

VII. ARTICLE I:1 CLAIMS

A. Claims raised by Japan

1. The National Car Programme of February 1996

7.1 **Japan** claims that the National Car Programme of February 1996 (See Section III.A) violates Article I:1 of GATT 1994. The following are **Japan's** arguments in support of this claim:

(a) Article I:1 of GATT 1994 requires immediate and unconditional MFN treatment for imported parts and components

7.2 The National Car Programme introduced in February 1996 accords a special advantage including exemption from customs duty to automotive parts and components imported or to be imported from Korea for use in assembling National Cars. This advantage constitutes a violation of Article I:1 of GATT 1994 which requires the "immediate and unconditional" extension of general most-favoured-nation treatment to imports from member countries relative to the treatment of imports of like products from any other country.

7.3 As the 12 December 1995 letter from the President Director of TPN to the State Minister for the Mobilization of Investment Coordinating Board shows clearly, TPN, which is currently the only National Car producer, has expressed its intention to rely on Kia Motors, Korea. In particular, the President Director of TPN stated plainly that the company applied to obtain approval to "(1) [m]anufacture four-wheeled motor vehicles with the 'TIMOR' brand name at *the KIA Motors Corp., South Korea* factory which are then to be delivered to Indonesia in SKD form with a local production of 65,000 units from 1996, 1997, and 1998; [and] (2) [m]anufacture four-wheeled motor vehicles with the 'TIMOR' brand name at third party's/parties' licensed assembly plant(s) in Indonesia with its primary material imported from overseas (*KIA Motors Corp.*) starting from full-CKD and gradually decreasing by the use of local components/parts with a total production from 1997, 1998, and 1999 of 125,000 units." (Italics added.) The correspondence between the President Director and the State Minister shows that both of them understood that most of the parts and components for assembling national cars in Indonesia would be imported from Korea at least in the initial stages and that they intended to effectuate this understanding. Accordingly, TPN is expected to import many of the parts and components for the purpose of assembling National Cars only from Kia. The preferential treatment for National Cars, including the duty-free treatment of imported parts and components in particular, is likely to lead to benefits for imports of parts and components from Korea, compared with those from other countries.

7.4 Article I:1 of the GATT provides as follows:

"With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed in the international transfer of payments for imports or exports and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraph 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other parties."

7.5 In EC - Bananas III, a recent WTO panel articulated the following three-part test to determine whether an import measure violates Article I:1:

[an import measure] is inconsistent with the European Communities' obligations under Article I:1 [if] it constitutes [1] an advantage [2] of the type covered by Article I that is accorded to [products from one country or group of countries] but [3] which is not accorded to like products from all Members ...<sup>333</sup> (emphasis added).

The National Car Programme must be evaluated under the same three-part test. It violates Article I:1 because the customs duty and luxury tax exemptions (1) confers an advantage, (2) of the type covered by Article I:1, (3) to imports of automotive parts and components from Korea but not to imports of like products from other WTO members.

7.6 In addition, Article I:1 requires that MFN treatment be accorded "immediately and unconditionally", but the National Car Programme also violates this requirement.

- (b) The National Car Programme of February 1996 in practice grants benefits only to automotive parts and components imported or to be imported from Korea in violation of Article I:1 of the GATT 1994

7.7 The February 1996 Programme grants benefits only to automotive parts and components from Korea. As such, it impermissibly provides advantages to Korean parts and components that are not accorded to parts and components from other WTO Members, in violation of Article 1 (regardless of whether or not the Programme constitutes a subsidy). In addition, such advantages can be accorded to imported parts and components from other countries only if they are for use in National Cars, in violation of the Article I:1 requirement of "unconditional" most favoured nation treatment. The discrimination in practice in favour of parts and components from Korea is precisely the sort of discrimination that preceding panels have long held to be inconsistent with Article I:1.

- (1) Indonesia grants benefits solely to imports from Korea

7.8 While National Cars are required to meet certain local content levels, the balance of the parts and components necessary to assemble National Cars is imported. Indonesia provides the sole National Car producer, PT Timor, with the benefits of duty free treatment of such parts and components.

7.9 While there is no reference to Korea or a Korean company in Indonesia's regulations which establish and regulate the National Car Programme, the intended beneficiary of the Programme, PT Timor, has intended, since even prior to the formal establishment of the Programme, to import parts and components for assembly of National Cars only from a Korean company. Even before the initiation of the Programme, the State Minister for the Mobilization of Investment Coordinating Board supported this intent and Indonesia effectuated it through Presidential Instruction No.2/1996.<sup>334</sup> Accordingly, only certain automobile parts and components from Korea are granted duty free treatment, while parts and components from any other country including Japan are not.

7.10 Indonesia also provides a luxury tax exemption for National Cars. On its face, this measure gives advantages to the sales of National Cars. In addition, the luxury tax exemption also indirectly benefits parts and components imported or to be imported from Korea for the purpose of assembling National Cars. The increase of the National Cars' market share, thanks to the luxury tax exemption, would naturally expand sales and profits of Kia. As parts and components for assembly of National

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<sup>333</sup> Report of the Panel on EC - Bananas III, para.7.194.

<sup>334</sup> Letter dated 27 December 1995 from Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board to Mr. Hutomo Mandala Putra, President Director of PT. Timor Putra Nasional (Japan Exhibit 35).

