body Report on US - Gasoline, p. 23; Appellate Body Report on Japan - Taxes on Alcoholic Beverages ("Japan - Alcoholic Beverages II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted on 1 November 1996, p. 12.

<sup>195</sup>See Panel Report on United States - Measures Affecting Alcoholic and Malt Beverages ("US - Malt Beverages"), DS23/R, adopted on 19 June 1992 (BISD 39S/206), para. 5.12.

to essentially repeal GATT Article III:2.<sup>196</sup> There is no danger of GATT Article III:2 reducing the SCM Agreement to inutility, but, as US - Malt Beverages recognized, adoption of Indonesia's argument would most certainly have that effect on GATT Article III:2.<sup>197</sup>

5.226 Other considerations also strongly dictate that the SCM Agreement must be construed to avoid this result. First, WTO cases that have addressed potential areas of conflict or overlap between WTO Agreements have favoured application of each agreement in accordance with its terms, rather than allowing one agreement to override another unnecessarily.<sup>198</sup> Second, numerous Panels over the years have recognized GATT Article III:2's critical importance both in its own right and in maintaining the effectiveness of Articles I (MFN) and II (tariff bindings).<sup>199</sup> Finally, there is no doubt that before the Uruguay Round Article III:2 prohibited discriminatory internal taxes and it would be perverse to construe a Uruguay Round Agreement in a manner that undermined an essential GATT discipline.

(c) GATT Article III does not "conflict" with the SCM Agreement

5.227 Indonesia also argues that the SCM Agreement conflicts with GATT Article III:2 and, per the General Interpretative Note, the SCM Agreement prevails in the conflict. That argument cannot be supported because there is no such conflict.

5.228 The Bananas III Panel construed the term "conflict" in the General Interpretative Note to include both cases of "mutually exclusive" obligations and cases where the GATT prohibits what an Annex 1A Agreement "explicitly permits," but not to cases where the two agreements provide for "different or complementary obligations." As the United States has observed, the Bananas III Panel construed the term "conflict" rather broadly. (See Section V.E.3). A finding that a "conflict" arises only where two agreements establish "mutually exclusive" obligations would be more in keeping with the drafting history of the General Interpretative Note (See Section V.E.1) and with earlier decisions that have sought to minimize potential conflicts between WTO agreements.<sup>200</sup> Even if one accepts the broad view of "conflict" from Bananas III, however, there is no "conflict" between the SCM Agreement and GATT Article III:2.

(1) The obligations of GATT Article III:2 and the SCM Agreement are not "mutually exclusive"

5.229 It is so clear that a Member may comply with the obligations of both GATT Article III and the SCM Agreement simply by not engaging in tax discrimination that Indonesia does not even seriously argue that the two are "mutually exclusive." Indonesia's does state that its "obligations under the two provisions would be mutually exclusive," but that cannot be regarded as a serious argument, because Indonesia did not (and could not) identify a single obligation of the SCM Agreement that requires

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<sup>196</sup>See, e.g., Appellate Body Report on Japan - Alcoholic Beverages II, p.12.

<sup>197</sup>Panel Report on US - Malt Beverages, para. 5.12.

<sup>198</sup>Panel Report on Canada - Certain Measures Concerning Periodicals ("Canada - Periodicals"), WT/DS31/R, adopted on 30 July 1997, as modified by the Appellate Body, paras. 5.17-5.18. Appellate Body Report on Canada - Periodicals, WT/DS31/AB/R, adopted on 30 July 1997, p. 18.

<sup>199</sup>See, e.g., Panel Report on US - Malt Beverages, paras. 5.9, 5.12.

<sup>200</sup>See, e.g., Report of the Appellate Body on Canada Periodicals, p. 18. The WTO Secretariat presented its views on the concept of "conflict" between two international agreements in connection with the negotiation of the Multilateral Agreement on Investment. The WTO Secretariat stated that, in the strict sense of the term, a conflict of law arises where an act obligated under one agreement is prohibited under another. The WTO Secretariat also differentiated the concept of "conflict" from the concept of "overlap." "Relationship of Proposed MAI Provisions to the WTO - Note by the WTO Secretariat," DAF/MAI/RD(96)37 (Japan Exhibit 68, p.2). See also "The Relationship between the MAI and the WTO Agreements (Note by the Chairman)," DAF/MAI/(96)21 (Japan Exhibit 69).

conduct in violation of GATT Article III:2. Instead, it appears that Indonesia has confused the two prongs of Bananas III.

- (2) The SCM Agreement does not "explicitly permit" tax discrimination in violation of GATT Article III:2

5.230 Indonesia's entire "conflict" argument depends on a finding that the SCM Agreement "explicitly permits" violations of Article III:2. But Indonesia fails to point the Panel to any such "explicit" language in the text. It would be impossible to do so. There simply is no language in the SCM Agreement that "explicitly permits" tax discrimination in violation of GATT Article III. The Textiles and Clothing Agreement explicitly authorized an exemption from the obligation to eliminate quantitative restrictions provided by GATT Article XI. Lacking any language in the SCM Agreement, equivalent to that under Articles I and II of the ATC, one cannot jump to the conclusion that the relationship between Article III and the SCM Agreement is "analogous to the relationship between Article XI and the ATC."

5.231 Lacking textual support, Indonesia nevertheless soldiers on by advancing a lengthy, elaborate, and rather convoluted argument about "actionable subsidies."

5.232 But still, nothing about Indonesia's argument shows that the SCM Agreement authorizes - explicitly or implicitly - "actionable subsidies" that violate GATT Article III:2. Indonesia concludes that "the SCM [Agreement] specifically does not prohibit developing countries from granting a subsidy involving differential internal tax treatment on products and ..., on the other hand, Article III:2 of GATT 1994 prohibits such differential internal tax treatment on products", and that this situation is "conflict". (See Section V.D.). Indonesia appears to be attempting, *sub silentio*, to stretch the definition of "explicitly permits". Indonesia would have the Panel believe that something the SCM Agreement "does not prohibit" is "explicitly permitted". Silence on tax discrimination can never mean "explicit permission", however. Therefore, the Panel should reject Indonesia's attempt to equate silence with "explicit permission".

5.233 The Indonesian argument seems to stem from a misunderstanding of Article 27.3 of the SCM Agreement. By its terms, SCM Article 27.3 provides developing country Members a temporary exemption from one obligation of the SCM Agreement, specifically, from SCM Article 3.1(b)'s prohibition of subsidies conditioned upon the use of domestic over imported goods. For developing country Members, during the five year transitional period, subsidies conditioned upon the use of domestic over imported goods are not deemed to be prohibited subsidies under Part II of the SCM Agreement, but are still actionable subsidies under Part III by virtue of Article 27.3. However, are actionable subsidies "explicitly permitted" to ignore GATT Article III? The answer is obviously negative. As demonstrated so far, GATT Article III does and should apply to subsidies under the SCM Agreement, including actionable subsidies. There is no reason to read an exemption from SCM Article 3.1(b) as an exemption from GATT Article III, or from any other WTO obligation. To the contrary, exceptions from GATT principles have traditionally been interpreted narrowly by GATT and WTO panels, and as already discussed, footnote 56 to the SCM Agreement provides that the SCM Agreement does not "preclude action under other relevant provisions of GATT 1994, where appropriate."

- (3) The SCM Agreement and GATT Article III:2 create "different or complementary" obligations

5.234 The Panel should recognize that the SCM Agreement and GATT Article III:2 create "different or complementary obligations". As described by the Bananas III Panel, two provisions are "different or complementary", and do not conflict, if "both can be complied with at the same time without the need to renounce explicit rights or authorizations". GATT Article III:2 and the SCM Agreement can both be complied with and Indonesia has failed to show that such compliance would require it to renounce any "explicit rights".

5.235 It should be recalled here that what triggers the luxury tax exemption is not merely the use of a domestic product (i.e., parts and components) by a domestic producer, it is the sale of a domestic product (i.e., an automobile) with domestic content to the final consumer. We therefore do not have here only the type of discrimination addressed by Article 3.1(b) of the SCM Agreement (i.e., a subsidy to a producer contingent upon use of a domestic product), but also a type of discrimination governed only by GATT Article III:2 (i.e., internal tax discrimination between imported and domestic products). This highlights the fact that GATT Article III and SCM Article 3.1(b) have clearly different purposes, coverage, and remedies.

5.236 Further, with regard to remedies, the SCM Agreement allows both dispute settlement procedures under Article 4 or Article 7 and countervailing measures in accordance with Part V of the Agreement, while remedies for violations of GATT Article III:2 are provided under GATT Article XXII and Article XXIII. In this respect, Indonesia attaches too much emphasis to the higher burden of proof under the SCM Agreement. However, Indonesia's proposition that the SCM Agreement is more favourable to defending parties than GATT Article III in terms of remedial procedures, and thus provides defending parties some procedural rights, is questionable. The remedial process under Article 7 of the SCM Agreement is much more expeditious than those under the Dispute Settlement Understanding. Complaining parties are required to prove adverse trade effects but they can secure remedies under Article 7 of the SCM Agreement much earlier than in the case of a claim concerning the infringement of the GATT obligations under the DSU. In other words, complaining parties bear the burden of proving adverse trade effects in exchange for a more expeditious remedy. Indonesia also stresses that, under Article 7 of the SCM Agreement, the only remedy required is to eliminate "the adverse effects". However, we do not see any substantial difference between the obligations to eliminate the adverse effects and those to bring the measures into conformity with the GATT obligations. It should also be noted that under Article 7 of the SCM Agreement "appropriate steps to remove the adverse effects" have to be taken within 6 months from the date of adoption of the recommendations by the DSB, only 2/5 of the 15 months guideline for the "reasonable period of time" to implement the DSB recommendations stipulated by Article 21.3 of the DSU. Therefore, even though Article III of the GATT 1994 is applicable, complaining parties may choose to resort to Article 7 of the SCM Agreement, as the United States and the European Communities do in this case.

(4) "Conflict" should be narrowly interpreted

5.237 In keeping with the fundamental objective and purpose of the WTO system - trade liberalization - WTO cases that have addressed potential areas of conflict and overlap between the WTO agreements have favoured application of each agreement in accordance with its terms to the maximum extent possible, rather than unnecessarily allowing one agreement to override another.<sup>201</sup>

5.238 Given that under the WTO system, waivers and exceptions "have to be interpreted narrowly"<sup>202</sup>, the waiver of the prohibition under Article 3.1(b) of the SCM Agreement cannot reasonably be interpreted as a license to violate any and all other obligations under the WTO agreements. Japan's claim under Article III of GATT 1994 is not that the Programme provides a prohibited subsidy, but that it violates national treatment, including Indonesia's obligation under GATT Article III:2 to tax domestic and imported like products at the same rate. If the WTO Members had intended to waive the obligations under GATT Article III:2 entirely for developing countries, they would have done so

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<sup>201</sup>See, e.g., Report of the Appellate Body on Canada - Periodicals, page 19.

<sup>202</sup>As noted in the GATT panel report on US - Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada, provisions that constitute "an exception to basic principles of the General Agreement had to be interpreted narrowly." BISD 38S/30, para. 4.4, adopted 11 July 1991. See also Norway - Procurement of Toll Collection Equipment, GPR DS2/R, para. 4.5, adopted 13 May 1992 ("Since Article V:16(3) [of the Government Procurement Agreement] was an exceptions provision, its scope had to be interpreted narrowly"); Canada - Import Restrictions on Ice Cream and Yoghurt, BISD 36S/68, para. 59, adopted 4 December 1989 (The panel "noted, as had previous panels, that exceptions were to be narrowly interpreted.").

explicitly, given that "[t]he MFN requirement in Article I, and also tariff bindings under Article II, would become ineffective" without enforcement of the Article III:2 prohibition on discriminatory tax measures, including discriminatory tax exemptions.<sup>203</sup>

5.239 The drafting history of the term "conflict" in the General Interpretative Note in the "third track" negotiating group also confirms that the term suggests an irreconcilable difference. The initial discussion on the relationship between GATT 1994 and the other WTO agreements occurred during the drafting of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") in the "third track" negotiating group chaired by Mr. Julio Lacarte. The delegation of Canada then submitted on 14 October 1993 a proposal entitled "Conflict of Substantive Provisions" that included the addition of the following "Headnote to Annex 1A in the MTO Agreement":

In the event of a conflict between a provision of the GATT (1993) and a provision of another agreement in Annex 1A, the provision of the other agreement shall take precedence to the extent of the inconsistency."<sup>204</sup>

5.240 At the session of 19 October 1993, the delegation of Japan proposed to delete the term "inconsistency" and replace it with the term "conflict". Other delegations approved this amendment, and it was incorporated in a working paper dated 6 December 1993 prepared by the secretariat to record the results of this session and to facilitate future discussions among the negotiating group.<sup>205</sup> The delegations that addressed this amendment at the session generally concurred that it was intended to clarify the limited number of instances in which the Note would apply. Whereas "inconsistency" was open to a broad interpretation, "conflict" referred only to irreconcilable differences between an obligation under GATT 1994 and an obligation under another WTO agreement, such that the provisions of the two agreements were mutually exclusive and could not both be enforced at the same time.

(d) GATT Article III:8(b) has never excused tax discrimination and should not be "re-thought" to excuse it now

(1) GATT Article III:8(b) has never excused tax discrimination

5.241 Article III:8(b) provides that Article III "shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article ...."

5.242 As is evident from the textual reference to "payments . . . derived from the proceeds of internal taxes," the scope of Article III:8(b) is limited to direct payments to producers. Other measures that may be characterized as "subsidies," such as discriminatory tax breaks for domestic products, are not covered.

5.243 This plain understanding of Article III:8(b) was confirmed by the GATT Panel in US - Malt Beverages.<sup>206</sup> That Panel unequivocally rejected the argument that discriminatory tax breaks were "subsidies" protected by Article III:8(b), declaring that such an argument was contrary to the text, "context, declared purpose and drafting history of Article III."<sup>207</sup> The drafting history could hardly be more clear about this point; the Havana Conference rejected an alternative to Article III:8(b) proposed by the Cuban delegate that would have expressly permitted "the exemption of domestic products from internal taxes as a means of indirect subsidization. . . ."<sup>208</sup> This evidence from the drafting history confirms the plain text of Article III:8(b) in showing that it is limited to direct payments to producers.

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<sup>203</sup>US - Malt Beverages, paras. 5.9, 5.12.

<sup>204</sup>Canadian Proposal "Conflict of Substantive Provisions" dated 14 October 1993 (Japan Exhibit 64).

<sup>205</sup>Draft prepared by the GATT Secretariat dated 6 December 1993 (Japan Exhibit 65).

<sup>206</sup>Panel Report on US - Malt Beverages, paras. 5.7-5.12.

<sup>207</sup>Id. at para. 5.9.

<sup>208</sup>Id. at para. 5.11.

Discriminatory tax breaks for products have never been covered by Article III:8(b), and are inconsistent with GATT Article III:8(b). The US - Malt Beverages decision was followed by the GATT Panel in US - Tobacco and it was reaffirmed in Canada - Periodicals, by the Appellate Body which declared that Article III:8(b) "was intended to exempt from the obligations of Article III only the payment of subsidies which involve the expenditure of revenue by a government."<sup>209</sup>

5.244 Therefore, it is beyond doubt that the well-settled understanding of Article III:8(b) is that it covers direct payments of subsidies, but not discriminatory tax breaks. Indonesia does not dispute this. Instead, it admits that its position is inconsistent with the prevailing understanding of Article III:8(b) by advocating a "re-thinking" of that Article. (See Section V.D.)

5.245 Also, even if the discriminatory tax breaks could be considered as "subsidies" under GATT Article III:8(b), they are not directed "exclusively to domestic producers". The direct beneficiaries of the luxury tax exemption are consumers, not the producer of National Cars or producers of its parts and components.<sup>210</sup>

(2) GATT Article III:8(b) should not be "re-thought" to excuse tax discrimination

5.246 Indonesia argues that GATT Article III:8(b) should be "re- thought" to exempt "all subsidies identified in Article 1 of the SCM Agreement" from the obligations of GATT Article III. (See Section V.D). In other words, Indonesia argues that the SCM Agreement's definition of "subsidy" should be read into Article III:8(b). Because the SCM Agreement's definition of "subsidy" includes foregoing "government revenue that is otherwise due", Indonesia argues that this Panel should reject US- Malt Beverages.

5.247 It is Indonesia's argument that should be rejected. The SCM Agreement itself rejects the notion that its definition of "subsidy" should be applied to other WTO Agreements. SCM Article 1.1 expressly states that the definition of "subsidy" is provided "[f]or the purpose of this Agreement." There is no suggestion anywhere in the WTO text that the SCM definition of "subsidy" should be applied to GATT Article III.

5.248 Indonesia's argument is also undermined by the fact that the Appellate Body reaffirmed US - Malt Beverages in Canada - Periodicals.<sup>211</sup> If the Appellate Body considered that the scope of Article III:8(b) had to be "re-thought" in light of the SCM Agreement, it could have and should have done so in Canada - Periodicals. But it did not "re-think" Article III:8(b); it reaffirmed the accepted understanding. Faced with this glaring flaw in its argument, Indonesia argues weakly that Canada did not argue for application of the SCM Agreement in that case. But what Canada did or did not argue in a previous case is wholly irrelevant here. What matters is that the Appellate Body has considered the scope of Article III:8(b) and has decided that it applies only to direct subsidy payments, not to discriminatory tax breaks. Indonesia's position is at odds with the Appellate Body's interpretation of Article III:8(b), and it should be rejected.

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<sup>209</sup>Panel Report on United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco, DS44/R, adopted on 4 October 1994, para. 109 & note; Report of the Appellate Body on Canada - Periodicals, pp. 31-33 (emphasis added).

<sup>210</sup>See Panel Report on Italian Agricultural Machinery, para.14 (holding that Article III:8(b) does not apply to payments granted to purchasers of agricultural machinery, because such payments cannot be regarded as subsidies to the producers of the machinery). See also European Economic Community - Payments and Subsidies paid to Processors and Producers of Oilseeds and related Animal-Feed Proteins ("EEC - Oilseeds"), L/6627, adopted on 25 January 1990, 37S/86, para.137 (holding that subsidy payments that economically benefit oilseed processors, and not only oilseed producers, are not subsidies paid "exclusively to domestic producers" under Article III:8(b)).

<sup>211</sup>Appellate Body Report on Canada - Periodicals, pp. 32-34.

5.249 Moreover, the rationale of US - Malt Beverages remains every bit as valid today as it was when adopted. It is still the case that including tax discrimination within the scope of Article III:8(b) is contrary to the text, context, declared purpose, and drafting history of Article III. It also remains true that "the prohibition of discriminatory internal taxes in Article III:2 would be ineffective if discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8(b)."<sup>212</sup> Thus, the Appellate Body's admonition against reducing WTO provisions to inutility precludes any "re-thinking" of Article III:8(b) that would render Article III:2 ineffective. And, once again, there is no reason whatsoever to believe that, by strengthening multilateral disciplines on subsidies, the Uruguay Round essentially repealed Article III:2's prohibition on discriminatory taxation. As stressed in the beginning of this Part, weakening Article III by abandoning its established interpretation and adopting Indonesia's proposed "re-thinking" would cause grave harm to the core WTO disciplines of MFN, tariff bindings, and national treatment.<sup>213</sup>

5.250 For all these reasons, the Government of Japan submits that there is no reason for the Panel to abandon a well-established and recently reaffirmed interpretation of a key GATT provision.

## 2. Rebuttal arguments of the European Communities

5.251 The following are the **European Communities'** arguments rebutting Indonesia's general response to the claims raised under Article III of GATT 1994:

### (a) GATT Article III and the SCM Agreement are not mutually exclusive

5.252 Indonesia does not even attempt to argue that the tax incentives identified in Section III.B are consistent with GATT Articles III:2, first sentence, and III:4. Instead, Indonesia contends that those measures are "subsidies" within the meaning of the SCM agreement and, as such, not subject to GATT Article III but only and exclusively to the SCM Agreement.

5.253 The European Communities does not dispute that the measures at issue are subsidies. Indeed, the European Communities claims that those measures are "specific subsidies" within the meaning of the SCM Agreement which cause "serious prejudice" to its interests, contrary to Indonesia's obligations under that Agreement. Nevertheless, the European Communities is of the view that GATT Article III and the SCM Agreement are not mutually exclusive and, therefore, can be applied simultaneously to the same measures.

### (1) GATT Article III:8(b) confirms that Article III applies to subsidies

5.254 Article III:8(b) of GATT reads as follows:

(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

5.255 Article III:8(b) does not create an exception to the other provisions of Article III. Rather, the purpose of Article III:8(b) is to clarify that the other provisions of Article III do not apply to certain

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<sup>212</sup>Panel Report on US - Malt Beverages, para. 5.9.

<sup>213</sup>Id. paras. 5.9, 5.12.



types of subsidies.<sup>214</sup> Those subsidies which are not covered by Article III:8(b) are not contrary per se to the other provisions of Article III. Nonetheless, Article III:8(b) has the clear implication that measures not falling within that provision are not exempt from the other provisions of Article III simply because they can be characterized as “subsidies”.

5.256 The use of the term “payment” in the phrase “payment of subsidies” clearly indicates that the scope of Article III:8(b) is limited to subsidies involving an actual transfer of funds from the Government to domestic producers. Exemptions or reductions from an indirect sales tax on products do not involve any such transfer of funds. Therefore, that type of subsidies is not covered by Article III:8(b). The same reasoning applies in the case of subsidies in the form of an exemption or reduction of import duties.

5.257 The drafting history of GATT provides further confirmation that Article III:8(b) was not intended to cover exemptions or reductions from indirect taxes on products. The Report of the Sub-Committee at the Havana Conference which examined this provisions noted that:

This subparagraph was re-drafted in order to make it clear that nothing in [Article III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in [Article III] would override the provisions of Section C of Chapter IV [on subsidies]<sup>215</sup>.

5.258 Furthermore, the drafters of Article III explicitly rejected a proposal by Cuba at the Havana Conference to amend that Article to read:

The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article [XVI].<sup>216</sup>

5.259 This view is also supported by the 1992 Panel Report on US - Measures Affecting Alcoholic and Malt Beverages. In that case, the United States argued that the application of a lower excise tax to small United States producers of beer was allowable as a subsidy under Article III:8(b). This defence was categorically rejected by the Panel:

5.12 The Panel found, therefore, that the expansive interpretation of Article III:8(b) suggested by the United States is not supported by the text, context, declared purpose and drafting history of Article III, and if carried to its logical conclusion, such an interpretation would virtually eliminate the prohibition in Article III:2 of discriminatory

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<sup>214</sup>As noted by the Panel Report on United States - Measures affecting Alcoholic and Malt Beverages (adopted on 19 June 1992, BISD 39S/206, at para 5.8)

“... in contrast to Article III:8 (a), where it is stated that ‘this Article shall not apply to ... [government procurement]’, the underlined words are not repeated in Article III:8 (b). The ordinary meaning of the text of Article III:8 (b), especially the words ‘shall not prevent’, therefore suggests that Article III does apply to subsidies, and that Article III:8(b) only clarifies that the product-related rules in paragraph 1 through 7 of Article III ‘shall not prevent the payment of subsidies exclusively to domestic producers’ [emphasis added by the Panel]

<sup>215</sup>Indonesia contends that neither previous GATT Panel Reports nor the Appellate Body Report on Canada - Certain Measures Concerning Periodicals (adopted on 30 June 1997, WT/DS 31/AB/R) have focused or analysed the last sentence of this citation. This is arguably true but irrelevant. That sentence confirms the proposition that Article III and Article XVI are not mutually exclusive: the mere fact that a measure is a subsidy falling within Article XVI does not exclude the application of Article III and, conversely, the application of Article III does not exclude the application of Article XVI.