Cars are imported only from Kia, such indirect benefits are to be exclusively granted to Kia's parts and components. Accordingly, only certain parts and components from Korea are granted indirect benefits of the luxury tax exemption, while parts and components from any other country including Japan are not.

(2) The benefits for imports from Korea constitute an advantage that is covered by Article I:1

7.11 The duty free treatment is an "advantage" prohibited under Article I:1 because duty free treatment obviously is an advantage with respect to "customs duties and charges of any kind imposed on or in connection with importation. The luxury tax exemption is also an "advantage" prohibited under Article I:1 because the exemption relates to "internal taxes or other internal charges" that are "matters referred to in paragraph 2 ... of Article III." Accordingly, the first and second part of the EC - Bananas III three-part test are satisfied.

(3) The advantage is not accorded to "like products" from any country other than Korea

7.12 Article I:1 of GATT 1994 obliges the GOI to accord the advantage to "like products" from all WTO Members, not only from Korea.

7.13 With respect to the "likeness", the discussion in terms of Article III should apply with equal force. First, the Report of the Working Party on Border Tax Adjustments<sup>335</sup> suggests that the criteria, such as "the product's end users, consumers' tastes and habits, and the product's properties, nature and quality", should be used "for interpreting 'like or similar products' generally in the various provisions of GATT 1947".<sup>336</sup> Also in the Spain - Tariff Treatments of Unroasted Coffee the panel found whether the products in their end-use are "regarded as a well-defined and single product" to be relevant in determining whether they are "like products"<sup>337</sup>, for the purpose of Article I:1.

7.14 Under the preceding criteria, parts and components imported from Japan, or any other country, and those imported from Korea for assembly of National Cars constitute "like products" for the purpose of Article I:1. Parts and components from Japan and those imported from Korea for assembly of National Cars are in their end-use regarded as a single product, that is, parts and components for use in the assembly of automobiles. Similarly, automotive parts and components imported from Korea and those imported from Japan and other countries share the same or similar properties, nature and quality. Thus, the third part of the EC - Bananas III three-part test is satisfied.

(4) The advantage is not accorded "unconditionally"

7.15 Article I:1 of GATT 1994 also obliges the GOI to accord all advantages "unconditionally".

7.16 Under Indonesia's Programme, in order to benefit from the duty free treatment and the indirect effect of the luxury tax exemption, parts and components must meet certain prerequisites; i.e., they must be for the assembly of National Cars. Accordingly, the Programme establishes "conditional most-favoured-nation" treatment and, therefore, violates Article I:1.<sup>338</sup>

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<sup>335</sup> Working Party Report on Border Tax Adjustment, para.18.

<sup>336</sup> Report of the Appellate Body on Japan-Alcoholic Beverages II, p.20.

<sup>337</sup> Spain - Tariff Treatment of Unroasted Coffee, L/5135, adopted 11 June 1981 (BISD 28S/102) para. 4.7.

<sup>338</sup> In the 1973 Working Party Report on the "Accession of Hungary," the GATT secretariat stated that "the prerequisite of having a co-operation contract [between the Hungarian government and importing companies] in order [for importing companies] to benefit from certain tariff treatment appeared to imply

- (c) The fact that Indonesia's legislation does not explicitly discriminate in favour of Korean products cannot be a defence

7.17 Indonesia may contend that its regulations only establish requirements for preferential treatment, but without preference for any specific country, and, therefore, are consistent with Article I:1.<sup>339</sup> However, this defence cannot prevail for the following reasons.

7.18 First, in the precedent cases, including the Belgian Family Allowances<sup>340</sup>, Spain Coffee, and EEC - Imports of Beef from Canada<sup>341</sup> cases, the panels have found that measures are inconsistent with Article I even if they do not explicitly mandate discrimination between countries, as long as they introduce discrimination between countries. In this case, Indonesia's measures obviously have introduced discrimination between Korean products and other countries' products. Moreover, Indonesia established the measures, well knowing that they would have such effects. Therefore, Indonesia's measures appear to intend to discriminate, and in practice do discriminate, between products from those countries.

7.19 In United States Standards for Reformulated and Conventional Gasoline, the Appellate Body emphasized the relevance of such "knowledge" in the context of Article III:4 violation:

In our view, [the failure to mitigate regulatory impact on foreign suppliers] go[es] well beyond what was necessary for the Panel to determine that a violation of Article III:4 had occurred in the first place. The resulting discrimination must have been foreseen, and was not merely inadvertent or unavoidable.<sup>342</sup>

Since the text of Article I:1 is no less stringent than that of Article III:4, the prior recognition and the impact of discrimination should be *prima facie* evidence of an Article I:1 violation. Thus although Indonesia may argue that the pioneer company is free to import from anyone, anywhere, Indonesia obviously knew how the benefits of the programme would be distributed among their trading partners and assisted the execution of the plan. In sum, this is a case of active intervention, which violates the Article I:1 of GATT 1994.

7.20 Second, as discussed, Article I:1 prohibits "conditional" most-favoured-nation treatment. Therefore, even if the regulations set out no preference for any specific country, they are "conditional," and thus inconsistent with Article I:1.

- (d) The fact that *only a certain portion of products* from Korea are granted preferential treatment cannot be a defence either

7.21 Indonesia may contend that only a certain portion, or not all, of parts and components from Korea are granted preferential treatment, and that, therefore, the measure is not inconsistent with Article I:1. However, this defence also fails, for the following reasons.

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conditional most-favoured-nation treatment and would, therefore, not appear to be compatible with the [GATT]." (BISD 20S/34) (1974), at 36 para.12 adopted 30 July 1973.

<sup>339</sup> In fact, Indonesia has presented this sort of argument in its replies to questions posed by Japan in the context of the updated subsidies notification. See SUBSIDIES/Replies to Questions posed by Japan concerning the Updating Notification of INDONESIA [G/SCM/Q2/IDN/9] (Japan Exhibit 20).

<sup>340</sup> Belgian Family Allowances, G132 (BISD 1S/59, 2S/18 and 7S/68), adopted 7 November 1952.

<sup>341</sup> EEC - Imports of Beef from Canada L/5099 (BISD 28S/92), adopted 10 March 1981.

<sup>342</sup> Report of the Appellate Body on United States - Standards for Reformulated and Conventional Gasoline (WT/DS2/AB/R) p.28.

7.22 First, the text of Article I:1 requires that any advantage to "any product" originating in any country shall be accorded to the like products from other Members of the WTO. The text does not prohibit advantages only when they are granted to "all products" or "most products" from a particular country. Thus, the GOI's possible contention must fail because it ignores the text of Article I. Indeed the recent WTO panel decision in the EC - Bananas III case confirmed that "Article I:1 obliges a Member to accord any advantage granted to any product originating in any country to the like product originating in the territories of all other Members, in respect [e.g.] of matters referred to in Article III:4."<sup>343</sup>

7.23 Further, the 1989 GATT panel report on US - Section 337 of the Tariff Act of 1930 stated as follows:

The 'no less favourable' treatment requirement [is] an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given either to other foreign products, under the most favoured nation standard, or to domestic products, under the national treatment standard of Article III .... The 'no less favourable treatment' requirement of Article III:4 [and, by analogy, Article 1.1] has to be understood as applicable to each individual case of imported products.<sup>344</sup>

In the context of the Article III:2 violation, the WTO Appellate Body quoted this language from the Section 337 panel report to support its own conclusion that "dissimilar taxation of even some imported products as compared to directly competitive or substitutable domestic products is inconsistent with the provisions of the second sentence of Article III:2".<sup>345</sup> (Emphasis added.) The same reasoning was followed by other GATT/WTO panels (or Appellate Body) reports including the US Beverages panel which concluded that, with regard to Article III, the fact that only certain domestic products are treated preferentially does not cure an Article III inconsistency. There is no reason to apply a different rule with respect to Article I:1.

## 2. The Extended National Car Programme of June 1996

7.24 **Japan** claims that the extended National Car Programme of June 1996 (See Section III.A) violates Article I:1 of GATT 1994. The following are **Japan's** arguments in support of this claim:

- (a) Indonesia granted benefits solely to imports of CBUs from Korea (i.e., National Cars assembled at the Kia factory in Korea) in violation of Article I:1 of GATT 1994
- (1) Indonesia granted benefits solely to imports from Korea

7.25 Indonesia granted the duty free treatment and the luxury tax exemption solely to CBUs (i.e. National Cars assembled at the factory of Kia) imported from Korea.

7.26 Although it is not known whether the application for the authorization specified that the imports came from Korea, in fact all Timor cars imported under the June Programme have come from Kia in Korea, as Indonesia has confirmed. It is not at all adventitious, since Sedan/S515 -1500cc is a copy of Kia's Sephia model and, therefore, no foreign company, other than Kia, may produce the S515. Further, this fact was also easily predictable due to the statement in the 12 December 1995 letter of the president director of TPN to the State Minister for the Mobilization of Investment

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<sup>343</sup> Report of the Panel on EC - Bananas III, para. 7.194.

<sup>344</sup> United States - Section 337 of the Tariff Act of 1930, L/6439 (BISD 36S/345), paras. 5.11, 5.14, adopted 7 November 1989.

<sup>345</sup> Report of the Appellate Body on Canada - Periodicals, page 28.

Coordination Board. This letter stated that TPN wished to "manufacture four-wheeled motor vehicles with the 'TIMOR' brand name at *the KIA Motors Corp., South Korean* factory which is then to be delivered to Indonesia in SKD form ..." (italics added) in the initial three years and, therefore, substantial production or involvement of Kia at least at the initial stage was expected from the outset.

(2) Indonesia violates Article I:1 of the GATT 1994

7.27 As discussed with regard to the "February 1996" Programme (Section VII.A.1), the duty free treatment and luxury tax exemptions are advantages accorded only to imports (in this case, imported CBUs) from Korea but not to imports (of CBUs) from Japan or any other country. As Indonesia admitted, the status of a "pioneer" company is not granted automatically. Indeed after over one and a half years, PT Timor is still the only company which has been granted this privileged status. It is even conceivable that PT Timor will remain the exclusive beneficiary of the Programme, because it is hard to imagine that there will be many "National" cars, granting unconditionally most favoured treatment to all trading partners in the end. In light of the magnitude of the privilege, it is difficult to believe that the present status is merely accidental. In addition, the fact that the 25 per cent counter-purchase requirement is imposed, which inherently limits the number of qualified exporting companies or countries, is expected to bring benefits only to the Korean company or Korea. Thus, this discriminatory treatment clearly constitutes the violation of Article I:1 of the GATT 1994. The arguments made in the context of the February 1996 Programme (See Section VII.A.1) are equally applicable to the advantages given to the imports of CBUs from Korea.