<sup>216</sup>E/CONF.2/C.3/6, p.17; E/CONF.2/C.3/A/W.32, page 2.

internal taxation by enabling contracting parties to exempt all domestic products from indirect taxes. The Panel accordingly found that the reduced federal excise tax rates on beer are not covered by Article III:8(b).<sup>217</sup>

5.260 Indonesia contends that the Panel Report on US - Measures affecting Alcoholic and Malt Beverages was adopted under the GATT 1947 and that it is necessary to "re-think" the scope of Article III:8 (b) in light of the WTO Agreement, and in particular of the SCM Agreement. More precisely, according to Indonesia, "under the WTO, the 'payment of subsidies' language in Article III:8 (b) must refer to all subsidies identified in Article 1 of the Subsidies Agreement". (See Section V.D.)

5.261 Yet, in the recent case Canada - Certain measures concerning Periodicals<sup>218</sup>, the Appellate Body has endorsed expressly the Panel Report on US - Measures Affecting Alcoholic and Malt Beverages, thus confirming that the interpretation of Article III:8 (b) of GATT made by that Panel remains still valid under GATT 1994.

5.262 The issue in dispute in Canada - Certain measures concerning Periodicals was whether the application by Canada Post of a reduced postal rate to certain domestic periodicals was a subsidy covered by Article III:8 (b). Following a careful examination of the text, the context and the drafting history of that provision in line with the analysis made in the preceding paragraphs, the Appellate Body concluded as follows:

We do not see a reason to distinguish a reduction of tax rates on a product from a reduction in transportation or postal rates. Indeed, an examination of the text, context, and object and purpose of Article III:8(b) suggests that it was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government,<sup>219</sup> [emphasis added].

5.263 The Appellate Body then went on to express its agreement with the following passage of the Panel Report on US - Measures affecting Alcoholic and Malt Beverages:

5.10 Article III:8(b) limits, therefore, the permissible producers subsidies to 'payments' after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests can be balanced.<sup>220</sup>

5.264 Thus, contrary to the suggestions advanced by Indonesia, in Canada - Certain measures concerning Periodicals the Appellate Body made it very clear that a subsidy in the form of an exemption or reduction of tax rates on a product does not fall within Article III:8(b). The Appellate Body Report on Canada - Certain measures concerning Periodicals cannot be explained away simply by saying that

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<sup>217</sup>Panel Report on United States - Measures affecting Alcoholic and Malt Beverages, adopted on 19 June 1992, BISD 39S/206, at para 5.12.

<sup>218</sup>Appellate Body Report on Canada - Certain Measures concerning Periodicals, adopted on 20 June 1997, WT/DS 31/AB/R.

<sup>219</sup>Id., at p. 34.

<sup>220</sup>Panel Report on United States - Measures affecting Alcoholic and Malt Beverages (adopted on 19 June 1992, BISD 39S/206, at para 5.10), reproduced in Appellate Body Report on Canada - Certain Measures concerning Periodicals, WT/DS 31/AB/R, p. 34.

Canada did not raise the argument that the measures at issue were subsidies covered by the SCM Agreement. (See Section V.D). GATT Article III:8(b) cannot have different meanings depending on the arguments raised by the parties to a dispute. If the SCM Agreement had changed the meaning of GATT Article III:8(b), the Appellate Body should have taken into account that new meaning, even if it was not invoked by Canada.

(2) The SCM Agreement is not *lex specialis*

5.265 As a preliminary remark, the European Communities notes that it may be questionable whether the *lex specialis* principle qualifies as a “customary rule of interpretation of public international law” in the sense of Article 3.2 of the DSU. The defendant has not provided any evidence to that effect. Furthermore, the European Communities notes that such principle is nowhere mentioned in the Vienna Convention on the Law of the Treaties.

5.266 Assuming that the *lex specialis* rule was in fact a customary rule of public international law, the General Interpretative Note to Annex 1A would exclude its application between the GATT and the other Annex 1A Agreements. The clear intention of the WTO drafters was that the relationship between the GATT 1994 and the other Agreements included in Annex 1A should be governed only and exclusively by the rule contained in the General Interpretative Note to Annex 1A. The wording of that Note was carefully chosen so as to restrict the number of instances where the other Agreements included in Annex 1A would prevail over GATT 1994. (See Section V.E.1.) Those cautions would have been unnecessary if the drafters had envisaged the application of the *lex specialis* rule between GATT and the other Annex 1 Agreements.<sup>221</sup>

5.267 In any event, Indonesia has not shown that the SCM Agreement is the *lex specialis* in this dispute. Unlike GATT Article III:2, which is specifically concerned with indirect taxation, the SCM Agreement does not contain any rule dealing specifically with indirect taxes. Moreover, whilst virtually all measures falling within Article III:2 may be construed as “subsidies” within the meaning of Article 1 of the SCM Agreement, the opposite is clearly not true: most subsidies subject to the SCM Agreement do not fall within either Article III:2 or any of the other provisions of Article III. Thus, if the *lex specialis* principle was deemed applicable, Article III:2 and not the SCM Agreement would have to be considered as the relevant *lex specialis* with respect to the tax exemptions and reductions granted by Indonesia. As will be shown below GATT Article III:4 and the SCM Agreement overlap. Some (but by

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<sup>221</sup>The *lex specialis* rule has never been invoked by prior Panels or by the Appellate Body in order to decide on the relationship between GATT 1994 and another Agreement contained in Annex 1A. The Panel Reports on EC - Regime for the Importation, Sale and Distribution of Bananas, examined the relationship between the GATT, on the one hand, and the TRIMs Agreement and the Agreement on Import Licensing Procedures, on the other hand, exclusively in light of the General Interpretative Note, even though, having regard to the greater degree of specificity of the obligations they impose, the two latter agreements are arguably *lex specialis* with respect to the GATT. According to the Panel, those two agreements and the GATT were “equally applicable” to the measures at issue in the absence of a “conflict” within the meaning of the General Interpretative Note. (See e.g. WT/DS27/R/USA, adopted on 25 September 1997, at paras 7.152.- 7.158)

The Report of the Appellate Body in the same case (WT/DS27/AB/R, adopted on 25 September 1997, at para 204) hold that:

“Although Article X:3(a) of the GATT 1994 and Article 1.3 of the Licensing Agreement both apply, the Panel, in our view, should have applied the Licensing Agreement first, since this agreement deals specifically, and in detail, with the administration of importing licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3 (a) of the GATT 1994)” [emphasis added]

Thus, the Appellate Body ruled that “both” Article X of GATT and the Licensing Agreement applied to the measures and that the latter should have been applied “first”, and not “instead of” GATT Article X, as the *lex specialis* rule would have required.

no means all) measures covered by Article III:4 are also covered by the SCM Agreement. Thus, it cannot be said that any one of them is *lex specialis* with respect to the other.<sup>222</sup>

(3) The application of GATT Article III to subsidies does not render the SCM Agreement redundant

5.268 Indonesia's contention that virtually all subsidies other than subsidized import duties are contrary to GATT Article III is based on a gross misinterpretation of the scope of that provision. Moreover, it ignores that the remedies provided by the SCM Agreement are different from the remedies available in case of breach of the GATT.

5.269 Article 1 of the SCM Agreement identifies three different ways in which a Government can provide a subsidy<sup>223</sup>:

- (i) by making a direct transfer of funds (e.g. grants, loans, an equity infusion);
- (ii) by foregoing or non collecting government revenue that is otherwise due (e.g. fiscal incentives such as tax credits); and
- (iii) by providing goods or services, or by purchasing goods.

5.270 Direct transfers of funds are not covered by GATT Article III:2, which is concerned only with the application of indirect taxes on products. Moreover, loans, grants or equity infusions are not "laws, regulations or requirements" which "affect" as such the internal sale, offering for sale, purchase, transportation, distribution or use of products.<sup>224</sup> For that reason, the granting of this category of subsidies cannot breach by itself GATT Article III:4. As shown by previous Panel Reports, this type of subsidies may be contrary to Article III:4 only to the extent that they are linked to a measure which affects the internal sale, purchase, use, etc. of domestic goods. For example, in Italian Agricultural Machinery<sup>225</sup>, the Panel found that an Italian law providing special credit terms to farmers for the purchase of agricultural machinery conditional upon the purchase of machinery produced in Italy was, by virtue of that condition, contrary to GATT Article III:4. As discussed above, that subsidies in the

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<sup>222</sup>The relationship between GATT Article III:4 and the SCM Agreement is similar to that between the GATT and the GATS as described by the Appellate Body in the following passage of its Report on EC - Regime for the Importation, Sale and Distribution of Bananas (WT/DS27/AB/R, adopted on 25 September 1997, at para 221):

"Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT and the GATS (...) In all such cases in this third category, the measure in question could be scrutinised under both the GATT 1994 and the GATS. However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular goods is scrutinized under the GATT 1996 or the GATS, or both, is a matter that can only be determined on a case-by-case basis".

<sup>223</sup>In addition, Article A.1 (a) (1) (iv) of the SCM Agreement refers to the hypothesis where a Government makes payments to a funding mechanism or entrusts or directs a private body to carry out one or more of the types of functions illustrated in (i) to (iii).

<sup>224</sup> E/CONF.2/C.3/6, p.17; E/CONF.2/C.3/A/W.32, p.2.

<sup>225</sup>Panel Report on Italian Agricultural Machinery, adopted on 23 October 1958, 7S/60.

form of direct transfer of funds are not caught by GATT Article III is further confirmed by GATT Article III:8(b).

5.271 The above considerations are equally applicable in the case of subsidies falling within category (iii), even if GATT Article III:8(b) does not refer to the provision of goods and services to a domestic producer. Thus, for instance, the provision of raw materials by the Government at a subsidized price would not be contrary to either Article III:2 or Article III:4, because it does not affect as such the internal sale, offering for sale, etc of goods. On the other hand, the provision by the Government of, for example, services of transportation or distribution at subsidized rates only for domestic goods would be contrary to Articles III:4<sup>226</sup> and/or III:2.

5.272 Category (ii) includes, in essence, three different types of subsidies: subsidies granted in respect of indirect taxes on products; subsidies granted in respect of import duties; and subsidies granted in respect of direct taxes.

5.273 If the taxes are indirect, GATT Article III:2 may apply. In contrast, subsidies granted in respect of direct taxes are not covered by Article III:2 which, to repeat, is concerned only with indirect taxes. Nor are those subsidies subject to GATT Article III:4. First, because direct taxes are not applied on “products” and therefore do not “affect” as such their sale, offering for sale, etc. Moreover, a reduction or exemption from a direct tax could never be considered to give “more favourable treatment” in the sense of Article III:4, given that foreign producers (and indirectly their products) are not subject to those taxes in the first place. Like the subsidies falling within the category (i), subsidies granted in respect of direct taxes may infringe Article III:4 only to the extent that they are linked to other conditions which favour the use, purchase, etc. of domestic products.

5.274 Subsidies granted in respect of import duties are not covered, in principle, by Article III since import duties are border measures. Nevertheless, this type of subsidies may violate Article III:4 where, as in the present dispute, its granting is conditional upon compliance with a measure, such as a local content target, which affects the internal use of products (see Section V.F.3).

5.275 In sum, whilst GATT Article III and the SCM Agreement may overlap in respect of certain measures, most subsidies covered by the SCM Agreement do not fall within the scope of GATT Article III.

5.276 Moreover, Articles 4 and 7 of the SCM Agreement provide specific remedies which are more rigorous for the subsidising Member than the ordinary remedies available under the DSU in case of breach of GATT Article III.

5.277 The importance of this difference is perfectly illustrated by the present dispute. If the Panel finds that Indonesia has violated Article III of GATT, Indonesia will be required “to bring the measure into conformity with” the GATT (cf. Article 19 of the DSU). In practice, this means that Indonesia will have to amend or repeal the measures, but only for the future.

5.278 In contrast, if the Panel found that those measures constitute subsidies which have caused “serious prejudice” to the interests of the EC, Indonesia would be required, in accordance with Article 7.8 of the SCM Agreement, to “withdraw” the subsidies or to “remove” its “adverse effects”. This may imply the obligation for Indonesia not just to repeal or amend the measures but in addition to recover the

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<sup>226</sup>Thus, for instance, in Canada - Certain measures concerning periodicals, the application by Canada Post of more favourable postage rates for domestic periodicals was found to violate Article III:4. (Panel Report WT/DS31/R, at paras 5.31-5.44, as modified by the Appellate Body Report, WT/DS31/AB/R, adopted on 20 June 1997, at pp. 32-35).

unpaid duties and taxes on motor vehicles which have already benefited from those exemptions, to the extent that those subsidies continue to cause “adverse effects”.

(4) The non-application of GATT Article III:2 to subsidies would render GATT Articles III:2 and III:8(b) superfluous

5.279 Whilst, for the reasons explained above, the application of GATT Article III to subsidies would by no means render the SCM Agreement redundant, its non-application would reduce GATT Article III:2 to inutility. In effect, any measure falling within GATT Article III:2 can be construed as “revenue foregone” within the meaning of Article 1.1 (a) (1) (ii) of the SCM Agreement and therefore as a “subsidy”.

5.280 As noted by the Panel Report on US - Measures affecting Alcoholic and Malt Beverages:

... As any fiscal burden imposed by discriminatory internal taxes on imported goods is likely to entail a trade-distorting advantage for import-competing domestic producers, the prohibition of discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8 (b).<sup>227</sup>

... carried to its logical conclusion, [the United States interpretation] would virtually eliminate the prohibition in Article III:2 of discriminatory internal taxation by enabling contracting parties to exempt all domestic producers from indirect taxes...<sup>228</sup>

5.281 Furthermore, Indonesia’s *lex specialis* argument also would reduce to inutility GATT Article III:8(b). In fact, if the SCM was *lex specialis* with respect to Article III:2 whenever a subsidy is involved, there would be no need to clarify in the GATT that certain categories of subsidies are not covered by GATT Article III.

(5) The SCM Agreement has not modified the relationship between the rules on subsidies and the rules on national treatment which existed under GATT 1947

5.282 Under GATT 1947, there was no question that Article XVI was *lex specialis* vis-à-vis Article III to the extent that “subsidies” were concerned; or that there was a “conflict” between those two provisions simply because Article XVI did not prohibit certain types of measures that were prohibited by Article III.

5.283 Indonesia does not, apparently, dispute that under GATT 1947 Article III and Article XVI were not mutually exclusive. Yet, Indonesia contends that “all of that changed with the entry into force of the WTO”. Indonesia gives two reasons for that “change”. The first reason is that the SCM Agreement provides an “all encompassing structure of remedies” against subsidies. The second reason is that the SCM Agreement contains a definition of “subsidy”. As will be shown below, both reasons are far from compelling.

5.284 Article XVI of GATT 1947 did contain also an “all encompassing structure of remedies applicable to subsidies”, in the sense that it provided remedies with respect to all subsidies. Section A laid down a remedy for all “subsidies in general”; whereas Section B provided additional remedies for export subsidies. The remedies provided in Section A of Article XVI in respect of the type of subsidies at issue in this dispute are less rigorous for the subsidising Member than those provided in the SCM Agreement. But they are no less “encompassing”. Formally, the relationship between the SCM

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<sup>227</sup>Panel Report on United States - Measures affecting Alcoholic and Malt Beverages (adopted on 19 June 1992, BISD 39S/206, at para 5.9.

<sup>228</sup>*Id.*, at para 5.12

Agreement and Article III of GATT 1994 is identical to the relationship between Article XVI of GATT 1947 and Article III of GATT 1947. The mere fact that the remedies against subsidies have been strengthened in the SCM Agreement is not a sufficient reason to conclude that Article III no longer applies to subsidies.

5.285 The fact that the SCM Agreement contains a definition of subsidies is also irrelevant. The absence of a definition of “subsidy” in GATT 1947 did not make Article XVI inapplicable, nor therefore prevented it from applying concurrently with Article III to the same measures. Furthermore, Article 1.1 of the SCM Agreement states very clearly that the definition of subsidy contained therein is only for the purposes of that Agreement.

(6) Article 32.1 *juncto* Footnote 56 of the SCM Agreement confirms that the SCM Agreement does not exclude the application of GATT Article III to subsidies

5.286 If, as claimed by Indonesia, the WTO Agreement had rendered GATT Article III inapplicable to subsidies, one would expect to find some indication in the SCM Agreement of the drafters’ intention to introduce such a fundamental change with respect to the situation existing under GATT 1947. Yet, the SCM Agreement does not contain the slightest trace of such intention.

5.287 To the contrary, Article 32.1 *juncto* Footnote No 56 of the SCM Agreement indicates that the drafters of the WTO Agreement expressly envisaged the continued application of GATT Article III to subsidies covered by the SCM Agreement.

5.288 Article 32.1 of the SCM Agreement reads as follows:

No specific action against a subsidy of another member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.

5.289 Footnote No 56 to this paragraph then states that:

This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

5.290 The obvious purpose of Article 32.1 is to prevent Members from taking action against subsidies on the basis of GATT Articles VI (to the extent that its provisions concern subsidies) or XVI, independently from the more precise rules laid down in the SCM Agreement. GATT Article III is not a provision “interpreted” by the SCM Agreement but, instead, one of the “other relevant provisions” to which reference is made in footnote No 56. Thus, in conformity with that footnote the SCM Agreement does not preclude the Community from taking action under Article III against a subsidy covered by the SCM Agreement.<sup>229</sup>

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<sup>229</sup>Article 32.1 and footnote No 56 of the SCM Agreement reproduce the wording of Article 19.1 of the Tokyo Round Code and footnote No 1 to that Article, with the only difference that the references in the latter agreement to “the General Agreement” have been replaced by references to the “GATT 1994”. The official title of the Tokyo Round Code was “Agreement on the Interpretation and Application of Articles VI, XVI and XXIII of GATT”. Moreover one of the recitals included in the Preamble to the Code referred expressly to the desire of the parties “to apply fully and to interpret the provisions of Articles VI, XVI and XXIII”. Thus, it was indisputable that the provisions referred to in Article 19.1 of the Tokyo Round Code as being “interpreted” by the Code were Articles VI, XVI and XXIII; and that the “other relevant provisions” of GATT referred to in the footnote included *inter alia* Article III. During the last phases of the Uruguay Round, the title of the SCM Agreement was changed from “Agreement on the Interpretation and Application of Articles VI, XVI and XXIII” to the current one because it was thought that the SCM Agreement created rights and obligations which went beyond merely “interpreting” and “applying” those provided in GATT Articles VI and XVI (see Appellate

- (7) Indonesia's interpretation would lead to an unjustified relaxation of the rules on tax discrimination existing under GATT 1947, contrary to the object and purpose of the WTO Agreement

5.291 The WTO Agreement is premised on the preservation of the level of trade liberalization already achieved under GATT 1947. This is apparent already from the Preamble to the WTO Agreement, which reads in pertinent part as follows:

Resolved, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations,

Determined to preserve the basic principles and to further the objectives underlying this multilateral trading system.

5.292 The same objective of preserving the GATT "acquis" also underlies the incorporation into GATT 1994 of the text of GATT 1947, together with all the legal instruments adopted under that agreement<sup>230</sup>, as well as the provision made in Article XVI.1 of the WTO Agreement to the effect that the WTO shall be guided by the "decisions, procedures and customary practices" followed under GATT 1947, except as otherwise provided.

5.293 For that reason, the instances where the WTO Agreement permits measures which would have been contrary to GATT 1947 are few and exceptional. Such derogations have generally a temporary character and/or are restricted to areas where the GATT 1947 was not enforced *de facto* (e.g. the textile sector now covered by the Agreement on Textiles and Clothing) and/or where the applicability of the GATT 1947 was unclear or at least had been disputed by some Members (e.g. in the case of TRIMs now covered by the TRIMs Agreement or in the case of VERs and other "grey area" import restrictions now expressly subject to the Agreement on Safeguards).

5.294 In contrast, Indonesia's *lex specialis* argument would lead, if accepted by the Panel, to the permanent nullification of a basic GATT rule which was largely non controversial under GATT 1947 and which was never the subject of specific discussions during the Uruguay Round.

5.295 Under GATT Article III:2, first sentence, the application of an internal tax to an imported products "in excess of" that applied to a like domestic product is always prohibited. This prohibition is not conditional on a trade effects test nor is it qualified by a *de minimis* standard. As noted by the Appellate Body in Japan - Taxes on Alcoholic Beverages, "even the smallest amount of 'excess' is too much".<sup>231</sup>

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Body Report on Brazil - Measures affecting desiccated Coconut, adopted on 20 March 1997, WT/DS22/AB/R, at p.17). Furthermore, unlike the Tokyo Round Code, the SCM Agreement has no Preamble. Article 32.1 and footnote No 56 were not adapted to take into account those changes, which has rendered their meaning somewhat less clear than in the Tokyo Round Code. Yet, there is no indication in the drafting history that the negotiators intended to give a different meaning to Article 32.1 and footnote No 56 from that which Article 19.1 and footnote No 1 to that Article had under the Tokyo Round Code. According to the EC's recollection of the negotiations, Article 32.1 and footnote No 56 were added to the Dunkel Text by the Secretariat, together with the other Final provisions, and adopted by the negotiators without discussion.

<sup>230</sup>See paragraph 1 of Annex 1A.

<sup>231</sup>Appellate Body Report on Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, at p. 23.



5.296 If the SCM Agreement excluded the application of Article III:2 to subsidies, tax discrimination between like products would no longer be prohibited<sup>232</sup>. Instead, the complainant would have to prove that the measure causes “adverse effects” to its interests.<sup>233</sup> Furthermore, if the tax exemption or reduction was granted to all domestic producers, it could not be considered as a “specific” subsidy within the meaning of Article 2 of the SCM Agreement and, therefore, would not be “actionable” at all.<sup>234</sup>

5.297 The consequences would be even less acceptable in the case of Article III:2, second sentence. In accordance with that provision, a Member is prevented from applying different taxes to two products which are “directly competitive or substitutable” so as to afford protection to its domestic production. Thus, for example, two previous Panels (one under GATT 1947<sup>235</sup> and one under GATT 1994<sup>236</sup>) have found that by applying a lower excise tax to local shochu than to imported whisky (a competing product) Japan afforded protection to its domestic production of shochu, thereby infringing GATT Article III:2, second sentence. If Indonesia’s *lex specialis* argument prevailed, Japan could argue that the tax differential constitutes a subsidy to its domestic shochu producers, which is therefore subject to the SCM Agreement and not to GATT Article III. Yet, the SCM Agreement is concerned only with the “adverse effects” caused by a subsidy with respect to imports of a “like product”. It provides no remedy in those cases where the subsidy causes “serious prejudice” to a competing importing product.<sup>237</sup> Thus, Indonesia’s argument would have the consequence that a tax system which has already been condemned twice would have to be tolerated in the future.<sup>238</sup>

(b) There is no conflict between GATT Article III and the SCM Agreement

5.298 In the alternative, Indonesia argues that the Panel should find that there is a “conflict” in the sense of the General Interpretative Note to Annex 1 A between the SCM Agreement and GATT Article III.

5.299 As recalled pertinently by Japan (See Section V.E.1), the drafting history of that Note indicates clearly that the term “conflict” must be interpreted narrowly. The drafters distinguished consciously that notion from broader notions such as “inconsistency” or mere “difference”. There was a general consensus among the negotiators that in practice the application of the rule laid down in the Note should be restricted to the very limited number of instances in which the obligations under the GATT and another Annex 1A agreement are truly irreconcilable. Clearly, the present case is not one of those instances.

5.300 As noted by the Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas, there is no “conflict” where, as in the present case:

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<sup>232</sup>Article 3.1 (b) of the SCM Agreement only prohibits subsidies contingent upon the use of domestic over imported goods but not subsidies which are granted only upon the production or sale of domestic products, to the exclusion of imported products.

<sup>233</sup>See Article 5 of the SCM Agreement.

<sup>234</sup>See Article 8.1 (a) of the SCM Agreement.

<sup>235</sup>Panel Report on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, adopted on 10 November 1987, BISD 34S/83.

<sup>236</sup>Panel Report on Japan - Taxes on Alcoholic Beverages, WT/DS8/R, WT/DS10/R, WT/DS11/R, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

<sup>237</sup>In addition, to the extent that the subsidy is granted to all Japanese shochu producers, Japan could argue that the subsidy is not “specific” within the meaning of Article 2 of the SCM Agreement.

<sup>238</sup>Indonesia might try to argue that the SCM Agreement is not *lex specialis* with respect to Article III:2, second sentence, but this would lead to an equally anomalous result: the remedy would be more rigorous in the case of discriminatory taxation between competing products than in the case of discriminatory taxation between like products.

... the rules contained in one of the Agreements listed in Annex 1A provide for different or complementary obligations in addition to those contained in GATT 1994.<sup>239</sup>

5.301 Instead, according to that Panel report, the concept of “conflict” is designed to deal with the following two situations:

... (i) clashes between obligations contained in GATT 1994 and obligations contained in Agreements listed in Annex 1A, where those obligations are mutually exclusive in the sense that a Member cannot comply with both obligations at the same time, and (ii) the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits<sup>240</sup>[emphasis added].

5.302 None of these two situations occurs in the present case.

5.303 Clearly, Indonesia is not subject to two mutually exclusive obligations, because there is nothing in the SCM Agreement which requires Indonesia to grant the subsidies at issue.

5.304 Nor does the SCM Agreement “permit explicitly” what the GATT Article III prohibits. It cannot be considered that a provision in an Annex 1A Agreement “permits explicitly” what GATT prohibits unless it states in positive terms a right to do it (e.g. “Members may apply or maintain measure X”), as opposed to merely abstain from prohibiting it. In addition, there must be identity between the prohibited measures and the explicitly permitted measures. An incidental overlap between two provisions which focus on two different types of measures does not constitute a “conflict”. As shown below, none of these two conditions is met in the present case.

5.305 By its own words, Article 27.3 of the SCM Agreement is limited to stipulate a temporary exception to the prohibition contained in Article 3.1 (b) of the same agreement in favour of developing Members. It does not “authorise explicitly” developing Members to deviate from any other obligation, either in the SCM Agreement, such as Article 5, or in other agreements, such as GATT Articles III:2 and III:4.

5.306 From the mere fact that Article 3 of the SCM Agreement does not prohibit a certain type of subsidies, it cannot be inferred *a contrario* that Members have an “explicit right” to grant that type of subsidies in violation of a different obligation contained in another agreement, such as GATT Article III. For instance, the fact that Article 3 of the SCM does not prohibit the granting of subsidies in the form of an exemption from an indirect tax only for domestic goods (irrespective of their local content level), does not mean that Members have been granted thereby an “explicit authorization” to tax imported products in excess of domestic like products, contrary to the prohibition contained in GATT Article III:2. By the same token, the fact that Article 3.1(b) *juncto* Article 27.3 of the SCM Agreement does not prohibit, on a temporary basis, the granting of local content subsidies by developing Members cannot be construed as an “explicit authorization” for those Members to violate GATT Articles III:2 and III:4.

5.307 Article 5 of the SCM Agreement lays down an obligation not to cause “adverse effects” through the granting of “actionable subsidies”. Clearly, this does not amount to an “explicit authorization” to take any measure which may be characterized as an “actionable subsidy” and which does not cause “adverse effects”, even if such measure is contrary to the provisions of GATT.

5.308 Finally, Article 8 of the SCM Agreement provides that certain types of subsidies shall be considered as non-actionable. This means simply that those subsidies are non-actionable under Parts III

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<sup>239</sup>See e.g. Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas, adopted 25 September 1997, WT/DS27/R/USA, at para 7.155.

<sup>240</sup>*Id.*, para 7.154.

or V of the SCM Agreement. It does not mean that Members have an “explicit right” to take measures which violate GATT Article III.

5.309 Furthermore, in the present case there can be no “conflict” because the required identity between the prohibited and the allegedly permitted measures does not exist. Article III prohibits measures which discriminate between imported and domestic products, whereas the measures allegedly permitted by the SCM Agreement are subsidies. These two categories of measures are conceptually different, even if certain individual measures may fall simultaneously within both categories. Given the lack of identity between the two categories of measures, it cannot be said that the SCM Agreement authorises “explicitly” what is prohibited by GATT Article III.

5.310 In EC - Regime for the Importation, Sale and Distribution of Bananas, the Panel elaborated on its interpretation of the notion of “conflict” in the Note by identifying as an example of such “conflict” the relationship between GATT Article XI:1 and Article 2 of the Agreement on Textiles and Clothing (the “ATC”):

For instance, Article XI:1 of GATT prohibits the imposition of quantitative restrictions, while Article XI:2 of GATT contains a rather limited catalogue of exceptions. At the same time, Article 2 of the Agreement on Textiles and Clothing authorises the imposition of quantitative restrictions in the textiles and clothing sector, subject to conditions specified in Article 2:1-21 of the ATC. In other words, Article XI:1 of GATT prohibits what Article 2 of the ATC permits in equally explicit terms. It is true that Members could theoretically comply with Article XI:1 of GATT, as well as with Article 2 of the ATC, simply by refraining from invoking the right to impose quantitative restrictions in the textiles sector because Article 2 of the ATC authorises rather than mandates the imposition of quantitative restrictions. However, such an interpretation would render whole Articles or sections covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A which were negotiated to create rights and obligations which in parts differ substantially from those of the GATT 1994.<sup>241</sup>

5.311 The relationship of Article 2 of the ATC to GATT Article XI is readily distinguishable from the relationship of the SCM Agreement to GATT Article III:

- Article 2 of the ATC grants a positive right to do something, namely to maintain quantitative restrictions. On the contrary, the SCM Agreement does not confer a positive right to grant subsidies. Its only purpose is to create remedies against certain categories of subsidies.
- There is total identity between the measures prohibited by GATT Article XI and those authorized by Article 2 of the ATC (quantitative restrictions in both cases). The SCM agreement and GATT Article III, on the other hand, are concerned each with a different type of measures (subsidies and measures which do not afford national treatment to imported products, respectively), even if the two categories may overlap in respect of certain individual measures.
- According to the Panel, the application of GATT Article XI:1 to measures covered by Article 2 of the ATC would have rendered the latter Article “meaningless”. In contrast, the application of Article III to subsidies does not render the SCM Agreement

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<sup>241</sup>Id. at footnote No 390.

redundant. Quite to the contrary, its non-application would reduce GATT Articles III:2 and III:8 (b) to inutility.

- According to the Panel, the ATC was negotiated with the object and purpose to derogate from the GATT. In fact, that intention is set out explicitly in Article 1.1 of the ATC Agreement. In contrast, there is no indication either in the text or in the drafting history of the SCM Agreement that it was negotiated with the intention of derogating from the GATT rules on national treatment. Moreover, unlike in the case of the ATC Agreement with respect to GATT Article XI, there would be no apparent rationale for such derogation. In particular, given that such derogation would be, again unlike in the case of the ATC with respect to GATT Article XI, permanent and not just temporary.

5.312 The absence of a conflict between the SCM agreement and GATT Article III is further confirmed by Article 32.1 juncto footnote 56 of the SCM Agreement, which as already discussed admits expressly the possibility that action against subsidies may also be taken under other GATT provisions, including Article III.

5.313 To conclude, it must be recalled that the relationship of the SCM Agreement to GATT Article III is formally identical to the relationship of GATT Article XVI to GATT Article III. The SCM Agreement does not “permit explicitly” subsidies which are contrary to GATT Article III any more than Article XVI did under GATT 1947. Thus, to hold that there is a “conflict” between the SCM Agreement and GATT Article III would be tantamount to admitting that there was also an “internal conflict” within GATT 1947. Yet, it is clear that the only purpose of the General Interpretative Note to Annex 1A was to solve the potential conflicts between GATT and the new agreements on trade in goods negotiated during the Uruguay Round which build upon the provisions of GATT. It was not the purpose of the Note to solve any inherited “internal conflicts” within GATT itself which, somehow, would have gone unnoticed for almost 50 years.

### 3. Rebuttal Arguments of the United States

5.314 The following are the **United States'** arguments rebutting Indonesia's general response to the claims raised under Article III of GATT 1994:

- (a) The tariff and tax incentives under the 1993 Programme and the National Car Programme violate Article III of GATT 1994

5.315 The tariff and tax incentives under the 1993 Programme and the National Car Programme violate Article III:4 of GATT 1994 because: (1) they each constitute regulations or requirements that “affect” the sale, purchase, transportation and distribution of imported and domestic automotive parts and subparts; (2) imported automotive parts and subparts are “like” domestic automotive parts and subparts; and (3) they each discriminate against imported automotive parts and subparts. In addition, the tax incentives under the National Car Programme violate Article III:2, first sentence, of GATT 1994, because they result in the imposition of taxes on imported products that are in excess of those applied to like domestic products. Alternatively, these tax incentives violate Article III:2, second sentence, of GATT 1994 because: (1) imported passenger cars and domestic passenger cars are directly competitive or substitutable products that are in competition with each other; (2) the directly competitive or substitutable imported or domestic passenger cars are not similarly taxed; and (3) the dissimilar taxation is applied so as to afford protection.

5.316 Indonesia has not disputed any of these conclusions that make up the elements of a violation of Article III:2 and Article III:4. Instead, Indonesia argues that Article III does not apply to the tax incentives because: (1) these incentives constitute “subsidies”; and (2) the SCM Agreement overrides Article III. In addition, and notwithstanding a ruling of the Appellate Body to the contrary, Indonesia

argues that the tariff incentives are not governed by Article III:4 because they constitute “border measures”. As the United States will demonstrate, not only are both arguments wrong as a matter of law, but, if accepted, they would have far-reaching and dangerous implications for the world trading system.

- (b) Indonesia's argument that the SCM Agreement overrides Article III is unsupported by the text of the SCM Agreement and GATT 1994, would result in the effective repeal of Article III:2, and is inconsistent with the negotiating history of the Uruguay Round, established principles of public international law, and WTO jurisprudence

5.317 In the case of the tax incentives provided under the 1993 Programme and the National Car Programme, Indonesia does not dispute that the measures violate Article III. Instead, it argues that Article III is inapplicable because the measures constitute subsidies, and, thus, according to Indonesia, are governed solely by the provisions of the SCM Agreement. According to Indonesia, because, under Article 27.3 of the SCM Agreement, Indonesia has a time-limited exemption from the prohibition against the use of local content subsidies contained in Article 3.1(b) of that agreement, only the provisions of the SCM Agreement apply. Any other result, according to Indonesia, results in a “conflict” within the meaning of the General Interpretative note to Annex 1A of the Marrakesh Agreement Establishing the World Trade Organization (“WTO Agreement”), because Article III prohibits what Article 27.3 allegedly permits. Indonesia’s argument is wrong for a variety of reasons.

- (1) Indonesia’s argument is unsupported by the text of the SCM Agreement and GATT 1994

5.318 Indonesia’s argument is premised on the existence of what it refers to as “an all-encompassing definition of subsidies” in the SCM Agreement that applies across the WTO agreements. However, the definition in the SCM Agreement is not “all-encompassing”. When one looks at the text of the SCM Agreement, as one must under the Vienna Convention on the Law of Treaties (“Vienna Convention”), Article 1.1 states very clearly that the definition of “subsidy” contained therein is “For the purpose of this Agreement ...” In other words, the definition of “subsidy” is limited to the SCM Agreement.

5.319 Second, Indonesia’s argument is also premised on what it refers to on page 91 of its first submission as “an all-encompassing structure of remedies ...”. Again, however, there is no such structure. Consider again the actual text of the treaty. Article 32.1 of the SCM Agreement provides as follows:

No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.

Moreover, Article 32.1 contains a footnote 56, which reads as follows:

This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

5.320 There can be no clearer indication that the drafters did not intend that the SCM Agreement be the exclusive remedy against a measure that happens to fall within that agreement’s definition of a subsidy.

5.321 Indonesia argues that the complainants' interpretation of note 56 is wrong because they somehow ignore the words "relevant" and "appropriate". According to Indonesia, because the measures at issue are covered by the SCM Agreement, other GATT provisions are neither "relevant" nor "appropriate".

5.322 This is a classic example of tautological reasoning that assumes the answer to the question posed. According to Indonesia, because the SCM Agreement is *lex specialis*, no other provision of GATT can be "relevant" or "appropriate" within the meaning of note 56.

5.323 However, it is Indonesia that ignores the text of note 56, and essentially renders that provision superfluous, in violation of established principles of treaty interpretation. Indeed, if the SCM Agreement truly were *lex specialis*, there would be no reason for note 56.

5.324 Other provisions support the conclusion that the SCM Agreement was not intended to be the exclusive mechanism for challenging measures that can be characterized as subsidies. For example, Article VI:5 of GATT 1994 provides as follows:

No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.

Article VI:5 recognizes that export subsidies may be characterized as a problem of dumping or subsidization, and simply precludes Members from imposing both remedies in the case of a single act of subsidization. Article VI:5 belies Indonesia's claim that the remedies in the SCM Agreement are exclusive or all-encompassing.

5.325 More generally, it has long been recognized that the GATT provisions that deal explicitly with subsidies are not the only provisions that are relevant to subsidies. In this regard, the following statement by Prof. John Jackson is worth noting:<sup>242</sup>

However, there are certain measures in other articles of GATT [other than Article XVI] that bear on the freedom of a nation to subsidize and that offer a measure of remedy for a GATT member that is harmed by another's subsidy. Four other articles in particular must be related to Article XVI. These are Article VI on anti-dumping and countervailing duties, Article XIX regarding increases of imports that threaten serious injury (the "escape clause"), Article XXIII regarding nullification and impairment, and Article III regarding national treatment.

5.326 In short, Indonesia's argument is contradicted by the text of the relevant agreements, and must be rejected for that reason.

(2) Indonesia's argument would result in the effective repeal of Article III:2

5.327 Aside from the fact that Indonesia's *lex specialis* argument ignores the text of the relevant agreements, the flaws in its argument can best be appreciated when one considers how Indonesia's theory operates with respect to Article III:2 of GATT 1994.

5.328 In this case, Indonesia argues that the tax discrimination in favour of Indonesian motor vehicles is a subsidy because it constitutes foregone government revenue within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. According to Indonesia, because this tax discrimination constitutes a subsidy, it can be remedied only under the SCM Agreement.

5.329 However, consider the consequences of Indonesia's argument. Suppose that a Member discriminates against imports across the board, so that all domestic products are taxed at one rate, and all imported products are taxed at a higher rate. Assume also that no local content requirements are involved. Based on Indonesia's logic, this tax discrimination constitutes a subsidy in the form of

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<sup>242</sup>J. Jackson, World Trade and the Law of GATT, § 15.4, page 377 (1969) (Emphasis added).

revenue foregone that is provided to all producers of domestic products and that can be remedied only under the SCM Agreement. Yet, when one turns to the SCM Agreement, one finds that there is no remedy. This is because under the SCM Agreement, a subsidy that is available to all domestic products is not specific within the meaning of Article 2 of the SCM Agreement, and, as such, is non-actionable under Article 8.1(a) of the SCM Agreement.

5.330 Thus, the consequence of Indonesia's argument is that Article III:2 effectively has been repealed and Members are free to engage in economy-wide tax discrimination against imported products. Article III:2 no longer applies, because it has been overridden by the SCM Agreement, but the SCM Agreement provides no redress because the "subsidy" is non-actionable.

5.331 There is not the slightest bit of evidence that the Uruguay Round negotiators intended such a dramatic and dangerous outcome. Moreover, the drafting history of GATT 1947 indicates that the drafters expressly rejected such an outcome. In particular, during the Havana negotiations, the drafters of Article III rejected the following proposal by Cuba:

The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in cases covered under Article XVI.

The absurd consequences of Indonesia's argument reveal exactly how erroneous that argument is.

(3) Indonesia's argument is contradicted by the Uruguay Round negotiating history

5.332 In light of the manifestly absurd results generated by Indonesia's argument, one should consider the negotiating history of the TRIMs Agreement and the SCM Agreement. While we are talking about Article III of GATT 1994 at the moment, Indonesia has argued that the TRIMs Agreement imposes no additional substantive obligations, but instead merely interprets Article III (See Section VI.D). The United States does not agree with Indonesia's characterization of the TRIMs Agreement, but, for the sake of argument, let us assume that Indonesia is correct.

5.333 Indonesia cites to a report of the Chairman of the Negotiating Group on Trade-Related Investment Measures (See Section VI.D). MTN.GNG/NG12/W/27 (19 July 1990). The report contained a bracketed Chairman's text, Article A2(c)(iii) of which read as follows:

(c) An investment measure is "applied" when:

....

(iii) it is a condition for, or a factor in determining eligibility for, receipt of an advantage from a contracting party or avoiding withdrawal of an advantage.

A bracketed footnote 2 to clause (iii) further provided the following:

An advantage can include the provision of a subsidy, and attention will be paid to the negotiations in the Negotiating Group on Subsidies to ensure no conflict.

5.334 As Indonesia correctly notes, the question of whether TRIMs would include "incentive-based" measures, including measures that could be characterized as subsidies, was a bone of contention during the TRIMs negotiations, as reflected by the brackets around the above-quoted language.

5.335 However, Indonesia leaves the drafting history at that, and fails to mention what happened thereafter. In the so-called Dunkel Draft, issued in December, 1991, the TRIMs Agreement appeared in what was, for substantive purposes, its final form. MTN.TNC/W/FA, page N.1 *et seq* (United States Exhibit 26). In the Dunkel Draft, paragraph 1 of the Illustrative List of TRIMs covered, as does its counterpart in the final TRIMs Agreement, TRIMs “compliance with which is necessary to obtain an advantage ... .” Thus, the battle over the inclusion of incentive-based measures had been resolved in favour of their inclusion, albeit by using different language from that in the Chairman’s draft.

5.336 In addition, the notification requirements and transitional arrangements contained in Article 5 of the TRIMs Agreement also had reached their final form in the Dunkel Draft. Under Article 5 of the Dunkel Draft, countries had 90 days in which to notify existing non-conforming TRIMs, and were granted a period of time in which to eliminate them. Developing countries had five years, while least-developed countries had seven years. In addition, countries were precluded from introducing new non-conforming TRIMs.

5.337 Now let us turn to the version of the SCM Agreement in the Dunkel Draft, and, in particular, Article 27. MTN.TNC/W/FA, pages I.33-35 (United States Exhibit 27). There one finds no exemption for developing country Members from the prohibition in Article 3.1(b) against the use of local content subsidies. Instead, Article 27.3 of the Dunkel Draft consisted of what ultimately became Article 27.4, the provision dealing with developing country Member phase outs of export subsidies.

5.338 Thus, in the Dunkel Draft, to the extent there was a “conflict” between the SCM Agreement, Article III:4, and the TRIMs Agreement, the “conflict” was exactly the opposite of the “conflict” alleged by Indonesia. Under the draft SCM Agreement, developing country Members were prohibited from using local content subsidies, but under the TRIMs Agreement, developing country Members could use such subsidies for a limited period of time, provided that they notified them in a timely manner.

5.339 Of course, as Indonesia correctly notes, the negotiators were aware of the overlap between the TRIMs Agreement and the SCM Agreement, and they subsequently proceeded to deal with it. On December 15, 1993, the Trade Negotiating Committee issued a draft Final Act. In the draft SCM Agreement, a new provision appeared, Article 27.2bis. MTN/FA II-13, page 32 (United States Exhibit 28). This provision, which ultimately was renumbered as Article 27.3, granted developing and least developed country Members a time-limited exemption from the prohibition against local content subsidies in Article 3.1(b) of the SCM Agreement.

5.340 With the addition of Article 27.2bis, the “conflict” between Article III:4, the TRIMs Agreement, and the SCM Agreement in the Dunkel Draft was eliminated. In the case of developing and least developed Members, those TRIMs that were permitted by Article 5 of the TRIMs Agreement during the transition period no longer were prohibited by the SCM Agreement.

5.341 What this drafting history shows is that it was not the intent of the negotiators that the SCM Agreement override Article III:4 or the TRIMs Agreement. Instead, as was the case under GATT 1947, there was to be overlapping, if not identical, treatment of local content incentives under these different regimes.

5.342 What this drafting history also highlights is that the “conflict” alleged by Indonesia in this case is an artificial one. If Indonesia had notified its pre-WTO TRIMs in accordance with the provisions of Article 5.1 of the TRIMs Agreement, they would have been protected under both the TRIMs Agreement and the SCM Agreement. As for Indonesia’s post-WTO TRIMs, it was never the intention of the drafters to permit such measures under Article III:4 or the TRIMs Agreement, even though they might be temporarily exempt from the special remedies of the SCM Agreement.



(4) Indonesia's argument is inconsistent with established principles of public international law

5.343 Indonesia cites the report of the panel in the Bananas III case for the proposition that a "conflict" exists where a rule in one agreement prohibits what a rule in another agreement explicitly permits.<sup>243</sup> However, Indonesia's reliance on Bananas III is misplaced for several reasons.<sup>244</sup>

5.344 First, neither the Bananas III panel nor Indonesia cites any support for the proposition that a "conflict," within the meaning of public international law, can exist in a situation where a rule in one agreement explicitly permits what a rule in another agreement prohibits. The absence of any citation is due to the fact that the rule under public international law is clear: a conflict exists only in situations where obligations are mutually exclusive; i.e., "when two (or more) treaty instruments contain obligations which cannot be complied with simultaneously." 7 Encyclopedia of Public International Law (North-Holland 1984), page 468.