(b) The fact that the previous authorization has expired cannot be a defence

7.28 Indonesia may contend that the authorization made in June 1996 expired on 30 June 1997 and, therefore, the Government of Japan has no legal interest in contesting this authorization.

7.29 However, Presidential Decree No.42/1996 remains in effect. (See Section X). Indonesia may designate other models to be imported as National Cars, under Presidential Decree No.42/1996. Further, at least one more vehicle model manufactured by Kia has been reported to be included in the National Car programme and to be eligible to receive authorization for importation as a National Car. On 5 November 1996, Kia announced in Seoul, Korea that "the company plans to manufacture 50,000 utility vans a year in Indonesia beginning in 1998. 'After discussions with our joint venture partner PT Timor Putra Nasional and the Indonesian Government, we have agreed to include production of utility vans in Indonesia's national-car project,' Kia's Executive Vice President Kim Seung-ahn said." A PT Timor spokesman confirmed that "Yes, we do have such a plan and I think it will be included (in the national car programme)."<sup>346</sup> In May 1997, Mr. Soemitro Soerachmad, chief executive of PT Timor's distribution subsidiary, said "'the company [PT Timor] had agreed with Kia Motors of South Korea to import the Sportage, a small sport utility vehicle, from early 1998.'... . The Sportage, a lightweight sports utility vehicle, called the J520i in Indonesia, will ..... qualify for the same tax and tariff breaks enjoyed by the Timor ... . However, Mr. Soemitro indicated early batches of the new model might have to be imported from Korea in completely built-up form pending completion of a new plant."<sup>347</sup> Therefore, the Government of Japan faces a tangible threat of further, renewed harm by reason of Indonesia's standing regulations.

7.30 Moreover, some preceding panels have examined measures and presented complete reports even though the relevant measures were terminated during the panel process, even prior to the

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<sup>346</sup> The Indonesian Observer, "PT Timor plans to manufacture utility vans", 6 November 1996, (Japan Exhibit 54).

<sup>347</sup> Financial Times, "Jakarta Plans New National Car", May 1997 (Japan Exhibit 55).

formation of the panel.<sup>348</sup> Therefore, the fact that the authorization made in June 1996 expired on 30 June 1997 is irrelevant to this proceeding.

B. Claims Raised by the European Communities

7.31 The **European Communities** claims that the following measures are inconsistent with Indonesia's obligations under Article I:1 of GATT:

- (1) the exemption from customs duties on imports of National Cars;
- (2) the exemption from the Sales Tax on Luxury Goods for imported National Cars;
- (3) the exemption from the Sales Tax on Luxury Goods for National Cars assembled in Indonesia; and
- (4) the exemption from customs duties on imports of parts and components for the assembly of National Cars in Indonesia.

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

7.33 Article I:1 of GATT is expressed as follows:

With respect to customs duties and charges of any kind imposed on or in connection with importation ... and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating ... in any other country shall be accorded immediately and unconditionally to the like product originating in .... all other contracting parties.

1. Measures concerning the importation of National Cars

7.34 Exemptions (1) and (2) infringe Article I:1 because they provide an "advantage" which de facto benefits only imports of motor vehicles of the Kia brand originating in Korea, to the exclusion of imports of "like" motor vehicles originating in other Members.

(a) The measures provide "advantages" covered by Article I:1 of GATT

7.35 GATT Article I:1 applies, *inter alia*, to any advantage granted by a Member "with respect to customs duties ... imposed on or in connection with importation ...". Accordingly, the exemption from customs duties on imports of National Cars is a measure covered by Article I:1.

7.36 Article I:1 of GATT also applies to any advantage granted with respect to "all matters referred to in paragraph 2 ... of Article III". Article III:2 refers to "internal taxes or other internal charges". As shown above, the Sales Tax on Luxury Goods is an "internal tax" within the meaning of Article III:2. Therefore, the exemption from the Sales Tax on Luxury Goods is also an advantage covered by Article I:1.

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<sup>348</sup> EEC Measures on Animal Feed Proteins, L/4599, adopted 14 March 1978 (BISD 25S/49); See also, United States - Prohibition of Imports of Tuna and Tuna Products from Canada, L/5198, adopted on 22 February 1982 (BISD 29S/91).

- (b) The cars covered by the measures are “like” other cars

7.37 As shown above, the definition of “National Cars” is not based on any factor which may affect *per se* the physical characteristics of those cars or their end uses. Consequently, in principle National Cars imported from Korea are “like” any motor vehicle imported from other Members.

- (c) The measures benefit only and exclusively imports of Kia cars originating in Korea

7.38 Article I:1 of GATT does not prohibit only measures which discriminate formally and openly according to the country of origin of the imported goods. Measures worded in generally applicable, origin neutral terms have also been found to infringe Article I:1 in instances where de facto they benefited only or mainly imports from a certain Member. This has been recently confirmed by the Appellate Body in EC - Regime for the Importation, Sale and Distribution of Bananas, where it stated that:

Articles I and II of the GATT have been applied, in past practice, to measures involving ‘de facto’ discrimination.<sup>349</sup>

7.39 As examples of that practice, the Appellate Body referred to the Panel reports on Spain - Tariff treatment of Unroasted Coffee<sup>350</sup>; EEC - Imports of Beef from Canada<sup>351</sup>; and Japan - Tariff on Imports of Spruce-Pine-Fir (SPF) Dimension Lumber<sup>352</sup>.