5.345 Moreover, even assuming for purposes of argument that the statement by the Bananas III panel is correct, there still is no conflict between the rules of Article III and the rules of the SCM Agreement. This is because, as previously noted, footnote 56 of the SCM Agreement expressly contemplates that subsidy practices may be actionable under other relevant provisions of GATT 1994.

5.346 In addition, again assuming for purposes of argument that the statement by the Bananas III panel was correct, there is no conflict because the SCM Agreement does not "explicitly permit" local content subsidies. Indeed, all that Article 27.3 does is to exempt developing country Members, for a period of time, from the prohibition of Article 3.1(b). More generally, to the extent that "permit" is a synonym for "authorize," the authority to provide subsidies does not flow from the SCM Agreement, but instead from a Member's sovereignty. The SCM Agreement simply specifies the circumstances under which one Member that has suffered adverse trade effects may seek redress against subsidies provided by another Member. In addition, the SCM Agreement also prohibits certain types of subsidies, and provides a remedy against them, because they are considered to be presumptively distortive and a cause of adverse trade effects.

5.347 In addition, simply as a textual matter, it is impossible to conclude that a time-limited exemption from a prohibition (which is what Article 27.3 provides) constitutes a positive conferral of an "explicit right" to do something.

5.348 Finally the fact that the SCM Agreement may not prohibit a certain type of subsidy cannot be construed as the conferral of an explicit right to violate a different obligation contained in a different WTO agreement. For example, as the United States demonstrated at the first meeting of the Panel, an exemption only for domestic products from an indirect tax would be a non-specific (generally available) subsidy under the SCM Agreement. As such, it would be a non-actionable subsidy. However, the fact that such a subsidy is not prohibited by, or even actionable under, the SCM Agreement does not mean that Members are "explicitly permitted" to tax imported products in excess of domestic like products in violation of Article III:2. Likewise, the fact that developing country Members are temporarily exempted from the prohibition in Article 3.1(b) does not mean that they are "explicitly permitted" to violate Article III:2 and Article III:4.

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<sup>243</sup> European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R, Report of the Panel, as modified by the Appellate Body, adopted on 25 September 1997, para. 7.159.

<sup>244</sup> Among other things, the panel's statement concerning the definition of a "conflict" was *dicta* inasmuch as the panel found that no conflict existed. Unfortunately, because this aspect of the panel report was not appealed, the Appellate Body was not presented with the opportunity to correct the panel's error.

5.349 Finally, it must be emphasized that under public international law “[t]here is a presumption against conflicts in that parties do not normally intend to incur conflicting obligations”. 7 Encyclopedia of Public International Law (North-Holland 1984), page 470. This presumption flows logically from the basic maxim *ut res magis valeat quam pereat*, a principle that is embodied in the Vienna Convention, and which requires that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in the context of the treaty and in the light of its object and purpose. More specifically, what this means is the following<sup>245</sup>:

When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted.

As discussed above, Indonesia’s argument utterly fails to comply with this fundamental principle, because the Indonesian argument would render Article III:2 a nullity.

5.350 Two corollary principles flow from this fundamental principle. First, the burden is on Indonesia, as the party alleging a conflict, to demonstrate convincingly that a conflict exists. Indonesia has failed to satisfy this burden.

5.351 Second, the Panel must, to the extent possible, interpret the relevant provisions so as to avoid a conflict. As discussed below, existing WTO jurisprudence provides a vehicle for avoiding a conflict.

(5) Existing WTO jurisprudence recognizes that the subject matter of the WTO agreements can overlap

5.352 Existing WTO jurisprudence recognizes that the subject matter of the WTO agreements can overlap. The Appellate Body acknowledged this point most recently in Bananas III, where it stated the following<sup>246</sup>:

The second issue is whether the GATS and the GATT 1994 are mutually exclusive agreements. The GATS was not intended to deal with the same subject matter as the GATT 1994. The GATS was intended to deal with a subject matter not covered by the GATT 1994, that is, with trade in services. Thus, the GATS applies to the supply of services. It provides, *inter alia*, for both MFN treatment and national treatment for services and service suppliers. Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994 and the GATS. However, while the same

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<sup>245</sup> 1966 Yearbook of the International Law Commission, Vol. II at 219; See also, United States - Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, Report of the Appellate Body adopted 20 May 1996, pages 24-25 (“One of the corollaries of the ‘general rule of interpretation’ in the Vienna Convention is that interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.”); and Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996), pages 11-12.

<sup>246</sup> European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997, para. 221 (footnote omitted).

measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis. This was also our conclusion in the Appellate Body Report in Canada - Periodicals.

5.353 Like the relationship between GATT 1994 and GATS discussed in Bananas III, the coverage of Article III and the SCM Agreement overlap, but the focus of each is different. The focus of the SCM Agreement is on subsidies, which in the context of this case, happen to be specific (or actionable) because their receipt is made contingent on the basis of discrimination against imported goods. By contrast, the national treatment provisions of Article III focus on the discrimination.

5.354 This difference in focus can be appreciated by considering the remedy applicable to prohibited subsidies under the SCM Agreement. Under Article 4.7 of the SCM Agreement, if a panel finds a measure to be a prohibited local content subsidy, the panel must "recommend that the subsidizing Member withdraw the subsidy without delay".<sup>247</sup> A panel is not allowed to recommend that the subsidizing Member eliminate the local content contingency of the subsidy.

5.355 More generally, if a Member were to violate Article III:4 by making use of domestic inputs a condition for the receipt of a subsidy, the measure would continue to be a violation of Article III:4 if the subsidy element were replaced with some other form of incentive or disincentive. On the other hand, if the local content aspect of a subsidy were dropped, the subsidy would continue to be subject to the SCM Agreement, although the nature of the relevant discipline under the SCM Agreement might be affected.

5.356 Thus, the Panel can avoid a "conflict" by simply recognizing that Article III and the SCM Agreement have overlapping coverage, but a different focus. In so doing, the Panel will have complied with its obligation under public international law principles to avoid interpreting Article III and the SCM Agreement in a manner that gives rise to a conflict.

(6) GATT and WTO Panels and the Appellate Body have not relied on the concept of *lex specialis* to determine that one WTO agreement takes precedence over another

5.357 In response to a question from the Panel concerning GATT/WTO panel reports, the **United States** stated that the concept of *lex specialis* had been discussed in the following reports.

5.358 In EEC Restrictions on Imports of Apples from Chile, L/5047, Report of the Panel adopted 10 November 1980, BISD 27S/98, although the term *lex specialis* was not used, the European Communities argued that with respect to Chile's claim under Article I of GATT 1947, the European Communities "action, being a quantitative restriction, should be examined in connection with the most-favoured-nation type commitment contained in Article XIII." Para. 3.2. The panel agreed with the European Communities. Para. 4.1. However, this case involved the relationship between different provisions of a single agreement, GATT 1947, as opposed to the relationship between different agreements.

5.359 In European Economic Community - Restrictions on Imports of Dessert Apples - Complaint by Chile, L/6491, Report of the Panel adopted 22 June 1989, BISD 36S/93, the same issue arose, and this time the European Communities did invoke expressly the concept of *lex specialis*. Para. 5.2. As in the

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<sup>247</sup>Under Article 1.2 and Appendix 2 of the DSU, Article 4.7 is a special or additional rule or procedure that prevails over the general rules of the DSU.

prior case, the panel agreed with the European Communities, stating as follows: "[Article XIII] deals with the non-discriminatory administration of quantitative restrictions and is thus the *lex specialis* in this particular case." Para. 12.28. Again, however, this case involved the relationship between different provisions of a single agreement.

5.360 In Panel on Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies, L/6304, Report of the Panel adopted 22 March 1988, BISD 35S/37, Canada argued that Article III of GATT 1947 was not relevant to the case because Article XVII contained the only obligation related to state trading. Para. 3.47. The EEC argued in response that Article XVII was not a *lex specialis* exempting state-trading from all other provisions of GATT 1947. Para. 3.48. The panel declined to reach the issue because it already had found that the measures in question violated Article XI. Para. 4.26. In *dicta*, however, the panel opined that Article III:4 was also applicable to state-trading enterprises, at least in certain situations. *Id.* Although the panel did not address the issue, this case, too, involved the relationship between different provisions of a single agreement.

5.361 In Bananas III, the concept of *lex specialis* was raised in several different ways. European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA, Report of the Panel, as modified by the Appellate Body, adopted 25 September 1997. First, the panel ruled that Article XIII:2(d) was *lex specialis* vis-à-vis Article XIII:1. Para. 7.75. This issue involved the relationship between different paragraphs of a single article of a particular agreement.

5.362 In Bananas III, the concept of *lex specialis* also was raised in connection with the relationship between (1) the Licensing Agreement and Article XIII; and (2) the TRIMs Agreement and Article III. The issue relating to the Licensing Agreement was described as follows:

The Complaining parties did not consider the concept of *lex specialis* to be relevant in this instance regarding the relation between the Licensing Agreement and Article XIII of GATT. Two separate agreements were involved, each of which were given equal force under the Marrakesh Protocol unless there was conflict between their provisions. Since there was no conflict between the provisions at issue, it was entirely permissible to assert a breach of Article XIII obligations in tandem with the Licensing Agreement violations discussed above. Para. 3.14.

5.363 The issue relating to the TRIMs Agreement was described as follows:

Second, Article 2.1 also made it clear that a Member did not cede any of its rights under Article III by raising a claim under the TRIMs. Thus, a Member was not restricted to arguing that a measure violated the TRIMs Agreement when there was an independent argument under Article III. Such measures were covered by both the TRIMs and the GATT, and not only by the TRIMs Agreement as *lex specialis*. Para. 445.

5.364 In resolving these issues concerning the relationship between GATT 1994 and the Annex 1A agreements, the panel did not rely on the concept of *lex specialis*. Instead, the panel relied on the General Interpretative Note to Annex 1A of the WTO Agreement, the note that deals with conflicts between GATT 1994 and the other Annex 1A agreements. Paras. 7.157-7.163. The United States will not reiterate its prior arguments concerning this aspect of the Bananas III report, but instead emphasizes the following points. First, if the panel had thought that the concept of *lex specialis* governed the relationship between GATT 1994 and the other Annex 1A agreements, there would have been no need to resort to the General Interpretative Note. Second, if the concept of *lex specialis* operated in the manner suggested by Indonesia, the General Interpretative Note would be superfluous, because there can be no conflict where, by virtue of *lex specialis*, a single agreement controls.

5.365 The concept of *lex specialis* also was invoked in the Bananas III appeal. WT/DS27/AB/R, Report of the Appellate Body adopted 25 September 1997. The European Communities challenged the panel's particular application of Article 1.3 of the Licensing Agreement, arguing that Article 1.3 is *lex specialis* for the administration of import licensing procedures, while Article X:3(a) of GATT 1994 is *lex generalis* for the administration of all "laws, regulations, decisions, and rulings ...". Para. 32. In response, the complainants argued that only in the event of a conflict between GATT 1994 and a provision of another Annex 1A agreement (such as the Licensing Agreement) would the provision of the latter agreement prevail. Para. 70.

5.366 The Appellate Body concluded that Article X:3(a) and Article 1.3 both applied in the sense that both provisions gave rise to separate and distinct obligations. Para. 204. However, the Appellate Body stated that the panel should have applied the Licensing Agreement first

since this agreement deals specifically, and in detail, with the administration of import licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3(a) of the GATT 1994. Id.

The Appellate Body did not find that one agreement trumped the other on the basis of *lex specialis*.

5.367 Finally, the concept of *lex specialis* was invoked by the United States in EC Measures Concerning Meat and Meat Products (Hormones), WT/DS26/R/USA, Report of the Panel circulated 18 August 1997, for the proposition that the panel should begin its analysis with the SPS Agreement. Para. IV.5. Without expressly endorsing the United States invocation of *lex specialis*, the panel decided to first examine claims raised under the SPS Agreement. Para. 8.42. The panel's decision on this particular point was not raised on appeal. WT/DS26/AB/R, Report of the Appellate Body circulated 16 January 1998.

5.368 Thus, while the concept of *lex specialis* has been invoked from time to time, in no instance has a panel or the Appellate Body relied on this concept to determine that one WTO agreement trumps another. To the contrary, such relationships have been resolved by applying the General Interpretative Note, which deals with conflicts between GATT 1994 and other Annex 1A agreements. As the United States previously has demonstrated, however, there is no conflict between the provisions of GATT 1994 and the SCM Agreement.

5.369 With respect to Japan's point regarding the General Interpretative Note, Indonesia fails to rebut Japan's argument. Japan's argument, as the United States understands it, is that if the SCM Agreement truly were *lex specialis*, it would control automatically, whether or not a "conflict" existed, and there would be no need for the General Interpretative Note. Put differently, to the extent that there is a rule of *lex specialis* in the WTO Agreement, it is found in the General Interpretative Note.

(7) Whether Indonesia's argument is characterized as *lex specialis* or conflict, if accepted, it would render Article III:2 of GATT 1994 a nullity

5.370 Whether Indonesia's argument is characterized as one based on *lex specialis* or "conflicts", Indonesia has not been able to explain how, under its argument, Article III:2 of GATT 1994 does not become a nullity. Likewise, Indonesia has not offered a scintilla of evidence that the Uruguay-Round negotiators intended such an outcome.

(8) Indonesia's erroneous assertion regarding the specificity of subsidies indicates that Indonesia was well aware of the flaws in its argument

5.371 Finally, on the subject of *lex specialis* and "conflicts", the United States would like to elaborate with respect to the question of whether or not most subsidies are specific. By way of background, one

of the most troubling aspects of Indonesia's arguments is the statement that: "The purpose of most subsidies is to provide financial assistance to a targeted industry or a small group of industries." (See Section V.D.2(c).)

5.372 The reason why this sentence was so troubling is as follows. Several members of the United States interagency team working on this dispute have spent most of their careers in the subsidies/countervailing duty area and are considered as experts in the area. In particular, they were intimately involved in the development and evolution of the so-called "specificity test" under the United States countervailing duty law, and one member of the team can claim, with some justification, to be the author of Article 2.1 of the SCM Agreement. While there is no global "census" of all government measures that satisfy the SCM Agreement's definition of "subsidy", these individuals knew, based on their experience, that most subsidy programmes are not, in fact, targeted to a small group of industries. Instead, most subsidy programmes involve the provision of small amounts of financial assistance to numerous industry groups or sectors. The very reason for a specificity test is to avoid having to subject such programmes to unilateral or multilateral subsidy remedies.

5.373 Moreover, these types of generally available subsidy programmes do not show up in notifications to the SCM Committee, because, under Article 25.2 of the SCM Agreement, only specific subsidies must be notified. Likewise, since the specificity test became firmly established as a part of the United States countervailing duty law in the mid-'80's, these types of generally available subsidy programmes also have largely disappeared from countervailing duty proceedings, because petitioning domestic industries know that the U.S. investigating authorities will find such programmes to be non-specific and, thus, non-countervailable. In other words, the specific subsidies that show up in notifications to the SCM Committee or countervailing duty proceedings are only the "tip of the subsidies iceberg".

5.374 Thus, the members of the United States team were troubled by the above-quoted sentence by Indonesia. The United States team concluded that Indonesia must have inserted the sentence in question for a reason, and the task was to determine what that reason was. Ultimately, the riddle was solved by asking and answering the following series of questions:

- |                 |   |
|-----------------|---|
| <u>Question</u> | Why would Indonesia make an assertion regarding the specificity of subsidies that is, at worst, inaccurate and, at best, unsupported by empirical evidence?   |
| <u>Answer</u>   | Indonesia does not want the Panel to think about non-specific subsidies.  |
| <u>Question</u> | Why does Indonesia not want the Panel to think about non-specific subsidies? What is it about non-specific subsidies that makes them different from specific subsidies?   |
| <u>Answer</u>   | Non-specific subsidies are non-actionable by virtue of Article 8.1(a).  |
| <u>Question</u> | Why is the non-actionability of non-specific subsidies relevant to Indonesia's argument that the SCM Agreement overrides provisions of GATT 1994?   |
| <u>Answer</u>   | It must be the case that if the SCM Agreement trumps GATT, then measures currently considered to be violative of one or more provisions of GATT 1994 would become permissible if characterized as non-specific subsidies. |
| <u>Question</u> | What types of measures would be most likely to become permissible if characterized as non-specific subsidies?   |
| <u>Answer</u>   | Discriminatory tax measures that violate Article III:2.   |

5.375 The upshot of all this is that with respect to Indonesia's argument concerning the supremacy of the SCM Agreement, the United States suspects that Indonesia was aware of the fatal flaw in its theory (i.e., the fact that, under its theory, Article III:2 becomes a nullity) long before the complainants had discovered it. Indonesia's assertion regarding the alleged specificity of most subsidies was simply a smokescreen intended to divert the Panel's attention from the consequences of Indonesia's argument.

5.376 In the final analysis, whether or not most subsidies are specific is not relevant to this dispute. What is relevant is the fact that if Indonesia's argument is accepted, any Member will be able to construct and maintain a tax system that discriminates against imports without running afoul of its obligations under Article III:2. All that a Member has to do is ensure that the beneficiaries of such a system constitute a sufficiently large segment of the economy so as to render the system non-specific. Under Indonesia's theory, if the system is non-specific, it is not actionable under the SCM Agreement and Article III:2 no longer applies.

(9) Indonesia's assertion that it would not have signed the WTO Agreement if Article III applied to local content subsidies is legally irrelevant and factually suspect

5.377 At bottom, Indonesia's argument that the SCM Agreement overrides Article III is based on its claim that neither Indonesia nor any other developing country would have signed the WTO Agreement if Article III continued to apply to local content subsidies. Although Indonesia has yet to make this assertion in writing, one of Indonesia's representatives made the assertion in his oral presentation at the first meeting of the Panel.<sup>248</sup> However, this assertion is legally irrelevant and factually suspect.

5.378 As a matter of law, it is irrelevant that a Member, with the benefit of hindsight, feels that it may have made a bad bargain, because neither panels nor the Appellate Body have the authority to renegotiate the bargains reflected in the text of the WTO agreements. As the Appellate Body has stated, panels and the Appellate Body must respect the balance of rights and obligations reflected in the language of the WTO agreements.<sup>249</sup> More recently, in the India Mailbox case, the Appellate Body chastized a panel for attempting to read into the TRIPS Agreement words that are not there based on the "legitimate expectations" of Members.<sup>250</sup> In that case, the Appellate Body stated the following:<sup>251</sup>

The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended.

5.379 As demonstrated above, when the principles of Article 31 of the Vienna Convention are applied, Indonesia's alleged "conflict" disappears. The fact that Indonesia wishes that Article III and the SCM Agreement said something other than what they in fact say is legally irrelevant.

5.380 In addition, the fact of the matter is that Indonesia did benefit from the last minute insertion of Article 27.3 into the text of the SCM Agreement, and the evidence suggests that Indonesia is well aware of the nature and the value of this benefit.

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<sup>248</sup>The written version of Indonesia's statements differ from the oral presentations, and, unfortunately, panels do not prepare transcripts of their meetings. However, the members of the United States delegation distinctly recall Indonesia making the assertion in question.

<sup>249</sup>United States - Measure Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/AB/R, Report of the Appellate Body adopted 23 May 1997, page 19.

<sup>250</sup>India - Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R, Report of the Appellate Body issued 19 December 1997, para. 45.

<sup>251</sup>Id.

5.381 Because Indonesia is temporarily exempt from the prohibition in Article 3.1(b), there has been little discussion in this case regarding the procedures in Article 4 of the SCM Agreement for challenging prohibited subsidies. It is appropriate at this point to recall what those procedures are. Suffice it to say that the process under Article 4 is rapid - very rapid.

5.382 Under Article 4.4 of the SCM Agreement, a complainant may request the establishment of a panel within 30 days of the request for consultations, as opposed to the standard period of 60 days under Article 4.7 of the DSU. Under Article 4.6 of the SCM Agreement, a panel is to circulate its final report to all Members within 90 days of the date of the composition and the establishment of the panel's terms of reference, with no provision made for extensions. Under Article 12.8 of the DSU, a panel normally has six months (180 days) within which to issue its report, but may take up to nine months (270 days).

5.383 Under Article 4.8 of the SCM Agreement, following the issuance of a panel report, the DSB must adopt the report (or one of the parties must notify its decision to appeal) within 30 days, as opposed to the standard period of 60 days under Article 16.4 of the DSU. If a report is appealed, under Article 4.9 of the SCM Agreement, the Appellate Body normally must issue its report within 30 days of the notice of appeal, but may take up to 60 days. Under Article 17.5 of the DSU, the Appellate Body normally has 60 days in which to issue its report, but may take up to 90 days.

5.384 Finally, under Article 4.7 of the SCM Agreement, if a measure is found to be a prohibited subsidy, the subsidizing Member must withdraw the subsidy "without delay." By contrast, under Article 21.3 of the DSU, a Member has "a reasonable period of time" in which to comply with a DSB recommendation or ruling, the benchmark for which, pursuant to Article 21.3(c), is 15 months from the date of adoption of a panel or Appellate Body report.

5.385 What all of this means is that if Indonesia had not been exempted by Article 27.3 from the prohibition of Article 3.1(b) and the remedies of Article 4, this Panel would not be here. If the complainants in this case, including the United States, had been able to bring a complaint under Article 3.1(b) and Article 4, and assuming that a panel was composed on the same day as this Panel was (30 July 1997), the panel would have issued its ruling on the Article 3.1(b) claim no later than 28 October 1997.<sup>252</sup> Indonesia would have filed its appeal no later than 27 November 1997.<sup>253</sup> Indonesia would have filed its appellant submission on 2 December, and the complainants in this case would have filed their appellee submissions on 9 December.<sup>254</sup> The oral hearing before the Appellate Body would have taken place on 12 December, and the Appellate Body's report would be due on 27 December.<sup>255</sup> The panel and Appellate Body reports would be adopted by the DSB no later than 22 January 1998, the next scheduled meeting of the DSB. Following adoption, Indonesia then would have to withdraw the subsidies "without delay" under Article 4.7 of the SCM Agreement. While the phrase "without delay" has yet to be construed, presumably it must mean a time period far shorter than the "reasonable period of time" referred to in Article 21.3 of the DSU or the six-month period for withdrawal set forth in Article 7.9 of the SCM Agreement with respect to adverse effects cases. Thus, if Article 3.1(b) and Article 4 of the SCM Agreement were applicable to the Indonesian subsidies, the complainants could expect a withdrawal of the subsidies some time in the first half of 1998.

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<sup>252</sup>Although this issue has never been definitively decided, presumably an Article 3.1(b) claim would have to be pursued separately from other claims if the complainant wished to take advantage of the accelerated timetable of Article 4.

<sup>253</sup>It would be Indonesia appealing, of course, because there is no question that the subsidies in question fall under Article 3.1(b).

<sup>254</sup>Annex 1 (Timetable for Appeals), Working Procedures for Appellate Review, WT/AB/WP/3 (28 February 1997).

<sup>255</sup>Id. Again, because there is no question that the Indonesian subsidies fall under Article 3.1(b), there would be no need for the Appellate Body to extend its deadline of 30 days.



5.386 As things now stand, however, the Panel has indicated that it will not be issuing its report until the end of April 1998. Even then, in all likelihood, the issuance of the report simply will trigger an appeal by Indonesia that will further delay the withdrawal of the measures in question. Once the Appellate Body rules in complainants' favour and the Panel and Appellate Body reports are adopted by the Dispute Settlement Body, then if it is impracticable for Indonesia to comply immediately, Indonesia will have a "reasonable period of time" in which to bring its measures into conformity with its obligations.<sup>256</sup> In short, the measures in question may not be withdrawn until some time in 1999.<sup>257</sup>

5.387 In the view of the United States, Indonesia has received quite a bargain. If Indonesia were subject to Article 3.1(b) and Article 4, we would be very close to the point at which the parties would be discussing the timing of Indonesia's withdrawal of its local content subsidies. However, because Indonesia is exempt from those provisions, the parties will not reach that stage until some time in late 1998.

5.388 Moreover, the evidence indicates that Indonesia understands full well the nature of the benefits it enjoys by virtue of its exemption from the expedited procedures for prohibited subsidies. Throughout the history of this dispute, officials of both Indonesia and TPN repeatedly have made statements to the public and the press that the National Car Programme is not in any jeopardy, because by the time the WTO dispute settlement process runs its course, the objectives of the National Car Programme will have been accomplished and TPN (or Kia Timor, depending on who one believes) will be firmly established as a bona fide (albeit subsidized) auto producer.<sup>258</sup> Recently, even officials from Kia Motors have taken up the refrain, stating that it will "take at least from two to three years for the WTO to come up with mediation-crafted measures".<sup>259</sup>

5.389 Moreover, when one steps back a bit, it is clear that at a minimum, Indonesia is no worse off than it was before the entry into force of the WTO Agreement. Under GATT 1947, the tax incentives in question were prohibited by Article III:2 and Article III:4, and also were actionable under the serious prejudice provisions of Article XVI. Because of Article 27.3, however, nothing has really changed in that regard. The tax incentives continue to be prohibited by Article III:2 and Article III:4 of GATT 1994 and continue to be subject to a serious prejudice claim under the SCM Agreement. Thus, it is incredible for Indonesia to claim, as it has via Dr. Makarim, that it would not have signed the WTO Agreement if it had known that its local content subsidies would be subject to Article III. If that truly were Indonesia's belief, then it would not have been a Contracting Party of GATT 1947.

5.390 In summary, the Panel should be extremely sceptical of assertions by Indonesia that it somehow got a raw deal by signing on to a package under which local content subsidies are prohibited by virtue of Article III. As discussed above, Indonesia benefits from being temporarily exempt from the accelerated procedures of Article 4 of the SCM Agreement. At a minimum, it is no worse off than it was under GATT 1947.

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<sup>256</sup>With respect to the United States claim of serious prejudice, under Article 7.9 of the SCM Agreement, Indonesia would have six months in which to withdraw the subsidies or remove the adverse effects.

<sup>257</sup>The United States assumes that Indonesia will abide by its commitment to the IMF to withdraw the measures once the DSB has ruled against it.

<sup>258</sup>"RI to Finish Car Program by '99", *Jakarta Post*, 23 April 1997 (US Exhibit 14, p. 105); "Indonesia Preparing Team to Defend Nat'l Car Policy at WTO", *ANTARA*, 9 May 1997 (US Exhibit 14, p. 117); "Astra, Indomobil Roped in to Speed Up Timor Car Project," *Business Times (Singapore)*, 16 May 1997 (US Exhibit 14, p. 121); "Bumpy Road Ahead for Motoring Plan", *South China Morning Post*, 8 June 1997 (US Exhibit 14, p. 132) (quoting a TPN official as stating that the WTO dispute "will not impact our activities. The WTO takes time."); and "Timor in Trouble at WTO and at Home", *Business Times (Singapore)*, 25 June 1997 (US Exhibit 14, p. 144) ("Jakarta is gambling that it has time on its side.").

<sup>259</sup>"Timor President's Resignation Won't Affect Kia in Indonesia", *Asia Pulse*, 4 November 1997 (US Exhibit 24, p. 25).

- (c) The tax incentives under the 1993 Programme and the National Car Programme are not protected by Article III:8(b) of GATT 1994

5.391 Indonesia appears to argue that the tax incentives provided under the 1993 Programme and the National Car Programme are protected by Article III:8(b) because the tax “subsidies” are received by producers or assemblers of automobiles. (See Section V.D.) This argument misses the point, and misstates the meaning of Article III:8(b) and the precedents relating thereto.

5.392 Insofar as Article III:4 is concerned, Article III:8(b) provides that the provision of a subsidy exclusively to a producer of a like domestic product and not to a foreign producer does not violate the non-discrimination requirements of Article III:4. However, insofar as Article III:4 is concerned, in the case of Indonesia’s tax incentives, the imported products discriminated against through the local content requirements are automotive parts and subparts, not finished automobiles. Thus, the fact that these tax incentives may constitute subsidies to purchasers of Indonesian automotive parts and subparts (i.e. producers of finished automobiles or finished parts) does not excuse the discriminatory treatment accorded to imported automotive parts and subparts.<sup>260</sup>

5.393 Moreover, Article III:8(b) does not insulate the Indonesian tax incentives from the requirements of Article III:2. In the Canada Periodicals case, the Appellate Body affirmed that Article III:8(b) “was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government”.<sup>261</sup> In so ruling, the Appellate Body quoted with approval the following passage from the United States - Malt Beverages case:<sup>262</sup>

Article III:8(b) limits, therefore, the permissible producer subsidies to “payments” after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.

5.394 Indonesia’s tax incentives do not involve the expenditure of revenue by Indonesia. For that reason, also, they are not protected by Article III:8(b). Indonesia’s argument to the contrary is that the introduction of the SCM Agreement effectively has amended the scope of Article III:8(b). This is nothing more than a recycled version of Indonesia’s “conflicts” argument, which the United States has addressed previously and exposed as a specious argument that is unsupported by the text of the agreements, their drafting history, public international law principles, and WTO jurisprudence.

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<sup>260</sup>Italian Agricultural Machinery, L/833, Report of the Panel adopted 23 October 1958, BISD 7S/60, 64, para. 14.

<sup>261</sup>Canada - Certain Measures Concerning Periodicals, WT/DS31/AB/R, Report of the Appellate Body adopted 30 July 1997, page 34.

<sup>262</sup>Id. quoting from BISD 39S/206, para. 5.10, adopted 19 June 1992.

F. Additional arguments regarding the claims under Article III:4 of GATT 1994 pertaining to the tariff measures

1. Specific response by Indonesia

5.395 In addition to its general response concerning all of the claims under Article III of GATT 1994, **Indonesia** makes a specific response with respect to the claims that the tariff measures at issue violate Article III:4 of GATT 1994. The following are **Indonesia's** arguments in this regard:

- (a) The customs import duties schedules for automotive companies using differing levels of domestic content are consistent with Article III:4 of GATT 1994 because the schedules are border measures which are not subject to Article III:4 of GATT 1994 and are subsidies Indonesia is permitted to maintain

5.396 Customs duties are, by definition (Article I:1 of GATT 1994), "imposed on or in connection with importation" and hence are border measures rather than internal regulations. Therefore they are not covered by Article III:4 (or any of Article III) of GATT 1994 which, as the title to the Article itself notes, is limited to "National Treatment on Internal Taxation and Regulation."<sup>263</sup>

5.397 As previously discussed, under the 1993 Incentive Programme, the level of the import duty imposed on imported automobiles and automotive parts is set by reference to the proportion of parts and components produced in Indonesia that are used in each particular automobile model. Similarly, under the February 1996 national car programme, producers designated as producers of a national car and meeting the criteria for that programme are exempt from import duties on imported parts and components. Both programmes grant exemptions from customs import duties, which are - irrefutably - border measures. There can be no serious argument that internal regulation is involved. Therefore, Article III of the General Agreement, including Article III:4, is inapplicable.

5.398 This conclusion is not affected by the Report of the Panel in Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140, which is the leading GATT decision regarding local content regimes. In FIRA corporate undertakings to purchase goods of Canadian origin became part of the conditions under which each proposed investment was approved, and derogations therefrom could be legally enforced. This legal obligation to purchase domestic goods was a "requirement" affecting the internal sale of a product and thus was within the scope of Article III:4. No border measures were involved.

5.399 For similar reasons the Report of the Panel in EEC-Regulation on Imports of Parts and Components (16 May 1990), BISD 37S/132, is inapposite. There, suspension by the European Communities of an anti-dumping circumvention proceeding depended on the undertaking of the Japanese respondent companies to change their sourcing from imported parts and materials to parts and materials produced in the European Communities. Neither the "advantage" found by the Panel (suspension of an EEC administrative proceeding) nor the undertaking to use EEC goods was a border measure. The same is true with respect to the Report of the Appellate Body in European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (9 September 1997). As the Appellate Body stated:

At issue in this appeal is not whether any import licensing requirement, as such, is within the scope of Article III:4, but whether the European Communities procedures and requirements for the distribution of import licences for imported bananas among

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<sup>263</sup>The United States' argument that the import duty incentives are within the scope of Article III:4 (See Section V.C.3 and V.F.4) is simply wrong.

eligible operators within the European Communities are within the scope of this provision. Id. at para. 211 (emphasis added).

The “advantage” within the scope of Article III:4 was the distribution of licences among eligible operators (an internal measure) and not the border measure (the licensing requirement) itself.

5.400 In the instant case, there is no classic local content requirement obligating a company to purchase locally.<sup>264</sup> All automotive companies are free to choose where to source automotive parts and components. Each company makes a corporate decision about whether it wishes to benefit from the subsidization of customs import duties granted to those choosing to use specified levels of domestically produced parts and components.<sup>265</sup>

(b) Indonesia’s customs import duties subsidy does not involve a "requirement" necessary to “secure an advantage” within the scope of Article III:4 of GATT 1994

5.401 Complainants erroneously contend that Indonesia’s subsidized customs import duties are within the scope of Article III: 4 of the General Agreement. They claim that the issue is “not the reduction of duties, as such, but conditioning such reduction on the purchase of domestic parts and components.”

5.402 The flaw in complainants’ position is fundamental - the scope of Article III is limited to internal laws, regulations and requirements; subsidized customs import duties are border measures, not internal laws, regulations or requirements. No WTO or GATT precedent supports expanding the scope of Article III to cover border measures. Indeed, the precedents Complainants cite – Italian Machinery,<sup>266</sup> EEC – Parts and Components<sup>267</sup>, EEC–Oilseeds<sup>268</sup>, Bananas III<sup>269</sup> and FIRA<sup>270</sup> - disprove their contention.

5.403 Italian Machinery involved credit facilities available only to purchasers of domestic tractors - clearly internal measures. The Panel’s identification of the scope of Article III was simple and unambiguous: “... the intention of the drafters of [Article III of the General] Agreement was clearly to treat imported products in the same way as the like domestic products once they had been cleared through customs.”<sup>271</sup>

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<sup>264</sup>The United States Government officially acknowledges this in the April 1997 report entitled Indonesia’s Automotive Market Summary prepared by the United States Department of Commerce (see Indonesia Exhibit 11) The Department declares that “local content requirements are not explicit” in the 1993 Incentive Programme.

<sup>265</sup>Even the United States recognizes that Indonesia’s system of sliding tariff rates is not a local content regime as that term has been understood and used in the WTO and the GATT. During the 26 October 1989 meeting of the Uruguay Round negotiating group on TRIMs, the United States defined local content as “a barrier that could not be overcome no matter how much better an imported product might be.” (MTN.GNG/NG12/13 at para. 43.) The Indonesian subsidy programmes, unlike the undertakings in FIRA or EEC-Parts and Components, do not present a barrier that cannot be overcome. Each company can choose whether it is in its commercial interest to source a certain amount locally and pay one rate of duty on imported parts or to source less in Indonesia and pay a different duty rate.

<sup>266</sup>Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60.

<sup>267</sup>EEC-Regulation on Imports of Parts and Components (16 May 1990), BISD 37S/132.

<sup>268</sup>European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (25 January 1990), BISD 37S/86.

<sup>269</sup>European Communities-Regime for the Importation, Sale and Distribution of Bananas (9 September 1997), WT/DS27/AB/R.

<sup>270</sup>Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140.

<sup>271</sup>Italian Discrimination Against Imported Agricultural Machinery (23 October 1958), BISD 7S/60, 64, para. 11 (emphasis added).

5.404 EEC - Parts and Components involved: (i) “anti-circumvention duties” imposed on finished products assembled in the European Communities (not on imported parts); and (ii) the suspension of European Communities administrative proceedings where companies agreed to limit their use of imported parts. Both clearly are internal measures, not border measures. After stating that the European Communities’s “anti-circumvention duties” were neither conditioned upon the importation of a product nor imposed at the time of importation, the Panel said: “the imposition of ‘ordinary customs duties’ for the purpose of protection is allowed unless they exceed tariff bindings. ... By contrast, internal taxes that discriminate against imported products are prohibited.”<sup>272</sup>

5.405 Oilseeds involved payments to processors of domestic oilseeds. The principle the European Communities believes relevant appears to be that “... the exposure of a particular imported product to a risk of discrimination constitutes, by itself, a form of discrimination.”<sup>273</sup> Once again, as the first emphasized portion of the quote demonstrates, the measure at issue was an internal measure affecting a product that already had been imported, not a border measure.

5.406 What of Bananas III? There, too, the Appellate Body expressly declared:

At issue in this appeal is not whether any import licensing requirement, as such, is within the scope of Article III:4, but whether the European Communities procedures and requirements for the distribution of import licences for imported bananas among eligible operators within the European Communities are within the scope of this provision.<sup>274</sup>

The "advantage" within the scope of Article III:4 was the distribution of licences among eligible operators, something that occurred after importation and thus was an internal measure. The "import licensing requirement, as such", - the border measure - was not addressed because, as a border measure, it could not be within the scope of Article III.

5.407 Lastly, the FIRA decision, addressed at pages 99 to 100 of Indonesia’s First Submission, provides Complainants no succour. In this, the leading GATT decision regarding local content regimes, the Panel found that corporate undertakings to purchase goods of Canadian origin, an internal requirement, were within the scope of Article III:4.<sup>275</sup> As in the other cases Complainants cite, no border measure was involved.

5.408 Complainants have not pointed to any precedent declaring that Article III applies to border measures. They cannot. No such precedent exists because Article III applies only to measures regarding imported goods that have cleared customs.

5.409 What of the linkage of the level of customs import duties to the level of domestic content? Rather than seeking to transform a border measure into an internal measure so as to apply Article III, the proper approach is to analyze whether this domestic content subsidy is consistent with Indonesia’s obligations, as a developing country, under the SCM Agreement.

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<sup>272</sup>European Economic Community-Regulation on Imports of Parts and Components (16 May 1990), BISD 37S/132, 192, para. 5.4.

<sup>273</sup>European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (25 January 1990), BISD 37S/86, 125, para. 141 (first emphasis added).

<sup>274</sup> European Communities-Regime for the Importation, Sale and Distribution of Bananas (9 September 1997), WT/DS27/AB/R, 85, para. 211 (emphasis added).

<sup>275</sup> Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140.

2. Rebuttal of Japan to Arguments of Indonesia

5.410 **Japan** argues, in rebuttal to Indonesia's response to the claim under Article III:4 pertaining to the tariff measures, that the February 1996 programme violates GATT Article III:4 and cannot escape review as a purported "border measure" or "voluntary measure." The following are **Japan's** rebuttal arguments in this regard:

(a) The February 1996 programme violates GATT Article III:4

5.411 The February 1996 programme waives payment of the 35 per cent luxury tax and import duties of up to 65 per cent on automotive parts and components in connection with the National Car, conditioned on the National Car meeting certain local content requirements. Thus, it creates strong incentives for the National Car manufacturer to favour Indonesian parts and components over like imported parts and components, in clear violation of GATT Article III:4. (See Section V.C.1.)

(b) Indonesia's "border measure" defence has no merit

5.412 Regarding the local content requirement in connection with the import duty exemption, Indonesia argues that it is a "border measure," because "[c]ustom duties are, by definition (Article I:1 of the General Agreement), 'imposed on or in connection with importation.'" Indonesia further argues that it follows that such a measure cannot be an "internal regulation" subject to Article III:4. However, both the text of GATT Article III:4 and the GATT/WTO precedent cases disprove this assertion.

(1) The text of GATT Article III:4 shows that it applies to "all" measures "affecting" conditions of internal sale

5.413 First, the text of GATT Article III:4 provides that the Article shall be applied "in respect of all laws, regulations and requirements affecting [imports] internal sale, offering for sale, purchase, transportation, distribution or use." Nothing in the text requires such laws, regulations, and requirements to affect only wholly internal matters, or in other words, not to have any connection whatsoever with the border. Nor is there any textual basis for the rigid distinction that Indonesia has attempted to draw between "border measures" and "internal measures". Rather, Article III:4, by its terms, applies to "all" measures "affecting [imports] internal sale, [etc.]," regardless of how Indonesia chooses to describe its measures for purposes of these proceedings.<sup>276</sup>

5.414 In the instant case, the issue is not the reduction of import duties as such. The Government of Japan is not challenging the duties of up to 65 per cent that Indonesia maintains on imports of automotive parts and components. Instead, the issue here concerns the incentives, including the import duty incentive, created by Indonesia to encourage the purchase of domestic automotive parts and components over like imports. Providing an Indonesian automaker with incentives to purchase domestic parts and components clearly "affects" the conditions of "internal sale." Moreover, what is encouraged by this measure is a purely internal activity (i.e. purchase of domestic parts and components), which has little connection with "borders." Thus, regardless of whether the incentives involve "border measures" such as import duties, they "affect" conditions of internal sale for imported automotive parts and components and are covered by the plain text of GATT Article III:4.

5.415 It should likewise be noted that, in connection with the luxury tax exemption, the issue for purposes of Article III:4 is not the luxury tax exemption as such. The discriminatory luxury tax

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<sup>276</sup>Indonesia seems to rely on the title of GATT Article III, underscoring the word "internal" in the title language "National Treatment on Internal Taxation and Regulation." However, the Government of Indonesia makes mistakes in interpreting the title, as is obvious from the text of GATT Article III:4. A regulation is subject to GATT Article III:4 if it affects conditions of internal sale.

exemption as such violates Article III:2. What matters for purposes of Article III:4 is the local content requirements which must be satisfied to obtain the luxury tax exemption. By creating incentives to purchase Indonesian parts and components, the local content requirements accord Indonesian products more favourable treatment than like imported products, in violation of Article III:4.

- (2) The GATT/WTO precedents also show that GATT Article III:4 applies to "border measures" that affect conditions of internal sale

5.416 Indonesia's argument is also inconsistent with the long-standing construction of Article III:4 that has been accepted by GATT and WTO panels since 1958. The early GATT precedent in Italian Discrimination Against Imported Agricultural Machinery, which has been cited approvingly many times since, stated that Article III:4 applies to laws "affecting internal sale, purchase, etc." and not only to laws "governing the conditions of sale or purchase." The Panel further elaborated, "the selection of the word 'affecting' would imply that the drafters of the Article intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market."<sup>277</sup>

5.417 Other, more recent decisions are even more directly on point in specifically holding that measures involving "border measures" and "affecting" the conditions of "internal sale" or purchase fall within the coverage of GATT Article III:4. For example, the Panel in United States - Section 337 of the Tariff Act of 1930 held that the "fact that Section 337 is used as a means for the enforcement of United States patent law at the border does not provide an escape from the applicability of Article III:4."<sup>278</sup>

5.418 This conclusion was most recently reaffirmed by both the Panel and the Appellate Body in EC - Regime for the Importation, Sale and Distribution of Bananas ("Bananas III").<sup>279</sup> In that case, the European Communities argued, to both the Panel and the Appellate Body, that the measure at issue was a border measure, not an internal measure subject to GATT Article III:<sup>280</sup>, but that argument was not accepted. Instead, the Panel found that the European Communities' measures violated GATT Article III:4 in that they affected internal sales conditions, by allocating a certain portion of the licences required to import bananas at a reduced duty rate exclusively to operators who marketed certain quantities of domestic bananas. The Panel expressly held that "border measures may be within the purview of the national treatment clause" of Article III:4.<sup>281</sup> It further stated, "if the mere fact that the European Communities regulations .... include or are related to a border measure such as a licensing requirement would mean that the Article III cannot apply, it would not be difficult to evade the GATT national treatment obligation."<sup>282</sup> The Panel's finding was examined and upheld by the Appellate Body.<sup>283</sup> Thus, it is clear that the Panel and the Appellate Body Report on Bananas III rejected an argument identical to Indonesia's in a very similar context.

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<sup>277</sup> Panel Report on Italian Discrimination Against Imported Agricultural Machinery ("Italian Agricultural Machinery"), L/833, adopted on 23 October 1958, 7S/60, 64, para.12. (Emphasis in original.)

<sup>278</sup> Panel Report on United States - Section 337 of the Tariff Act of 1930 ("US - Section 337"), L/6439, adopted on 7 November 1989, BISD 36S/345, 385-386, para. 5.10. See also Panel Report on EEC - Regulation on Imports of Parts and Components, L/6657, adopted on 16 May 1990, BISD 37S/132, 197.

<sup>279</sup> Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas ("Bananas III"), WT/D2S7/R/USA, adopted on 25 September 1997, as modified by the Appellate Body. Appellate Body Report on Bananas III, WT/DS27/AB/R, adopted on 25 September 1997.

<sup>280</sup> Panel Report on Bananas III, paras. 4.265-4.271. Appellate Body Report on Bananas III, paras. 33-36.

<sup>281</sup> Panel Report on Bananas III, para. 7.176.

<sup>282</sup> Id., para. 7.177.

<sup>283</sup> Appellate Body Report on Bananas III, paras. 209-211.

5.419 Indonesia's curious attempt to claim that the Appellate Body's report in Bananas III supports its position not only fails, but undercuts the heart of its argument. Indonesia quotes the Appellate Body as stating:

At issue in this appeal is not whether any import licensing requirement, as such, is within the scope of Article III:4, but whether the European Communities procedures and requirements for the distribution of import licences for imported bananas among eligible operators within the European Communities are within the scope of this provision.

But, far from supporting Indonesia's position, this quotation highlights its error. The quotation demonstrates that GATT Article III:4 does in fact apply to measures, such as Indonesia's import duty incentive, that "affect" internal sales conditions for imports regardless of whether such measures also have some relationship with the border. Indeed, the Appellate Body's statement so undercuts Indonesia's position and supports Japan's that it may be reformulated easily to apply to this case as follows:

At issue in this case is not whether any import duty, as such, is within the scope of Article III:4, but whether Indonesia's requirements which encourage internal purchase of domestic automotive parts and components within Indonesia are within the scope of this provision.