7.40 Presidential Decree 42/96 has been carefully drafted so as to avoid any appearance of discrimination among Members. On paper, Presidential Decree 42/96 allows Pioneer Companies to

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<sup>349</sup> Appellate Body Report on EC - Regime for the Importation, Sale and Distribution of Bananas, adopted on 25 September, WT/DS 27/AB/R, para 232.

In the same report, the Appellate Body affirmed the Panel’s findings that the “operator category rules”, the “activity function rules” and the “hurricane licence rules” applied by the Community in order to allocate licences for importing bananas under a tariff quota violated the Most-Favoured-Nation obligation contained in Article II of GATS because in respect of each of those measures a majority of the service suppliers of ACP origin fell within the “more favoured” category of suppliers and/or a majority of the “like” suppliers of the Complainants’ origin were found in the “less favoured” category. In reaching this conclusion, the Appellate Body rejected an argument by the Community to the effect that the measures pursued a “legitimate policy” and were not “inherently discriminatory”. According to the Appellate Body, the “aims” of a measure are not “relevant” in order to establish whether it affords de facto Most-Favoured-Nation treatment (at paras. 240-248).

<sup>350</sup> In Spain - Tariff Treatment of Unroasted Coffee (adopted on 11 June 1981, BISD 28S/102, 111-112), the Panel concluded that by applying different tariff rates to different varieties of coffee which had been previously found to be “like”, Spain had infringed its obligations under Article I:1. The Panel noted that the complainant, Brazil, exported to Spain mainly those varieties that were subject to higher import duties. Thus, even if the application by Spain of different tariff rates to different coffee varieties was formally origin neutral, imports from Brazil were discriminated de facto vis-à-vis imports from other countries that exported mainly the varieties subject to the lower duty rates.

<sup>351</sup> In EEC - Imports of Beef from Canada (adopted on 10 March 1981, BISD 28S/92, 113) the Panel examined a tariff concession for high quality beef granted by the Community during the Tokyo Round. The Panel did not consider necessary to judge whether the terms of the concession were in themselves discriminatory. The Panel limited itself to note that a regulation implementing the concession required a certificate of authenticity issued and endorsed by one of the authorities included in an annex to that regulation. The annex in question listed only a US agency, it being specified that this agency was empowered to certify only meat of US origin. In light of this, the Panel concluded that the measures at issue

“...in their present form had the effect of preventing access of like products from other origin than the United States, thus being inconsistent with the most favoured nation principle in Article I of the General Agreement” [emphasis supplied] (at para 4.10).

<sup>352</sup> Japan - Tariff on Imports of Spruce-Pine-Fir (SPF) Dimension Lumber, adopted on 19 July 1989 BISD 36S/167.



import duty free and tax free National Cars from any country in the world. De facto, however, all the cars which have so far benefited from Presidential Decree 42/96 were of Korean origin. This is not fortuitous. Presidential Decree 42/96 was conceived and applied from the outset by the Indonesian authorities with the deliberate and sole purpose of permitting the importation duty free and tax free by PT TPN of Kia cars made in Korea only, and no other cars.

7.41 The Indonesian authorities have acknowledged publicly that it is their policy to reserve the benefits of the National Car Programme exclusively for PT TPN. At a press conference held on 15 March 1996, Indonesia's Minister of Industry and Trade, Mr. Tunky Ariwibowo, announced the Indonesian Government's policy of reserving the benefits of the National Car Programme for PT TPN. Since then, this policy has been reiterated by Mr. Ariwibowo and other senior officials on many occasions.<sup>353</sup> That policy is confirmed by the fact that, as of date, PT TPN remains the only company which has been granted Pioneer status, even though other Indonesian car producers have also requested that status. Thus, in practice, Presidential Decree 42/96, even if drafted in generally applicable terms, had but a single addressee and beneficiary: PT TPN.

7.42 The decision of the Indonesian authorities to reserve the benefits of the National Car Programme for PT TPN entailed also a conscious, even if not explicit, decision by those authorities to grant the benefits provided by Presidential Decree 42/96 only with respect to imports of cars manufactured by Kia in Korea.

7.43 When adopting Presidential Decree 42/96, the Indonesian authorities could not have ignored that PT TPN would take advantage of that measure in order to import exclusively motor vehicles made by Kia in Korea. In particular, since they well were aware that:

- Mr Hutomo Mandala Putra, the owner of PT TPN, had set up a joint venture with Kia for the assembly of Kia cars in Indonesia already in 1993;
- the first National Car which PT TPN planned to assemble in Indonesia (the Timor S-515) is a version of an already existing Kia model, the Sephia;
- Kia's main operating facilities for the assembly of the Sephia are located in Korea.