5.420 The other two cases cited by Indonesia likewise fail to support its argument. While it may be true, as Indonesia says, that the measures at issue in Canada - Administration of the Foreign Investment Review Act were not border measures, nothing about that decision supports the alleged interpretation that any measure related to border measures cannot be subject to GATT Article III:4. That Panel simply did not address this issue. Finally, as for EEC - Regulation on Imports of Parts and Components, Indonesia's assertion that the measures at issue there did not involve border measures is simply incorrect. The "advantage" found by that Panel to violate Article III:4 concerned the suspension of proceedings under the anti-circumvention provision of the anti-dumping legislation, which, contrary to Indonesia's characterization, obviously implicates border measures. In fact, the European Communities argued in that dispute that the measures "were not internal measures within the meaning of [GATT Article III]"<sup>284</sup>, which the Panel rejected.

5.421 Therefore, Indonesia's "border measure" defence is inconsistent with both the plain text of Article III:4 and its well-established understanding.

(c) Indonesia's "voluntary measure" defence has no merit

5.422 Indonesia also seems to argue that, since the measures at issue in this case are not mandatory measures but measures with which the company may comply voluntarily to obtain a benefit, they are not covered by GATT Article III:4 (see Section V.F.1). However, that argument does not have any merit.

5.423 Indonesia's argument is inconsistent with the firmly established interpretation of GATT Article III:4 that has been affirmed by many GATT/WTO panels. These decisions establish that where compliance with a certain measure is necessary to secure an "advantage," such a measure is covered by GATT Article III:4. For example, the Panel in Italian Agricultural Machinery found inconsistent with GATT Article III:4 an Italian law that created voluntary incentives for farmers to purchase domestic agricultural machinery by providing special credit terms to farmers for the purchase of domestic

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<sup>284</sup>Panel Report on EEC - Parts and Components, para.3.43.



machinery, but not for imports.<sup>285</sup> Other similar examples include the Panel Report on EEC - Parts and Components<sup>286</sup> and the recent Panel and Appellate Body Reports on Bananas III.<sup>287</sup>

5.424 The well-established conclusion that GATT Article III:4 covers not only mandatory measures but also voluntary measures is reinforced by the Illustrative List of the TRIMs Agreement, which explicitly provides that "TRIMs that are inconsistent with .... [GATT Article III:4] include those .... compliance with which is necessary to obtain an advantage ...." (See also Section VI.A.)

### 3. Rebuttal of European Communities to arguments of Indonesia

5.425 The **European Communities** argues, in rebuttal to Indonesia's response to the claim under Article III:4 pertaining to the tariff measures, that import duty relief contingent on local content requirements violates GATT Article III:4 and cannot escape review as a purported "border measure" or "voluntary measure". The following are **the European Communities'** rebuttal arguments in this regard:

5.426 Indonesia argues that Article III:4 does not apply to the measures mentioned in numbers (v) and (vi) of part (b) of the European Communities' claims (See Section III.B), because they are border measures.

5.427 The European Communities would agree that the application of a reduced or zero customs duty rate on imports of automotive parts and components is a "border measure" which, if applied in isolation, would fall outside the scope of GATT Article III:4. In the present case, however, the granting of that tariff advantage is conditional upon the motor vehicles into which the imported parts and components are assembled reaching a certain percentage of local content. In order to reach that percentage, local assemblers must use local parts and components instead of imported ones. Therefore, it is indisputable that the measure "affects" the internal use within Indonesia of parts and components within the meaning of GATT Article III:4.

5.428 It is a well established principle that GATT Article III:4 does not apply only to "mandatory" measures but also where compliance with a certain measure (such as the local content targets at issue in the present case) is necessary in order to secure an advantage or benefit (such as the possibility to import inputs at a reduced or zero rate). As noted by the Panel Report on EEC - Regulation on Imports of Parts and Components:

... the comprehensive coverage of 'all laws, regulations or requirements affecting [emphasis added by the Panel] the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, such as those examined by the FIRA Panel .... but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute 'requirements' within the meaning of that provisions<sup>288</sup>, [emphasis added].

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<sup>285</sup>Panel Report on Italian Agricultural Machinery, paras. 11-12. See para. 3.07 above.

<sup>286</sup>Panel Report on EEC - Parts and Components, para. 5.21. See para. 3.11 above.

<sup>287</sup>Panel Report on Bananas III, para. 7.178. Appellate Body Report on Bananas III, paras. 211- 214. See paras. 3.09-3.10 above.

<sup>288</sup>Panel Report on European Communities - Regulation on imports of Parts and Components, adopted on 16 May 1990, 37S/132, 197, para 5.21. This principle has been applied also by other Panels. Thus, the Panel Report on Italian discrimination against Imported Agricultural Machinery (adopted on 23 October 1958, BISD 7S/60, 64, para 12) found that an Italian law providing especial credit terms to farmers for the purchase of agricultural machinery conditional on the purchase by the farmers of Italian machinery was contrary to Article III:4. Similarly, the Panel Report on EEC - Payments and subsidies paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins (adopted on 25 January 1990, BISD 37S/86, 124-125) concluded

5.429 The “advantage” in question may consist of a benefit granted with respect to a border measure, such as for instance a tariff exemption or reduction. This has been confirmed by the recent Panel reports on EC - Regime for the Importation, Sale and Distribution of Bananas.<sup>289</sup>

5.430 One of the measures in dispute in that case were the so-called “operator category rules” for the allocation of licences to import of “third country” bananas at lower tariff rates within a tariff quota. In accordance with those rules, 30 per cent of the tariff quota was reserved for operators who had marketed during a preceding three-year period bananas of European Communities origin or of traditional ACP sources.

5.431 The Panel found that the requirement to market bananas of European Communities origin afforded more favourable treatment to those bananas than to like imported bananas and therefore violated Article III:4 of GATT. In reaching this conclusion the Panel rejected expressly an argument submitted by the European Communities to the effect that the measures were border measures and as such not subject to Article III:4. The Panel restated the view of a previous (unadopted) Panel Report dealing with the same matter that

“... a requirement to purchase a domestic product in order to obtain the right to import a product at a lower rate of duty under a tariff quota is therefore a requirement affecting the purchase of a product within the meaning of Article III:290”.

5.432 The situation is identical in the present case. In order to obtain the right to import parts and components at a lower rate of duty, the assemblers of motor vehicles are required to use (and purchase previously if they do not manufacture them internally) domestic parts and components, thereby affording more favourable treatment to those parts and components than to like imported parts and components.

5.433 The findings of the Panel Reports on EC - Regime for the Importation, Sale and Distribution of Bananas with respect to the operator category rules were upheld by the Appellate Body on appeal.<sup>291</sup> Indonesia misreads the findings of the Appellate Body. The obvious meaning of the passage of the Appellate Body report cited by Indonesia in its submission (See Section V.F.1) is that while, in principle, import licensing requirements are not within the scope of Article III:4, the requirements applied by the European Communities went “far beyond the mere import licence requirements needed to administer the tariff quota” and affected the “internal sale, offering for sale... etc” of bananas. By the same token, in the present case, the local content targets go beyond what is necessary to apply a tariff reduction/exemption and affect the internal use of parts and components within the meaning of Article III:4.

#### 4. Rebuttal of United States to arguments of Indonesia

5.434 The **United States** argues that Indonesia’s argument that Indonesia's tariff incentives do not violate Article III:4 of GATT 1994 because they are “border measures” has been rejected by the Appellate Body. The following are the **United States'** arguments in this regard:

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that the payment by the Community of subsidies to the processors of oilseeds who purchased oilseeds of Community origin was contrary to Article III:4.

<sup>289</sup>See e.g. Panel Report on EC - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/GTM, WT/DS27/R/HND, adopted on 25 September 1997, at paras 7.171-7.182, 7.216-7.219 and 7.244-7.250.

<sup>290</sup>Id. at para 7.179, quoting the Panel Report on EEC - Import regime for Bananas, issued on 11 February 1994 (not adopted), DS 38/R, para 146.

<sup>291</sup>Appellate Body report on EC - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R, adopted on 27 September 1997, at para 211.

5.435 Indonesia argues that the tariff incentives under the 1993 Programme and the National Car Programme do not violate Article III:4 of GATT 1994 because Article III:4 does not address “advantages” that are conferred in the form of border measures. According to Indonesia, “There can be no serious argument that internal regulation is involved. Therefore, Article III of the General Agreement, including Article III:4, is inapplicable.”

5.436 To the contrary, there can be no serious argument that internal regulation is not involved. Indonesia’s argument consists of a discussion of panel decisions that found violations of Article III:4, but that did not involve border measures. From this, Indonesia concludes that Article III:4 does not cover advantages conferred in the form of border measures.

5.437 This is a classic non sequitur. The fact that these panels were not dealing with border measures does not prove that advantages conferred in the form of border measures are not covered by Article III:4. All it proves is that these panels did not address the question.

5.438 However, the Appellate Body has addressed and rejected the very argument advanced here by Indonesia. In Bananas III, in connection with the European Communities’s licensing regime, the European Communities argued that (1) the panel erred in finding the licensing regime to be an internal measure subject to Article III:4, and not a border measure, and (2) the panel misunderstood the notion of internal measures in GATT 1994.<sup>292</sup> However, the Appellate Body flatly rejected this argument. Of particular relevance is the following discussion of the Appellate Body regarding hurricane licences<sup>293</sup>:

Hurricane licences allow for additional imports of third-country (and non-traditional ACP) bananas at the lower in-quota tariff rate. Although their issuance results in increased exports from those countries, we note that hurricane licences are issued exclusively to European Communities producers and producer organizations, or to operators including or directly representing them. We also note that, as a result of the European Communities practice relating to hurricane licences, these producers, producer organizations or operators can expect, in the event of a hurricane, to be compensated for their losses in the form of "quota rents" generated by hurricane licences. Thus, the practice of issuing hurricane licences constitutes an incentive for operators to market European Communities bananas to the exclusion of third-country and non-traditional ACP bananas. This practice therefore affects the competitive conditions in the market in favour of European Communities bananas ... .

For these reasons, we agree with the Panel that the European Communities practice of issuing hurricane licences is inconsistent with Article III:4 of the GATT 1994.

5.439 Like the hurricane licences in Bananas III, the tariff incentives provided by Indonesia may constitute border measures. However, the manner in which they are awarded constitutes an incentive to favour Indonesian automotive parts and subparts over imported parts and subparts, thereby affecting the competitive conditions in the Indonesian market in favour of Indonesian parts and subparts. As such, they violate Article III:4.

## VI. CLAIMS UNDER THE TRIMS AGREEMENT

### A. Claims Raised by Japan

6.1 **Japan** argues that the National Car Programme (see Section III.A) violates Article 2 of the TRIMs Agreement. The following are **Japan's** arguments in support of this claim:

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<sup>292</sup>Id. at para. 33.

<sup>293</sup>Id. at para. 213-214.

6.2 Article 2:1 of the TRIMs Agreement provides that "no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994." The issues before this panel, therefore, are twofold: (i) whether or not the National Car Programme is a "TRIM", and (ii) whether or not it violates either of the relevant GATT articles. As we have demonstrated, the exemption from the luxury tax and the import duty on the basis of local content is in violation of Article III:4. Consequently, the second of the above has been met, and the focus of the analysis here is on the first of the two issues.

1. Indonesia's Programmes are "TRIMs" as defined in the TRIMs Agreement

6.3 There is no doubt that Indonesia's programmes constitute "investment measures related to trade".<sup>294</sup> First, in the context of GATT/WTO, a "measure" is interpreted broadly. For example, in the case of GATS, it is expressly stated that "'measure' means any measure by a Member, whether in the form of law, regulation, rule, procedure, decision, administrative action, or any other form".<sup>295</sup> In light of the usage of the term within the context of the TRIMs Agreement, the notion of a "measure" should be interpreted similarly. Government regulations requiring certain local content to obtain an exemption from a luxury tax or specifying levels of import duty thus constitute "measures" within the meaning of the TRIMs Agreement.

6.4 Second, Indonesia's programmes are all "trade-related investment measures". The National Car Programme has been established specifically "with a view to supporting the development of the automotive industry."<sup>296</sup> The central aspect of the National Car Programme is to develop the domestic manufacturing capability of automobiles and automotive parts and components. The fact that the Programme includes "investment measures" is also obvious from the fact that one of its implementing regulations is entitled "Investment Provisions for Realization of the National Automobile Industry."<sup>297</sup> The Programme indeed impacts on the automobile industry in Indonesia where foreign-owned manufacturers are actively participating. Furthermore, these are all "trade-related" since the Programme is conditioned on local contents requirements and thus naturally affects trade.

6.5 Indonesia has essentially confirmed this point in prior meetings of the WTO Committee on Trade-Related Investment Measures. In the Minutes of the Meeting Held on 30 September and 1 November 1996, the representative of Indonesia stated:

[T]he National Car Programme was intended to bring about major structural changes in the Indonesian automotive sector so that it could develop into a world standard industry ... . These policies were expected to encourage car companies to increase their local content, resulting in a rapid growth of investments in the automotive component industry. (Emphasis added)<sup>298</sup>

6.6 In addition, the Illustrative List in the Annex to the TRIMs Agreement, paragraph 1, specifically includes local content requirements as TRIMs that are inconsistent with Article III:4:

TRIMs that are inconsistent with the obligation of national treatment provided for in [Article III:4] include those ... compliance with which is necessary to obtain an advantage, and which require:

- (a) the purchase or use by an enterprise of products of domestic origin ... specified in terms of a proportion of volume or value of its local production ....

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<sup>294</sup>TRIMs Agreement Article 1.

<sup>295</sup>1994 GATS Article XXVIII(a).

<sup>296</sup>Government Regulation No. 36/1996 (Japan Exhibit 25), preamble.

<sup>297</sup>Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No.01/SK/1996 (Japan Exhibit 29).

<sup>298</sup>G/TRIMS/M/5 (Japan Exhibit 63), para. 24, 27 November 1996.

Indonesia's measures, which are contingent on compliance with local content requirements, thus clearly constitute prohibited TRIMs as set forth in the Illustrative List.

6.7 Furthermore, Japan considers that any TRIMs which violate GATT Article III, including both Article III:2 and Article III:4, are inconsistent with Article 2.1 of the TRIMs Agreement. Japan believes that the February 1996 Programme violates GATT Article III, is a "trade-related investment measure", and thus violates TRIMs Article 2.1.

2. Even if Indonesia's measures were deemed to constitute a subsidy, it is nonetheless also a TRIM

6.8 Indonesia claims that the measure is a "subsidy" rather than a "TRIM".<sup>299</sup> However, the concepts of a TRIM and subsidy are not mutually exclusive. Nothing in the text, objective or purpose of the TRIMs Agreement would support the contention that a TRIM is no longer a TRIM simply because the local administering authority prefers to call it a subsidy rather than a TRIM.

3. Indonesia cannot enjoy the benefit of the transitional period

6.9 Nor can Indonesia enjoy the benefit of the five-year transitional period for developing countries stipulated in TRIMs Agreement, Article 5.2, in light of Indonesia's failure to comply with its notification and standstill obligations. The TRIMs Agreement, Article 5.2 requires notification for Members to benefit from the transitional period, and Article 5.4 imposes a standstill obligation during the period. Indonesia has complied with neither provision. First, there is no notification. Indonesia submitted a notification on 23 May 1995<sup>300</sup>, which specifies certain automotive related measures, but the notification was withdrawn in October 1996.<sup>301</sup> Second, even if the notification had not been withdrawn, its content is irrelevant to the National Car Programme. While the measures appeared in the notification may be tangentially related to the National Car Programme, the Programme itself was not specified in the notification. Moreover, the National Car Programme, which was introduced in 1996, could have never been notified in the notification, which was due within 90 days after the date of entry into force of the WTO Agreement (i.e., 1 January 1995) and was actually made by Indonesia in May 1995. Therefore, Indonesia cannot enjoy the benefit of the transitional period under Article 5.2. of the TRIMs Agreement.

B. Claims Raised by the European Communities

6.10 The **European Communities** claims that Indonesia has violated its obligations under Article 2.1 of the TRIMs Agreement, as the following measures (See Section III.B) are TRIMs inconsistent with Article III of GATT 1994:

- (1) the exemption from the Sales Tax on Luxury Goods of locally manufactured combines, minibuses, vans and pick-ups with more than 60 per cent local content;
- (2) the exemption from the Sales Tax on Luxury Goods of locally manufactured sedans and stations wagons of less than 1,600 cc with more than 60 per cent local content;
- (3) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Indonesia by Pioneer Companies meeting certain local content requirements;

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<sup>299</sup> See Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia Addendum (G/TRIMS/N/1/IDN/1/Add.1) (Japan Exhibit 18); SUBSIDIES / Replies to Questions posed by JAPAN Concerning the Updating Notification of INDONESIA (G/SCM/Q2/IDN/9) (Japan Exhibit 20), 2.(iii).

<sup>300</sup> Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia (G/TRIMS/N/1/IDN/1) (Japan Exhibit 17).

<sup>301</sup> Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia Addendum (G/TRIMS/N/1/IDN/1/Add.1) (Japan Exhibit 18).

- (4) the exemption from the Sales Tax on Luxury Goods of National Cars assembled in Korea by “overseas producers” meeting certain counter-purchasing obligations;
- (5) the grant of duty relief to parts and components used in the assembly of motor vehicles (or of other parts and components for the assembly of motor vehicles) in Indonesia based on the finished vehicles (or the parts and components) meeting certain local content requirements; and
- (6) the exemption of import duties for parts and components used for the assembly of National Cars in Indonesia by Pioneer Companies meeting certain local content obligations.

6.11 The following are the **European Communities'** arguments in support of this claim:

6.12 Article 2.1 of the TRIMs Agreement provides that:

Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT.

6.13 The notion of TRIM (“Trade Related Investment Measure”) is not defined in the TRIMs Agreement. Nevertheless, the Annex to the TRIMs Agreement contains what Article 2.2 of that Agreement describes as:

An Illustrative List of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI.

6.14 The above measures are “investment measures” because they are specifically designed to promote investment into the automotive sector with the purpose of achieving “full manufacturing” of motor vehicles in Indonesia. Further, the measures are “trade related” because they encourage the use of domestic parts and components over imported ones. Finally, as demonstrated above, the measures are inconsistent with Article III:4 and, in some cases, also with Article III:2, first sentence.

6.15 The above analysis is confirmed by the Illustrative List annexed to the TRIMs Agreement. Indeed, the measures at issue fall squarely within the category defined in Item 1 (a) of the Illustrative List, which reads as follows:

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those [...] compliance with which is necessary to obtain an advantage, and which require:
  - (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source [...] in terms of a proportion of volume or value of its local production.

6.16 Article 5.2 of the TRIMs Agreement provides a temporary derogation from the obligation contained in Article 2 in respect of TRIMs which were in force at least 180 days before the entry into force of the WTO Agreement and which have been duly notified by the Member concerned within 90 days from the entry into force of the WTO Agreement, as required by Article 5.1 of the TRIMs Agreement. In the case of developing country Members, such as Indonesia, this temporary derogation has a duration of five years.

6.17 On 23 May 1995, Indonesia made a notification under Article 5.1 of the TRIMs Agreement<sup>302</sup>. This notification, however, does not entitle Indonesia to invoke the temporary arrangement provided in Article 5.2 with respect to the measures at issue.

6.18 In the first place, Indonesia's notification was made more than 90 days after the entry into force of the WTO Agreement. Accordingly, it does not constitute a valid notification under Article 5.1.

6.19 Moreover, Indonesia's notification covered only the measures provided in Decree 645/93. The tax benefits provided in Government Regulation 36/96 and the incentives granted under the National Car Programme were introduced by Indonesia only after the entry into force of the WTO Agreement. For that reason, they were not, and could not have been, notified under Article 5.1.

6.20 On 28 October 1996 (i.e. immediately before the first round of consultations with the Community took place) Indonesia withdrew formally its notification. Allegedly because, based on a further analysis of the measures concerned, it had concluded that the measures were not TRIMs<sup>303</sup>. In reality, however, the obvious reason for withdrawing the notification was Indonesia's belated realisation that the notification would not only fail to provide the expected immunity for the notified measures, but, in addition, would represent an open admission that both the notified measures and the non-notified ones are contrary to Articles III:4 of GATT and 2 of the TRIMs Agreement.

#### C. Claims raised by the United States

6.21 The **United States** claims that Indonesia's system of tariff and tax incentives and the government-directed \$690 million loan to TPN (See Section III.C) are inconsistent with Article 2 of the TRIMs Agreement. The following are the **United States'** arguments in support of this claim:

6.22 Indonesia's system of tariff and tax incentives and the government-directed \$690 million loan to TPN are based upon the achievement of designated local content targets and, as such, discriminate against imported automotive parts (and subparts) in favour of their domestic counterparts. In addition to violating Article III:4 of GATT 1994, these measures also violate Article 2 of the TRIMs Agreement.

6.23 Article 2 of the TRIMs Agreements, in pertinent part, states the following:

1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III ... of GATT 1994.

2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 ... is contained in the Annex to this Agreement.

6.24 Paragraph 1(a) of the Illustrative List, in turn, provides as follows:

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:

(a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular

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<sup>302</sup>G/TRIMS/N/1/IDN/1, dated 1 June 1995.

<sup>303</sup>G/TRIMS/N/1/IDN/1/Add.1, dated 31 October 1996.

products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production ... . (emphasis added).

6.25 The tariff and tax incentives provided by Indonesia fall squarely within the example of a TRIM in paragraph 1(a) of the Illustrative List. The tax and tariff incentives under the 1993 Programme and the National Car Programme require, within the meaning of Article 1(a) of the Illustrative List, "the purchase or use by an enterprise of products of domestic origin or from any domestic source ...". "Compliance" with these requirements "is necessary to obtain an advantage" within the meaning of Article 1 of the Illustrative List. As such, these incentives fall squarely within the Illustrative List. Under both the 1993 programme and the National Motor Vehicle programme, in order to obtain the "advantage" of tariff or tax reductions or exemptions, an "enterprise" must "comply" with the requirement to "use . . . products of domestic origin". Likewise, the provision of the government-directed \$690 million loan to TPN was based on TPN's status as a participant in the production of a "national motor vehicle", a status which, in turn, was based on compliance with the requirement to satisfy the local content requirements for a "national motor vehicle". Therefore, the tariff and tax incentives and the provision of the government-directed \$690 million loan constitute TRIMs that are prohibited by Article 2.1 of the TRIMs Agreement.

6.26 With respect to the 1993 programme, Indonesia, as a developing country, could have taken advantage of the notification and transitional arrangements of Article 5 of the TRIMs Agreement. Paragraphs 1 and 2 of Article 5 provide, in pertinent part:

1. Members, within 90 days of the date of entry into force of the WTO Agreement [i.e., by 31 March 1995], shall notify the Council for Trade in Goods of all TRIMs they are applying that are not in conformity with the provisions of this Agreement. Such TRIMs of general or specific application shall be notified, along with their principal features.

2. Each Member shall eliminate all TRIMs which are notified under paragraph 1 ... within five years [of the date of entry into force of the WTO Agreement] in the case of a developing country Member ... . (footnote omitted).

6.27 Indonesia did notify, pursuant to Article 5.1, that portion of the 1993 programme providing tariff incentives. However, that notification was untimely, because it was made on 23 May 1995, well after the deadline for notifying TRIMs under Article 5.1 had closed.<sup>304</sup> Moreover, the notification did not cover that portion of the 1993 programme providing tax incentives.<sup>305</sup> Subsequently, Indonesia withdrew that portion of its notification pertaining to the tariff incentives for motor vehicles.<sup>306</sup> As a result, Indonesia has not notified any of the TRIMs described above, and, thus, is ineligible to take advantage of the transitional arrangements in Article 5.2.<sup>307</sup>

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<sup>304</sup>G/TRIMS/N/IDN/1 (1 June 1995).

<sup>305</sup>Id.

<sup>306</sup>G/TRIMS/N/IDN/1/Add. 1 (31 October 1996).

<sup>307</sup>Of course, Indonesia could not have notified its TRIMs under the National Motor Vehicle programme, because Indonesia did not introduce those TRIMs until after the 90-day notification window of Article 5.1 had closed.



D. Response by Indonesia to Claims under the TRIMs Agreement

6.28 **Indonesia** argues, in response to the claims under the TRIMs Agreement, that the TRIMs Agreement interprets Article III of the GATT 1994, and adds no new obligations; thus it cannot alter the fact that Article III is not applicable. The following are **Indonesia's** arguments in this regard.

1. Summary

6.29 At the start of the Uruguay Round negotiations, the United States, the European Communities, Japan and other developed countries had grand plans for an agreement that would broadly discipline investment measures. Throughout the negotiations, however, the developed countries' efforts were countered by virtually all developing countries. To avoid the absence of any agreement at all, the agreed-upon TRIMs text provides that the type of local content measure found to be inconsistent with Article III of the General Agreement in Canada-Administration of the Foreign Investment Review Act (7 February 1994), BISD 30S/140, (as well as another type of measure previously found to be inconsistent with Article XI) should also be proscribed as a TRIM. In other words, to be a TRIM, a measure must be inconsistent with GATT Articles III or XI.

6.30 Article 2.1 of the TRIMs Agreement states:

Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994. (Emphasis added.)

The TRIMs Agreement does not add any new obligations; it merely interprets Article III. This was recognized in the Report of the Panel on European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA (22 May 1997), which declares at paragraph 7.185:

In considering these arguments, we first examine the relationship of the TRIMs Agreement to the provisions of GATT. We note that with the exception of its transition provisions the TRIMs Agreement essentially interprets and clarifies the provisions of Article III (and also Article XI) where trade-related investment measures are concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment-related matters. (Emphasis added; footnote omitted.)

6.31 As demonstrated (See Section V.D), Indonesia's luxury tax subsidy is not inconsistent with Article III of the General Agreement. Therefore, the TRIMs Agreement is not germane to this dispute.

2. The TRIMs "Illustrative List" cannot alter the fact that Article III is inapplicable

6.32 Complainants seek to use the TRIMs Illustrative List as the tail to wag the Article III dog, claiming that the Indonesian measures fall within the scope of paragraph 1(a) of the List and hence are TRIMs.

6.33 During the Uruguay Round negotiations, the United States clearly indicated the subordinate nature of the Illustrative List. The official minutes of the 10-11 July 1989 meeting of the TRIMs negotiating group record the following exchange:

One participant asked for clarification on the nature of and the role that would be assigned to "illustrative lists"; were they only concepts within the framework of the negotiations, would they remain illustrative rather than

definitive in any final agreement and would they be open-ended so that they could be added to at a later stage? ... The representative of the United States said that the lists should be purely illustrative. Disciplines should be based on general criteria such as the inherently trade distorting nature of TRIMs and illustrative lists could then be drawn up with specific examples of TRIMs that were subject to specific disciplines. In that way any new measure that was devised could still be caught by the discipline even if it did not appear on an illustrative list.<sup>308</sup>

6.34 The United States, the European Communities, Japan and other developed countries had extensive negotiating goals for the TRIMs Agreement, but at the end of the negotiation the parties could not even agree upon basic definitions such as "investment" measure and "trade-related." The only "general criteria" that survived the negotiating process and was reflected in the final text of the TRIMs Agreement was that a TRIM must be inconsistent with the obligations of either Article III or XI of the General Agreement. In sum, because the luxury tax subsidy is not inconsistent with Article III, it cannot be proscribed by the TRIMs Agreement.

3. Subsidies are governed by the subsidies agreement and are not within the scope of the TRIMs Agreement

6.35 One of the many fundamental issues on which there were major differences of opinion among the participants in the Uruguay Round TRIMs negotiating group was whether subsidies were governed solely by the Subsidies Agreement or also could be considered to be an "incentive" or a "condition for receipt of an advantage" and thus governed by the TRIMs Agreement. The United States and Japan argued that subsidies could also be TRIMs. Argentina, Hungary, India, the Nordics, the Philippines (for ASEAN), Poland and others disagreed.<sup>309</sup> So did the European Communities, which included the following in its 13 November 1989 submission to the TRIMs negotiating group:

[G]overnment incentives, including subsidies, are being addressed in the Negotiating Group on Subsidies; such incentives are therefore not the subject of the current negotiations on TRIMs.<sup>310</sup>

6.36 The disagreement remained throughout the life of the negotiating group. In the "Chairman's Report on the Status of Work in the Negotiating Group" (MTN.GNG/NG12/W/27), the paragraph and accompanying footnote asserting that subsidies could be TRIMs was in brackets, thereby signifying lack of agreement with the proposition.<sup>311</sup> In its 1997 Report to the WTO Council for Trade in Goods, the TRIMs Committee stated: "[d]iffering views continue to be expressed on issues such as ... the

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<sup>308</sup>MTN.GNG/NG12/11 at para. 55 (emphasis added).

<sup>309</sup>Argentina and other developing countries declared that "any suggestion that investment measures themselves, including incentives, should be prohibited is not only inappropriate but unrealistic and unacceptable." MTN.GNG/NG12/W/25 at para. 4 (emphasis added). Hungary "...wanted it spelled out that a TRIMs agreement would not establish different disciplines on investment incentives or subsidies to those agreed to in the Subsidies Negotiating Group." MTN.GNG/NG12/22 at para. 7. India said that it could not be presumed that investment measures constitute a form of subsidization. MTN.GNG/NG12/W/18 at para. 52. The Nordics declared explicitly that "incentives" were covered by the Subsidies Agreement, not the TRIMs Agreement. MTN.GNG/NG12/W/23 at para. 10. They also said "there appeared to be a consensus emerging in the Group ... that incentives lay outside the ambit of this Group and remedies to their adverse trade effects could be found in GATT disciplines on subsidies." MTN.GNG/NG12/14 at para. 100. According to the Philippines, "incentives contingent upon investment measures should be outside the scope of the TRIMs negotiations." MTN.GNG/NG12/20 at para. 2. Poland said that incentives linked to TRIMs are subsidies and should be disciplined by GATT Article XVI and the Subsidies Agreement. MTN.GNG/NG12/14 at para. 75.

<sup>310</sup>MTN.GNG/NG12/W/22 at para. A.3.

<sup>311</sup>See id. at para. A2(c)(iii) and note 2.

relationship of the provisions of the [TRIMs] Agreement to those of other WTO agreements, including the Agreement on Subsidies and Countervailing Measures and the Agreement on Agriculture.”<sup>312</sup> Even the United States has acknowledged that “[o]ther issues that appear to require additional follow [sic] include: ... the relationship of the TRIMs Agreement with the Agreement on Subsidies and Countervailing Measures.”<sup>313</sup>

6.37 The foregoing clarifies that no consensus exists that subsidy measures also are subject to the disciplines (whatever they might be) of the TRIMs Agreement. The luxury tax reductions and exemption under the 1993 Incentive Programme and the February 1996 national car programme are not TRIMs; they are subsidies. They are governed by and subject to the disciplines of the Subsidies Agreement.

4. Customs import duty subsidies are not within the scope of the TRIMs Agreement

6.38 The TRIMs Agreement merely interprets Article III of the General Agreement. It does not add new obligations. Therefore, where, as here, Article III is not applicable, the TRIMs Agreement is not applicable. The “Illustrative List,” therefore, is irrelevant. Customs duty subsidies are governed by the Subsidies Agreement and are not within the scope of the TRIMs Agreement.

5. Indonesia has not violated the TRIMs Agreement: The TRIMs Agreement does not apply - it adds no new obligations, but merely puts a gloss on Article III of GATT 1994

(a) The TRIMs Agreement, unlike the SCM Agreement, is not *lex specialis*; it neither defines “TRIM” nor sets forth special remedies

6.39 The TRIMs Agreement differs substantially from the SCM Agreement. Unlike the SCM Agreement, which is *lex specialis* for this dispute, the TRIMs Agreement is not *lex specialis* for this or, for that matter, any dispute. This is because the TRIMs Agreement:

- first, does not define “TRIM” (in fact, it does not contain even a limited definition of “TRIM”); and
- second, does not set forth special remedies for measures found to be TRIMs (in fact, it sets forth no remedies at all).

To Indonesia’s knowledge, these facts concerning the TRIMs Agreement are not in dispute.

(b) The TRIMs Agreement does not establish a “new balance of rights and obligations”; rather, it merely elaborates on the FIRA Panel’s decision regarding the coverage of Article III of GATT

6.40 The United States asserts that the TRIMs Agreement establishes a “new balance of rights and obligations,” and that Indonesia ignores it (See Section VI.E.3). These allegations are unfounded. It should go without saying that any contract, memorandum of understanding or trade agreement establishes a “balance of rights and obligations”. The real question, however, is: what was agreed to? Indonesia has demonstrated conclusively that the developing countries successfully countered the developed states’ drive to increase the scope of what became the TRIMs Agreement.

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<sup>312</sup>G/L/193 (15 October 1997) at para. 5.

<sup>313</sup> “United States Paper on WTO Agenda” para. C.4, reprinted in Inside US Trade at 10 (18 April 1997).

6.41 As Indonesia has demonstrated, the TRIMs Agreement was conceived of and drafted in order to further specify the application of Article III of the GATT to trade-related investment measures. No provision of the TRIMs Agreement brings Indonesia's subsidies within the scope of the Agreement.

6.42 In further specifying Article III, the TRIMs Agreement elaborates on the decision of the Panel in Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1994), BISD 30S/140. The United States, in discussing this fact, attempts to undercut Indonesia's argument by focusing on the word "essentially" in the following passage from paragraph 7.185 of Bananas III:

the TRIMs Agreement essentially interprets and clarifies the provisions of Article III (and also Article XI) where trade-related investment measures are concerned.

The United States asserts that "essentially" indicates that the TRIMs Agreement must cover other items (See Section VI.E.3). But the United States ignores, as it must, the very next sentence from the Panel report, which clarifies that the Panel did not use "essentially" to indicate that the phrase following it is false or incomplete:

Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment-related measures.

This quotation pretty much sums it up. It is a precise statement of Indonesia's position.

6.43 Thus, the United States, in its arguments, runs afoul of the very criticism it levies against Indonesia. It is complainants, not Indonesia, that come before this Panel seeking to revisit and rewrite the TRIMs Agreement by having the Panel adopt interpretations explicitly rejected during the negotiations.

6. Japan is in Error; the Government most certainly does not view the National Car Programme as an investment programme

6.44 The two measures which make up the National Car Programme are subsidies. This has been the consistent view of Indonesia since this dispute began. When the measures initially were introduced, the Indonesian Government, on the basis of an incomplete and unsound analysis of the legal nature of the subsidies under the WTO Agreements, notified them as TRIMs. Upon a more exacting legal analysis, the Government realized its mistake, withdrew its TRIMs notification and notified the measures as subsidies.

6.45 From time to time, some Indonesian officials have referred to the measures as relating to industrial development, trade, investment, etc. These references do not and cannot alter the nature of the measures. Nor do the statements of various officials from competing bureaucracies change the Government's position that the measures are subsidies. As demonstrated, the measures are subsidies to a domestic industry to encourage its development. Alternative descriptions or characterizations cannot alter this fact.

7. The underlying decree, rules and regulations, and Indonesia's statements to the Committee on TRIMs establish that the National Car Programme does not involve a TRIM

6.46 Japan claims that because one implementing decree<sup>314</sup> contains the word "investment" in its title (which, according to Japan, means that it addresses the measure as an investment measure), the subsidy must be a TRIM. This is incorrect. Of the large number of regulations and decrees regarding the National Car Programme, Japan selected a single regulation on the basis of its heading. Japan then arbitrarily affixed the designation "key" to that single regulation and, finally, promoted it to the rank of evidence that the National Car Programme is an "investment measure."

6.47 The seminal regulation for the February 1996 measure is Presidential Instruction No. 2/1996 of 19 February 1996. It simply instructs two Ministers, the Minister of Industry & Trade (MIT) and the Minister of Finance (MOF), to perform detailed activities. It also charges the Minister for the Mobilization of Investment Funds/Chairman of the Investment Coordinating Board (BKPM) with the very general task of "safeguarding" the development of the national car industry.

6.48 On 19 February 1996, the same day that Presidential Instruction No. 2/1996 was issued, both MIT and MOF issued their implementation decrees. MIT implemented the Presidential Instruction by issuing Decree No. 31/MPP/SK/2/1996; MOF issued implementing Decree No. 82/KMK.01/1996.<sup>315</sup>

6.49 The BKPM implementing regulation appeared eight days later, on 27 February 1996. BKPM had to wait until further implementing regulations were issued by the two principal ministries before ascertaining what secondary supporting regulation was appropriate for it to promulgate. The principal implementing regulation (supplementing the two decrees cited above) was issued by MIT's Director General for the Metal, Machinery & Chemical Industries (Decree No. 002/SK/DJ-ILMK/II/1996), appointing a Pioneer Motor Vehicle Industrial Enterprise. Only after the Director General issued this decree did BKPM issue the Investment Provisions for the Realization of the National Automobile Industry. Even then, on closer scrutiny, the "Investment Provisions" turn out to be merely a rehash of the earlier MIT Decree (No. 31/MPP/SK/2/1996).

6.50 Why did BKPM have to issue a regulation at all? It had to issue the regulation because TPN is a Domestic Capital Investment Company (a PMDN), and all PMDN companies operate under the auspices of BKPM. BKPM Decree No. 01/SK/1996 is not a "key implementing regulation." It is merely an administrative and procedural regulation that could not be issued prior to the MIT and MOF decrees. Moreover, it simply repeats another Ministerial decree. Again, the February 1996 national car measure is a subsidy and Complainants' misrepresentations do not bring it under the TRIMs Agreement.

6.51 Japan similarly misuses Indonesia's presentation at the 30 September 1996 meeting of the Committee on TRIMs. At this meeting, Indonesia responded to questions posed by the delegation of Japan and mentioned at least seven objectives of the National Car Programme:

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<sup>314</sup>Decree of the State Minister for the Mobilization of Investment Funds/Chairman of the Investment Coordinating Board No. 01/SK/1996 regarding Investment Regulations within the Framework of the Realization of the Establishment of the National Automobile Industry (27 February 1996).

<sup>315</sup>MIT and MOF had been in close coordination with the Office of the President in the planning and drafting of the regulations giving birth to the national car. That is why their implementing regulations appeared the same day as the regulation they are intended to implement.

- to improve the competitiveness of local companies and strengthen overall industrial development;
- to promote the competitiveness of Indonesia's automotive production;
- to develop the capacity of multiple-source auto parts and components;
- to encourage the development of the automotive industry and the automotive component industry;
- to bring about major structural changes in the Indonesian automobile industry;
- to encourage the transfer of technology and contribute to large-scale job creation; and
- to encourage car companies to increase their local content, resulting in a rapid growth of investment in the automotive component industry.

6.52 Like Japan's selective use of Indonesia's regulations to buttress its assertion that Indonesia's national car policy is an investment measure, Japan again has acted arbitrarily here. It has chosen one of the seven objectives to carry its allegation that the February 1996 national car measure is a TRIM and, even then, its conclusion does not reflect the facts.

6.53 The single sentence used by Japan as evidence that the national car measure is a TRIM is in item 4 of page 2 of Indonesia's response:

These policies are expected to encourage car companies to increase their local content, resulting in a rapid growth of investments in the automotive component industry.

But Japan's interpretation even of this one (of seven) goals is inaccurate. The expectation and, therefore, the objective is directed toward car companies increasing their local content. The measure is a subsidy conditioned upon the increasing use of local content. The "rapid growth of investments" is not an objective of the national car measure; it is only a side product of such objective.

8. The measures are not investment measures but subsidies granted to an automaker to use domestic parts and components

6.54 The Indonesian measures are not investment measures, but subsidies granted to an automaker to use domestic parts and components, for the following reasons:

1. The subsidies are granted by the Minister of Finance.
2. The regulating authority over the automaker vests with the Minister of Industry and Trade.
3. The involvement of the Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Coordinating Board is purely administrative and is required only because the automaker happens to be a domestic capital investment company.
4. The considerable number of regulations providing and implementing the subsidy do not once refer to "investments".

5. Although subsidies may at times indirectly affect investment decisions of the recipient of the subsidy or other parties, these decisions are not the object, but rather the unintended result, of the subsidy. Indeed, increased investment indirectly results from many subsidies.
6. Moreover, even if the TRIMs Agreement did apply, the subsidies are not inconsistent with Article III of GATT 1994.

9. The measures are not TRIMs that violate Article III:2 of GATT 1994

6.55 The government measures are not TRIMs. Specific subsidies by definition discriminate between products benefiting from the subsidies and those that do not. If GATT Article III:2 and Article III:4 were applied every time a specific subsidy came up, virtually all actionable subsidies granted by developing countries would be undone by GATT Articles III:2 and III:4 and the TRIMs Agreement. Article 32.1 of the SCM Agreement unequivocally provides that GATT actions against subsidies are to be resolved under the SCM Agreement. It is the SCM Agreement that deals with actionable subsidies under Art. 27.3, not the GATT.

10. The TRIMs Agreement is not *lex specialis* to any dispute

6.56 Unlike the SCM Agreement, the TRIMs Agreement is not *lex specialis* to any dispute. By its very terms it cannot be. For example, Article 2.1 of the TRIMs Agreement states that the TRIMs Agreement operates "[w]ithout prejudice to other rights and obligations under GATT 1994".

6.57 The Article continues, stating, "no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994". (This passage breathes new life into Article III of GATT 1994 which, complainants assert, Indonesia's *lex specialis* and conflict arguments would render moribund.) Thus the TRIMs Agreement itself states that it is naught but a general agreement that depends upon the General Agreement to have any meaning whatsoever.

6.58 Given this, other Annex 1A and 1C Agreements can apply and, more importantly, in the case of those agreements which are *lex specialis*, such as the SCM Agreement, control certain disputes, such as this one, to the complete exclusion of the TRIMs Agreement.

E. Arguments made in rebuttal to Indonesia's responses to the claims under the TRIMs Agreement

1. Rebuttal arguments made by Japan

6.59 **Japan** makes the following arguments in rebuttal to Indonesia's responses to the claims under the TRIMs Agreement:

- (a) The February 1996 Programme violates TRIMs Article 2.1

6.60 As demonstrated (See Section VI.A), the February 1996 Programme violates GATT Article III, is a "trade-related investment measure," and thus violates TRIMs Article 2.1.

6.61 Indonesia argues that the TRIMs Agreement only interprets GATT Article III and GATT Article III is not applicable to the February 1996 Programme. As discussed (See Section VI.D), GATT Article III does apply and the Programme is inconsistent with it.<sup>316</sup>

6.62 Indonesia also attempts to evade its violation of the TRIMs Agreement by arguing that the Illustrative List of the TRIMs Agreement is "purely illustrative" and that the List cannot alter the "fact" that GATT Article III is inapplicable. Once again, however, the Government of Japan has amply demonstrated that Article III does in fact apply. It appears, moreover, that Indonesia misunderstands Japan's argument. The Government of Japan does not argue that the National Car Programme violates TRIMs Article 2 because it is on the Illustrative List, but that it violates TRIMs Article 2 because it is a TRIM and it is inconsistent with GATT Article III. Thus, Indonesia's argument about the nature of the List is irrelevant.

6.63 Therefore, the February 1996 Programme is inconsistent with the TRIMs Agreement and the Government of Indonesia's contrary argument lacks any merit.

(b) The SCM Agreement does not excuse indonesia's violations of the TRIMs Agreement

6.64 Indonesia seems to argue that there is a conflict between SCM Article 27.3 and TRIMs Article 2.1, such that SCM Article 27.3 excuses the violations of TRIMs Article 2.1. However, that argument also lacks any merit. These provisions do not conflict and Indonesia's assumption that the SCM Agreement would prevail in a hypothetical conflict is unfounded.

6.65 As discussed (See Section V.E.1), the Bananas III Panel found that a conflict between two WTO Agreements can only arise if the two establish "mutually exclusive" obligations or one "explicitly permits" what another prohibits. As already shown with respect to GATT Article III, however, the SCM Agreement neither creates obligations that are "mutually exclusive" with TRIMs Article 2.1 nor "explicitly permits" violations of TRIMs Article 2.1.

6.66 Rather, the TRIMs and SCM Agreements create "different or complementary obligations." The TRIMs Agreement applies to TRIMs regardless of whether such TRIMs are also "subsidies" under the SCM Agreement and the SCM Agreement applies to "subsidies" regardless of whether such "subsidies" are also TRIMs. A WTO Member can, and therefore must, comply with the provisions of both Agreements with respect to a measure that is both a "subsidy" under the SCM Agreement and a TRIM under the TRIMs Agreement. Nothing in the text, context, object or purpose of the TRIMs Agreement supports the Indonesian contention that a TRIM is no longer a TRIM simply because the administering authority prefers to call it something else.

6.67 This conclusion is strengthened by a review of the TRIMs and SCM provisions that establish the transition periods for developing country Members. SCM Article 27.3 allows developing countries a period of time (five years for Indonesia) before they must comply with the prohibition on subsidies contingent on the use of domestic over imported products. TRIMs Article 5.1 likewise also allows developing country Members time before they must comply with the TRIMs Article 2 provisions on

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<sup>316</sup>The Government of Indonesia misunderstands the nature of the TRIMs Agreement. Contrary to Indonesia's assertion that the "TRIMs Agreement does not add any new obligations; it merely interprets Article III," it in fact contains a variety of procedural and substantive obligations. The fact that TRIMs Article 2.1 references GATT Article III does not mean that the TRIMs Agreement "merely interprets" Article III, as Indonesia would have it. Instead, the principle of *pacta sunt servanda* requires that the TRIMs Agreement must apply in accordance with its terms to all measures within its scope (i.e., to all TRIMs). The language from Bananas III quoted by Indonesia fails to support its position. That language shows that the Bananas III Panel correctly noted that TRIMs Article 2.1 neither adds to nor detracts from GATT obligations. All that signifies, however, is that Article 2.1 does not modify the scope of the GATT provisions in cases where those provisions apply.



local content requirements which are inconsistent with GATT Article III, provided that the measure existed when the WTO Agreements entered into force (i.e., on 1 January 1995) and that the Member notified the measure within ninety days of such entry into force (i.e., by 1 April 1995).<sup>317</sup> For TRIMs that are also "subsidies" under the SCM Agreement, it is clearly possible for developing country Members to receive the benefits of the transitional arrangements under both Agreements by acting in accordance with the terms of each Agreement. Moreover, if such TRIMs should be subject only to the SCM Agreement, it would render the specifically crafted notification requirement under the TRIMs Agreement, for the substantial part of its coverage, meaningless.