7.44 Indeed, there is evidence in the record showing that Presidential Decree 42/96 was adopted in response to a precise request from PT TPN to be allowed to import specifically motor vehicles manufactured by Kia in Korea, and no other kind of motor vehicles. As discussed in the factual part, in a letter dated 12 December 1995, PT TPN asked the approval of the Indonesian authorities for *inter alia*:

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<sup>353</sup> "Indonesia backs its Trade Policy for Auto Makers", Asian Wall Street Journal, Jakarta, 18 March 1996 (EC Exhibit C-1); "Jakarta's tax breaks for car firm unfair: Japan", The Strait Times, Singapore, 24 March 1996 (EC Exhibit C-2); "The prospects for national cars", Business News, Jakarta, 18 April 1996 (EC Exhibit C-3). "Govt not to grant incentives for Bimantara cars", The Jakarta Post, Jakarta, 1 June 1996 (EC Exhibit C-4); "Another Suharto son launches Indonesia car", Reuters, Jakarta, 23 July 1996 (EC Exhibit C-7); "National car plan presses on in Indonesia", Financial Times, 9 July 1996 (EC Exhibit C-6); "Bimantara's request for car policy review refused", The Jakarta Post, Jakarta, 6 June 1996 (EC Exhibit C-5); "Only one car firm to get protection", The Jakarta Post, Jakarta, 15 November 1996 (EC Exhibit C-8); "Only one car firm to get protection", The Jakarta Post, Jakarta 15 November 1996 (EC Exhibit C-8); "Indonesia backs its Trade Policy for auto makers" Asian Wall Street Journal, 18 March 1996 (EC Exhibit C-1); "Only one car firm to get protection", The Jakarta Post, Jakarta, 15 November 1996 (EC Exhibit C-8).

1. Manufacture four wheeled motor vehicles with the “TIMOR” brand name at the Kia Motors corp., South Korean factory which is then to be delivered to Indonesia in SKD form [..].
3. Import vehicles in SKD resulting from production referred to in point 1 using domestic (Indonesian) components/parts exported to the Kia Motors Corp. plan with exemption of Import Duty, Additional Import Duty and Tax on Luxury Goods (Ppn BM) for such vehicles.

7.45 The subsequent implementation of Presidential Decree 42/96 provides further confirmation that this measure was devised with the exclusive purpose of permitting the importation duty free and tax free by PT TPN of cars manufactured by Kia in Korea.

7.46 On 7 June 1996, PT TPN was authorised on the basis of Presidential Decree 42/96 to import 45,000 cars. This authorization remains to date the only one issued pursuant to Presidential Decree 42/96. The authorization specifies the "kind/type" of the cars to be imported in the following terms: "sedan S/515 - 1500 cc". The technical specifications of the S-515 are the same as those of Kia's model "Sephia". Thus, even if the authorization did not direct expressly PT TPN to purchase the cars from any particular source, it was implicit in its terms that it covered only cars made by Kia in Korea.

7.47 In light of the above considerations, it comes as no surprise that each and every one of the 39,727 cars imported by PT TPN under Presidential Decree 42/96 as of 30 June 1997, the date on which the aforesaid authorization expired, were manufactured by Kia and imported from Korea.

## 2. Measures concerning the assembly of National Cars in Indonesia

7.48 Exemptions (3) and (4) violate Article I:1 of GATT because they provide an “advantage” which de facto benefits mainly, if not exclusively, imports of parts and components originating in Korea, to the detriment of imports of “like” parts and components from other Members.

### (a) The measures provide “advantages” covered by Article I:1 of GATT

7.49 As discussed, GATT Article I:1 applies to any advantage granted by a Member with respect to the imposition of customs duties on or in connection with the importation of goods. Thus, the exemption from customs duties on imports of parts and components for the assembly of National Cars is an “advantage” covered by Article I:1.

7.50 Article I:1 also applies to any advantage granted with respect to “all matters referred to ... in paragraph 2 ... of Articles III”. The Sales Tax on Luxury Goods is an internal tax and, therefore, a “matter” referred to in Article III:2. The exemption from that tax of the sales of National Cars assembled in Indonesia represents an “advantage” not only for the National Cars as such but, indirectly, also for the parts and components assembled therein. That indirect “advantage” is also covered by Article I:1.

### (b) Parts and components made in South Korea are “like” other parts and components

7.51 The mere fact of being manufactured in Korea does not confer to parts and components any specific physical characteristics or end uses which make them “unlike” parts and components manufactured elsewhere.

- (c) The measures will benefit mainly, if not exclusively, imports of parts and components from South Korea

7.52 The first National Car to be assembled in Indonesia by PT TPN (the Timor S-515) is but a re-badged replica of Kia's model Sephia. Most of the parts and components assembled by Kia into its model Sephia are manufactured in Korea by Kia itself or its affiliates or by independent part makers linked to Kia by long standing supply relationships.

7.53 For PT TPN, it would make no commercial sense to try and import the parts and components for assembling the Timor S-515 from other suppliers established in third countries. This was already anticipated by PT TPN in its letter of 12 December 1995, in which it requested the approval of the Indonesian authorities for:

2. Manufacture four-wheeled vehicles with the "TIMOR" brand name at third party's/parties licensed assembly plant(s) in Indonesia with its primary material imported from overseas (Kia Motors Corp.) starting from full-CKD and gradually decreasing by the use of local components [...]

7.54 As a result, de facto the tariff and tax benefits for the assembly of National Cars in Indonesia will benefit predominantly, if not exclusively, imports of parts and components originating in Korea, thereby infringing Article I:1 of GATT.

C. Claims Raised by the United States

7.55 The **United States** claims that Indonesia's exemption of CBU Kia Sephia sedans imported from Korea from import duties and the luxury tax violates Article I:1 of GATT 1994. The following are the **United States'** arguments in support of this claim:

7.56 Under Presidential Decree No. 42/1996, "national motor vehicles" produced abroad were "granted the same treatment as that of national automobiles produced in Indonesia". This meant that CBU Kia Sephia sedans could be imported from Korea without being subject to (a) the 200 per cent tariff on imported CBU passenger cars; and (b) the 35 per cent luxury tax. This preferential treatment accorded to motor vehicles imported from Korea violates Article I:1 of GATT 1994.