6.68 Finally, if a conflict may some day arise between the TRIMs and SCM Agreements, there is no reason to assume - as Indonesia apparently does - that the SCM Agreement would prevail in such a conflict. Indonesia's faulty assumption seems to result from its mistaken equating of the GATT and the TRIMs Agreement, discussed above. The plain text of the General Interpretative Note refutes this assumption. That Note expressly provides that Annex 1A Agreements - including both the TRIMs Agreement and the SCM Agreement - prevail over the GATT to the extent of a conflict. The General Interpretative Note thus gives the TRIMs and SCM Agreements alike a hierarchical status above the GATT in the event of a conflict, but it does not establish any hierarchy between the two. Recent Appellate Body Reports also support the conclusion.<sup>318</sup> For example, in Canada - Certain Measures Concerning Periodicals, a WTO panel firmly rejected an argument by Canada that the scope of the GATS and the GATT were mutually exclusive, holding that:

The ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicates that obligations under GATT 1994 and GATS can co-exist and that the one does not override the other. If the consequences suggested by Canada were intended, there would have been provisions similar to Article XVI:3 of the WTO Agreement or the General Interpretative Note to Annex 1A in order to establish hierarchical order between GATT 1994 and GATS. The absence of such provisions between the two instruments implies that GATT 1994 and GATS are standing on the same plain in the WTO Agreement, without any hierarchical order between the two."<sup>319</sup>

The WTO Appellate Body approved this aspect of the panel decision in the Periodicals case, quoting the above reasoning by the panel and noting that: "The entry into force of the GATS ... does not diminish the scope of application of GATT 1994".<sup>320</sup> Since GATS is not covered by the General Interpretative Note (which gives WTO agreements in Annex 1A other than GATT precedence over GATT in the event of a conflict), GATS is on equal footing with GATT. In the same way, the TRIMs Agreement is on equal footing with the SCM Agreement. Thus, the Panel should not, without any textual basis, elevate one Annex 1A Agreement over the others.

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<sup>317</sup>In this connection, India, a third party, stated at the first meeting that "[w]hile we agree that delay in notifying measures should ideally not occur, it must at the same time also be realized that small delegations often have constraints of resources which at times leads to an unintended delay in the notification of their measures." This point is irrelevant to our arguments and it is not necessary for this Panel to decide the procedural question raised by India. It is clear that the issue in this dispute is not merely procedural because the Government of Indonesia introduced the National Car Programme after the entry into force of the WTO, even after the deadline specified by Article 5.1 of the TRIMs Agreement, and it could never have notified the measure in accordance with Article 5.1, needless to say, regardless of how large a delegation it has in Geneva.

<sup>318</sup> Appellate Body Report on Canada - Periodicals, pp.18-19. Appellate Body Report on Bananas III, paras. 221-222.

<sup>319</sup>Report of the Panel on Canada - Periodicals, WT/DS31/R, para. 5.17.

<sup>320</sup>Report of the Appellate Body on Canada - Periodicals, page 19.

(c) Incentive measures are covered by the TRIMs Agreement

6.69 The Government of Indonesia also contends that “no consensus exist[ed] that subsidy measures also are subject to the disciplines of the TRIMs Agreement,” that its incentives to encourage purchases of domestic goods over imports “are not TRIMs; they are subsidies”, and thus “they are subject to the disciplines of the Subsidies Agreement”. (See Section VI.D).

6.70 However, Indonesia’s allegation contradicts the text of the TRIMs Agreement. The text of the Agreement requires only two elements for a measure to constitute a violation of TRIMs Article 2.1: first, the measure is an “investment measure related to trade in goods”; and second, the measure is “inconsistent with the provisions of [GATT] Article III or Article XI”. As described in paragraph 3.14 above, it has been firmly established that GATT Article III:4 applies not only to mandatory measures but also to measures with which a company may comply voluntarily to obtain a benefit. Therefore, it is clear that TRIMs Article 2.1 also applies to such voluntary measures, or incentive measures, as long as they fall within the concept of “TRIMs”.

6.71 The Illustrative List in the Annex of the TRIMs Agreement also demonstrates that the February 1996 Programme is a TRIM. That list explicitly provides that prohibited TRIMs include any local content requirement “compliance with which is necessary to obtain an advantage”.

6.72 Because the text of the TRIMs Agreement clearly and unambiguously establishes that it applies not only to mandatory measures but also to measures “compliance with which is necessary to obtain an advantage”, there is no need to resort to the drafting history to understand this point.<sup>321</sup> In fact, however, a review of the preparatory work of the TRIMs Agreement confirms - unsurprisingly, in view of the plain text - that the negotiators decided to include so-called “incentive measures” in the TRIMs Agreement.

6.73 Although the preparatory work shows active discussion about the definition of a “TRIM” throughout the negotiations and a wide variety of views were expressed<sup>322</sup>, at the final stage a consensus was created, as discussed below.

6.74 Late in the TRIMs negotiations (i.e., October 1991 through 20 December 1991), the Chairman distributed texts for the purpose of discussion. The key phrase concerning incentive measures (i.e., “TRIMs ... compliance with which is necessary to obtain advantage”) was included in the Chairman’s first draft, removed in the revised text of 25 November 1991 at the behest of India and other developing countries, and revived in the Chairman’s second draft after developed countries objected to the earlier deletion. Ultimately, this phrase was finally adopted, with the developing countries accepting it in exchange for the developed countries’ acceptance of the five-year transition period. Indeed, the negotiating group rejected a proposal by one Member that would have expressly limited TRIMs to mandatory measures.

6.75 It is also relevant to note that the final TRIMs Agreement did not incorporate a position advanced by some developing countries that would have provided for only the disciplines of the SCM Agreement to apply, when a “subsidy” (as defined in the SCM Agreement) was granted contingent on meeting certain requirements, such as local content requirements. That position was rejected, because most Members recognized that it would create too large a loophole in the TRIMs Agreement. This

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<sup>321</sup>Vienna Convention on the Law of Treaties, arts. 31-32.

<sup>322</sup>See Submission by Japan (MTN.GNG/NG12/W/12) dated 9 June 1988; Submission by Japan (MTN.GNG/NG12/W/20) dated 13 September 1989; Submission by India (MTN.GNG/NG12/W/18) dated 11 September 1989; Submission by the European Communities (MTN.GNG/NG12/W/22) dated 16 November 1989; Submission by the Nordic Countries (MTN.GNG/NG12/W/23) dated 22 November 1989; and Communication from the United States (MTN.GNG/NG12/W/24) dated 24 January 1990.

loophole was avoided by leaving both the SCM Agreement and the TRIMs Agreement silent about their relationship, thereby ensuring that the disciplines of both would apply to measures that were both TRIMs and "subsidies."

6.76 Thus, it is clear that the positions advanced in the quotations from the preparatory work cited in Indonesia's First Submission were not adopted in the final text of the TRIMs Agreement. Of course, it is the text of a treaty itself that governs and any views expressed during the negotiations that do not comport with the text carry no weight.<sup>323</sup>

6.77 Finally, subsequent practice under the WTO, which is relevant to its interpretation<sup>324</sup>, confirms that TRIMs that fall within the SCM definition of "subsidy" have nevertheless been understood to also be subject to the TRIMs Agreement. This is demonstrated by the fact that even many developing country Members have included such measures in their notifications to the TRIMs Committee under Article 5.<sup>325</sup> In fact, the Government of Indonesia itself notified the TRIMs Committee of the incentive measures in its 1993 automobile programmes, although it did so late and later withdrew the notification, apparently in connection with these proceedings.<sup>326</sup>

(d) Indonesia's arguments would render parts of the TRIMs Agreement virtually meaningless

6.78 Finally, it should also be noted that Indonesia's argument that incentive measures should be governed only by the SCM Agreement, not by the TRIMs Agreement, would render parts of the TRIMs Agreement virtually meaningless.

6.79 As discussed (See Section VI.A), the text of the TRIMs Agreement clearly shows that an incentive measure, or a measure "compliance with which is necessary to obtain an advantage", is within the coverage of the Agreement. It appears that a TRIM that is an incentive measure would very often also be a "subsidy" under the SCM Agreement. Therefore, if an interpretation were taken that a measure, which constitutes both a "TRIM" under the TRIMs Agreement and a "subsidy" under the SCM Agreement, shall be governed only by the SCM Agreement, that would negate a substantial part of the TRIMs Agreement coverage.

6.80 Accordingly, a "TRIM" under the TRIMs Agreement should not be excluded from the coverage of the TRIMs Agreement, only because it constitutes a "subsidy" under the SCM Agreement.

2. Rebuttal arguments made by the European Communities

6.81 The following are the **European Communities'** rebuttal arguments to Indonesia's responses to the claims under the TRIMs Agreement:

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<sup>323</sup>See Vienna Convention on the Law of Treaties, arts. 31-32. See also Appellate Body Report on Japan - Alcoholic Beverages II, pp. 10-12.

<sup>324</sup>See Vienna Convention on the Law of Treaties, art. 31(3)(b).

<sup>325</sup>Incentive measures were notified, for example, by Venezuela, on 12 April 1995, G/TRIMS/N/1/VEN/1, by South Africa, on 8 May 1995, G/TRIMS/N/1/ZAF/1, and by the Dominican Republic, on 10 May 1995, G/TRIMS/N/1/DOM/1.

<sup>326</sup>Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia (G/TRIMS/N/1/IDN/1) (Japan Exhibit 17). Notification under Article 5.1 of the Agreement on Trade-Related Investment Measures, Indonesia Addendum (G/TRIMS/N/1/IDN/1/Add.1) (Japan Exhibit 18).

- (a) The measures at issue infringe GATT Article III and are therefore contrary to Article 2.1 of the TRIMs Agreement

6.82 Indonesia argues that the measures at issue do not infringe Article 2.1 of the TRIMs Agreement because they are not within the scope of, and therefore cannot be “inconsistent” with, Article III. The European Communities has shown (see Sections V.A.2 and V.C.2) that the measures at issue are inconsistent with GATT Articles III:2 and/or III:4. Therefore, they are contrary also to Article 2.1 of the TRIMs Agreement.

- (b) Article 2.1 of the TRIMs Agreement lays down a legally distinct obligation

6.83 Indonesia claims that the TRIMs Agreement “interprets GATT Article III and does not add new obligations”. Indonesia relies for this proposition on the following passage of the Panel Reports on EC regime concerning the Importation, Sale and Distribution of Bananas :

with the exception of its transitional provisions, the TRIMs Agreement, essentially interprets and clarifies the provisions of Article III (and also Article XI) were trade-related investment measures concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment matters<sup>327</sup>.

6.84 Properly interpreted, this passage means that, in substance, the TRIMs Agreement is limited to restate and clarify the obligations laid down GATT Article III. Formally, however, Article 2.1 of the TRIMs Agreement lays down an obligation which is distinct from the obligation contained in GATT III. This is confirmed by the prior finding in the same Panel Report that the provisions of GATT and the TRIMs Agreement were “equally applicable” to the European Communities’s import licensing procedures.<sup>328</sup> Furthermore, if Article 2.1 of the TRIMs did not provide for an additional and distinct obligation, it would have been superfluous to stipulate in Article 3 of the TRIMs Agreement that all exceptions under GATT 1994 shall apply also to the provisions of the TRIMs Agreement. Likewise, it would have been unnecessary to state in Article 4 of the TRIMs Agreement that developing Members shall be free to deviate from Article 2 “to the extent and in such manner” as Article XVIII of GATT and other related legal instruments permit those Members to deviate from GATT Articles III and XI.

- (c) Even if it was found that there is a “conflict” between GATT Article III and the SCM Agreement, that conflict would not preclude a violation of Article 2 of the TRIMs Agreement

6.85 The General Interpretative Note to Annex 1A only applies to conflicts between GATT and the other Annex 1A Agreements. It does not apply to conflicts between the TRIMs Agreement and the SCM Agreement. Accordingly, even if it was found by the Panel that there is a “conflict” between GATT Article III and the SCM Agreement, such “conflict” would not preclude a violation of the legally distinct obligation contained in Article 2 of the TRIMs Agreement. In fact, the existence of a “conflict” between the SCM Agreement and GATT Article III would not make the measures concerned “consistent” with GATT Article III but merely exclude the application of that provision. Quite to the contrary, the existence of a “conflict” between the SCM Agreement and GATT Article III would presuppose necessarily that the measures are “inconsistent” with the latter.

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<sup>327</sup>See e.g. WT/DS27/R/USA, adopted 25 September 1997, at para 7.185.

<sup>328</sup>Id. at para 7.158.

(d) The TRIMs Agreement may apply to subsidies

6.86 The TRIMs Agreement applies to any trade related investment measure which is inconsistent with GATT Article III. Given that GATT Article III may apply to measures which are “subsidies” within the meaning of the SCM Agreement, it follows that the TRIMs Agreement may also apply to “subsidies”. This is confirmed by the Illustrative List. In accordance with its ordinary meaning, the term “advantage” used in the Illustrative List may include also “subsidies” within the meaning of the SCM Agreement.<sup>329</sup>

3. Rebuttal Arguments made by the United States

6.+87 Noting that it agrees with the points made by Japan and the EC at the second meeting of the Panel, and, in particular, the arguments made by the European Communities (See Section VI.E.2(b)), the **United States** makes the following arguments in rebuttal to Indonesia's responses to the claims under the TRIMs Agreement:

(a) The tariff and tax incentives under the 1993 Programme and the National Car Programme are inconsistent with Article 2 of the TRIMs Agreement

6.88 With respect to Indonesia's violations of Article 2 of the TRIMs Agreement, Indonesia argues that the TRIMs Agreement imposes no new obligations, but is merely an interpretation of Article III of GATT 1994. Indonesia, of course, must advance this argument in light of its “conflict” argument (the flaws in which we have addressed (See Section V.E.III)), because the General interpretative headnote to Annex 1A addresses only alleged “conflicts” between the GATT 1994 and the provisions of another Annex 1A agreement, not alleged “conflicts” between two or more Annex 1A agreements other than GATT 1994.

6.89 In advancing its argument, Indonesia relies on a statement made by the panel in the Bananas III case at para. 7.185 of the report.<sup>330</sup> Indonesia argues that the panel ruled that the TRIMs Agreement does not add any new obligations. However, that is not what the Bananas III panel said. While the panel said that the TRIMs Agreement “essentially” interprets Article III and Article XI of GATT 1994, the panel also noted that the TRIMs Agreement clarified those obligations and granted transition provisions. Moreover, the panel's holding simply was that in the context of that particular case, the panel did not need to make a specific ruling under the TRIMs Agreement, because it already had found

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<sup>329</sup> As recalled by Indonesia, one of the issues discussed during the negotiations of the TRIMs Agreement was whether the definition of TRIMs should cover subsidies. All the negotiating positions cited in Indonesia's submission correspond to this phase of the negotiations. Eventually, however, no agreement could be reached to prohibit (or otherwise limit the use) of any other TRIMs beyond those already prohibited by Articles III and XI of GATT 1947. In view of that, it was no longer considered necessary to define the notion of TRIMs, with the consequence that the question whether or not to include subsidies in that definition became moot.

It is worth noting that, despite the “lack of consensus” alleged by Indonesia, a majority of the Members which have made notifications under Article 5.1 of the TRIMs Agreement (15 out of a total of 24, according to the European Communities's own estimate) have included therein TRIMs linked to tax and tariff benefits which *prima facie* are subsidies within the meaning of Article 1 of the SCM Agreement. Namely, the list of such Members include Argentina, Chile, Colombia, Costa Rica, Dominican Republic, Egypt, Indonesia (withdrawn), Malaysia, Pakistan, Poland, Romania, Thailand, Uruguay, Venezuela and South Africa. Some of the notified schemes are remarkably similar to the ones at issue in this dispute. For instance, South Africa grants a rebate from an excise tax to motor vehicles which attain a minimum local content (G/TRIMS/N/1/ZAF/1), whereas Venezuela applies a lower import duty on imports of automotive parts and components by car assemblers which meet certain local content requirements (G/TRIMS/N/1/VEN/1).

<sup>330</sup> European Communities - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R, Report of the Panel, as modified by the Appellate Body, adopted 25 September 1997, para. 7.185.

the measures in question to be violative of Article III:4. That limited holding is far different from holding that the TRIMs Agreement does not, in itself, impose obligations.

6.90 Indeed, the Bananas III panel itself recognized that the TRIMs Agreement reflected a new balance of rights and obligations; namely, a trade-off between the clarification of obligations and the grant of transition periods. An additional trade-off that the panel did not mention was the addition of transparency requirements in the form of the notification provisions in Article 5. For purposes of our Autos dispute, the most important clarification was that “incentive-based” measures, such as Indonesia’s local content incentives, are covered.

6.91 As the Appellate Body stated in the Wool Shirts case, page 16, where an agreement reflects a carefully drawn balance of rights and obligations of Members, “[t]hat balance must be respected”.<sup>331</sup> Rather than respecting the balance reflected in the TRIMs Agreement, Indonesia would have this Panel ignore it.

6.92 Indonesia’s other argument is that the drafting history of the TRIMs Agreement somehow demonstrates that the TRIMs Agreement was not intended to impose a new balance of rights and obligations. This argument, too, is easily disposed of.

6.93 Indonesia cites to a statement made by the United States during the TRIMs negotiations that allegedly demonstrates the subordinate nature of the TRIMs Illustrative List. However, the statement in question was made in the context of a United States proposal that was not adopted, and, thus, is of limited, if any, relevance.

6.94 Second, Indonesia refers to the fact that an issue in the negotiations was whether subsidies could be considered an “incentive” or a “condition for receipt of an advantage” and, thus, subject to the TRIMs Agreement. As discussed previously in connection with Indonesia’s “conflicts” argument, the drafting history of the TRIMs Agreement demonstrates: (1) that local content subsidies are covered by the TRIMs Agreement; and (2) that Article 27.3 of the SCM Agreement was added at the last minute to ensure that subsidies permitted by the transitional provisions of the TRIMs Agreement would not be precluded by the SCM Agreement. Indeed, the very fact that Article 27.3 was added to the SCM Agreement demonstrates that the drafters intended that local content subsidies would be covered by the TRIMs Agreement.

6.95 Third, Indonesia refers to a document, “US Paper on WTO Agenda”<sup>332</sup>, which states that “[o]ther issues that appear to require additional follow [sic] include: ... the relationship of the TRIMs Agreement with the Agreement on Subsidies and Countervailing Measures.” The document was drafted for the so-called “Invisibles Committee” (senior Capital-Based Officials), which functions as an ad hoc and unofficial steering group of sorts. Other participants in the Committee had asked the United States to draft the paper as a means of “kick-starting” a collective assessment of the Singapore Ministerial and the ensuing and continuing work across the spectrum of WTO activities. Thus, the paper was a discussion paper, and was intended to provide a representative mix of Members’ actual or perceived thoughts about where the WTO has been and where it ought to go. It definitely was not intended to convey US positions on particular issues.

6.96 With respect to the discussion of the TRIMs Agreement, the paper draws no conclusions about the legal relationships between the agreements cited, nor does it even suggest that there are conflicts among them. Instead, it merely expresses the commonsense and obvious point that in considering the future work of the TRIMs Committee, it might be appropriate to look at how the three agreements

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<sup>331</sup>United States - Measures Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/AB/R, Report of the Appellate Body adopted 23 May 1997, page 19.

<sup>332</sup>US Exhibit 40.

relate to one another given their obvious overlap. Given the views that Indonesia already had articulated in the TRIMs Committee and the SCM Committee, it is hardly surprising that this issue would be identified as one for further discussion. Also, by the time the paper was drafted, there already had been several "sleights of hand" by several Members that were making multiple notifications under the TRIMs and SCM Agreements and then later "withdrawing" some. Because a measure can be both a TRIM and a subsidy in substance, the italicized "Question for Discussion" in the paper appropriately suggests that Members should take a look at all of the notification provisions to see where gaps from one could fill in for another, or where improvements are needed in order to monitor phase-out obligations across agreements.

6.97 Thus, even if this Panel should find incorrectly that Article III:4 of GATT 1994 does not apply to the Indonesian tax and tariff incentives due to an alleged "conflict" with the SCM Agreement, those measures nonetheless violate Article 2 of the TRIMs Agreement.

(b) The Indonesian measures are "trade related investment measures"

6.98 Indonesia also argues that the measures in question do not violate Article 2.1 of the TRIMs Agreement because they are not "investment" measures. In the view of the United States, if a measure described in the Illustrative List of the TRIMs Agreement is being applied, nothing more need be shown to establish an Article 2 violation. If any Member, in whatever context, requires the purchase by an enterprise of a domestic product in order to obtain an advantage, that requirement by definition has investment consequences for such an enterprise, putting the measure within the coverage of the TRIMs Agreement. The United States is unaware of anything in the negotiating history of the TRIMs Agreement that would warrant a different conclusion.

6.99. Moreover, even if the identification of a relationship to an investment were necessary to prove an inconsistency with the TRIMs Agreement, the Indonesian measures in question fulfil such a condition, because they necessitate an investment in Indonesia (either as a producer of motor vehicles or motor vehicle parts) to qualify for the various tax and tariff incentives.

(c) The TRIMs Agreement imposed a new obligation on Indonesia

6.100 Indonesia's argument that because the TRIMs Agreement allegedly merely restates Article III, the TRIMs Agreement does not give rise to a separate obligation, reflects a fundamental misperception of the significance of the TRIMs Agreement. It is true that, to an extent, the TRIMs Agreement codifies the GATT 1947 panel jurisprudence concerning Article III:4 arising out of such cases as Italian Tractors, EC Parts and Components, and FIRA. However, because panel decisions were not, and are still not, stare decisis, Indonesia was not bound by this jurisprudence. Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, pages 14-16. By signing the WTO Agreement, Indonesia did become bound by this jurisprudence, as codified in the TRIMs Agreement. Thus, the TRIMs Agreement imposed a new obligation on Indonesia.

(d) The notion of *lex specialis* is irrelevant in this case with respect to the relationship between Article III and the TRIMs Agreement

6.101 Insofar as the issues in this dispute are concerned, because Indonesia did not notify the measures in question pursuant to Article 5.1 of the TRIMs Agreement, there are no conflicting obligations between Article III and the TRIMs Agreement. Thus, the notion of *lex specialis* is irrelevant.

6.102 Having said that, however, the United States should note that in the *Bananas III* case, the Panel found, at para. 7.158, that in the absence of a "conflict" between GATT 1994 and the TRIMs Agreement, both agreements applied equally. This finding would not have been necessary if the Panel had considered that the TRIMs Agreement was *lex specialis* in relationship to GATT 1994.

6.103. More generally, Article III:2, Article III:4, and the TRIMs Agreement each impose legally distinct obligations on Members, and a single measure may be found to be inconsistent with all three.