7.57 Article I:1 provides, in pertinent part:

With respect to customs duties and charges of any kind imposed on or in connection with importation ... and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation ..., and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in ... any other country shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties.

7.58 The exclusive exemption from the 200 per cent tariff and the 35 per cent luxury tax of Kia Sephia sedans imported from Korea clearly constitutes an "advantage, favour, privilege or immunity" within the meaning of Article I:1 that is not "accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties". Imports of CBU passenger cars that are "like" the Kia Sephia are ineligible for the same treatment. Instead, they are put at a competitive disadvantage by being subject to the 200 per cent tariff and the 35 per cent luxury tax. As such, this exemption violates Article I:1.

7.59 Indonesia has gone on record as asserting that this tariff and tax exemption does not violate Article I:1 “because it does not direct recipients of the subsidy to import automobiles from any particular country. Private parties designated as national car companies are free to import qualifying automobiles from any country”.<sup>354</sup>

7.60 This attempted justification of such a blatantly WTO-inconsistent measure is disingenuous, at best. At the time Presidential Decree No. 42/1996 was issued, the Government of Indonesia already had approved the Kia Timor joint venture as the sole producer of a “national motor vehicle” and the sole beneficiary of benefits under the National Motor Vehicle programme. This project called for the production/assembly in Indonesia of Kia Sephia sedans, to be renamed the Timor S515 and S515i sedans. Indeed, Indonesia has claimed that it will not extend “national motor vehicle” benefits to any other vehicle to be produced by the Kia Timor joint venture.<sup>355</sup> Therefore, there was one car, and only one car, that could be imported as a “national motor vehicle”, and that was a Korean car, the Kia Sephia sedan.

7.61 Moreover, the Government of Indonesia provided the one-year exemption from import duties and the luxury tax to facilitate the production/assembly in Indonesia of the Timor Kia Sephia sedan. As stated by the Minister of Industry and Trade: “This aims at accelerating the production process of Timor so that [the car] can quickly enter the market. The government gives PT Timor Putra Nasional a period of 12 months, from June 1996 through June 1997, to assemble the cars in Kia’s factory in Korea.”<sup>356</sup>

7.62 In light of this, it simply is incredible to claim, as does Indonesia, that private parties, either TPN or Kia Timor, were “free to import qualifying automobiles from any source”. The objective of the one-year tariff and tax exemption on imported “national motor vehicles” was to facilitate the entry into the Indonesian market of the Timor Kia Sephia sedan - the only designated “national motor vehicle” at the time. This objective could not have been accomplished if Kia Timor or TPN were free to import any vehicle from any source they chose, such as an Opel Optima or a Ford Escort. Therefore, in reality, only Kia Sephia sedans from Korea were eligible for the preferential treatment accorded by Presidential Decree No. 42/1996.

7.63 Indeed, this case is analogous to the EEC Beef case, in which the panel found a violation of Article I in a situation where “exports of like products of other origin than that of the United States were in effect denied access to the European Communities market considering that the only certifying agency authorized to certify the meat ... was a United States agency mandated to certify only meat from the United States”.<sup>357</sup> Just as only USDA-certified beef was eligible for access to the European Communities market in EEC Beef, in the instant case, the only motor vehicle “certified” for tariff- and tax-free treatment under Presidential Decree No. 42/1996 was the Kia Sephia sedan from Korea.

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<sup>354</sup> G/SCM/Q2/IDN/9 (23 May 1997), p. 3.

<sup>355</sup> In responding to a question under the Annex V procedure, Indonesia stated, “[T]he Government does not intend to grant National Car benefits to PT. Timor Putra Nasional (‘TPN’) for other models”. (AV/14, p.4, Question #10(a)) and “In accordance with Manufacturing Licence for TPN, TPN also plans to produce or and assemble Timor commercial cars (Category I and IV). However, the Government of Indonesia maintains its position that the only national car produced in Indonesia is the S515i model sedan.” (AV/16, p.3, Question #12/28(b)).

<sup>356</sup> “Indonesia’s ‘National Car’ to Be Built in S. Korea”, The Reuter Asia-Pacific Business Report, 5 June 1996 (US Exhibit 14, pp. 62-63).

<sup>357</sup> “EEC - Imports of Beef from Canada, L/5099, Report of the Panel adopted 10 March 1981, BISD 28S/92, para. 4.2(a).

D. Indonesia's response to the claims raised under Article I:1 of GATT 1994

7.64 The following are **Indonesia's** arguments in response to the claims raised under Article I:1 of GATT 1994:

1. The June 1996 Programme expired 30 June 1997, so there can be no present violation of Article I of GATT 1994

(a) The legal authority for the June 1996 Programme expired on 30 June 1997

7.65 By its terms, the June 1996 programme was a one-time, one-year programme. Article 2 of Decree of the President No. 42/1996 (4 June 1996)<sup>358</sup>, which provided the underlying authority for the programme, declared expressly:

The equal treatment contemplated in Article 1 is only granted once for a maximum period of one year and for amounts stipulated by the Minister of Industry and Trade. (Emphasis added.)

The limitation to a one-time, one-year grant is reaffirmed in Decree of the Minister of Industry and Trade No. 142/MPP/Kep/6/1996 (5 June 1996), which implemented the Presidential Decree.<sup>359</sup> Article 1 thereof states:

Within the framework of preparations the production of national cars can be carried out overseas for a one-time maximum period of 1 (one) year on the condition that Indonesian made parts and components are used. (Emphasis added.)

7.66 These limitations are reflected in the authorization for TPN to import Timor S515 sedans under authority of the June 1996 programme. The "Recognition of Registered Importer/Sole Agent (IT/AT)," file number 1410/MPP/6/1996, signed by the Minister of Industry and Trade on 7 June 1996, notes in its title that it is valid through 30 June 1997.<sup>360</sup> It includes the following limitation in paragraph 1 of its terms and conditions: "Only to import a total of 45,000 units of sedan with importation period limited to 30 June 1997" (emphasis added).<sup>361</sup>

7.67 On 30 June 1997, the legal authority for the June 1996 programme expired as scheduled and the importation authority provided by "Recognition" number 1410/MPP/6/1997 ceased to be valid.<sup>362</sup> No comparable programme has been or will be authorized. Therefore, not only did the imports which Complainants claim violate Article I of the General Agreement cease over four-and-one-half months ago, there is no legal authority under which they could resume. The June 1996 programme has ended and, as demonstrated below, has no relevance to these proceedings.

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<sup>358</sup> Indonesia Exhibit 6.

<sup>359</sup> Indonesia Exhibit 7.

<sup>360</sup> Indonesia Exhibit 13.

<sup>361</sup> Indonesia Exhibit 13.

<sup>362</sup> Id.

- (b) Because the programme and the authority under which it was granted have terminated, there is no basis for an affirmative determination by the Panel

7.68 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.)

Article 3.7 of the DSU confirms that this forward-looking remedy - elimination of an inconsistent measure - is the only WTO-consistent remedy. (Compensation is expressly recognized as "a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement.")

7.69 The measure has been eliminated because the June 1996 programme and the legal authority under which it was granted expired on 30 June 1997. Therefore, even if the measure 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 expiry of the programme and declare that no determination is warranted as to the claimed inconsistency of the expired programme.

- (c) Prior Panel decisions support the refusal to rule on an expired measure

7.70 In Thailand-Restrictions on Importation of and Internal Taxes on Cigarettes (7 November 1990), BISD 37S/200, the complaint included allegations regarding an excise tax and a business and municipal tax. Prior to the panel's decision, Thailand issued regulations applying a single excise tax rate for all cigarettes (imported and domestic) and removing cigarettes from the products subject to the business and municipal tax. 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. The mere fact that by subsequent regulation Thailand conceivably could reintroduce taxes that discriminated against imports was insufficient to warrant a ruling of inconsistency. (See *id.* paras. 84-86 and 88 at pp. 227-28.)

7.71 In Thai Cigarettes the fact that the measures as they existed at the time of the panel's decision were not inconsistent with the General Agreement was sufficient to warrant a negative ruling by the panel. In the instant case, the June 1996 programme has ended and the very authority under which it was promulgated has expired.

7.72 The decision of the 1989 panel in Chile's complaint with respect to EEC - Restrictions on Imports of Dessert Apples (22 June 1987), BISD 36S/93, also is instructive. Chile urged the panel to rule that the European Communities should offer compensation to Chile because a ruling that the measures should be withdrawn would be meaningless because the measures had lapsed. The panel refused to make a finding of "retroactive prejudice" and to recommend compensation. (See *id.* para. 12.35 at p. 137.)<sup>363</sup>

7.73 In sum, prior panel decisions also support the conclusion that where, as here, a programme and its underlying legal authority have expired, the panel should declare that no decision on the merits of the alleged inconsistency with Article I of the General Agreement is appropriate.

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<sup>363</sup> The Government Procurement panel in Norway-Procurement of Toll Collection Equipment for the City of Trondheim (13 May 1992), GPR/DS2/R, reached the same conclusion. See *id.*, paras. 4.17-4.26.

2. Indonesia has not violated Article I of GATT 1994 because it did not grant an advantage to automobiles or parts originating in one country that it did not accord to like products originating in other countries

(a) Indonesia did not grant an advantage to automobiles or parts originating in one country

7.74 Complainants concede that nothing in the regulations or decrees establishing either the February 1996 or the June 1996 programmes<sup>364</sup> mandates preferential treatment of automobiles, components or parts from any particular country.<sup>365</sup> Decree of the State Minister for the Mobilisation of Investment Funds No. 01/SK/1996 (27 February 1996)<sup>366</sup> expressly states that a national car producer has the freedom to determine the sources of technology and of components and parts. Further, the 7 June 1996 “Recognition of Registered Importer/Sole Agent (IT/AT),” file number 1410/MPP/6/1996, the document in which one would most expect to find such direction, contains no such limitation.<sup>367</sup> Indeed, there is nothing in the Recognition (or in any other official document) that even implies such an intention.

(b) That TPN made a commercial decision, without government involvement, to enter into a commercial relationship with a particular company does not constitute a de facto violation of Article I

7.75 Every automotive company around the world makes corporate decisions as to its suppliers, some of which are located in different countries. The mere fact that a company like TPN receives a subsidy does not constitute a de facto violation of Article I of the General Agreement. TPN is free to import automobiles, components and parts from whatever sources it chooses. In all of the panel reports cited by Complainants, the responding government had established a legal structure which in fact compelled or led to a particular result.

7.76 In Spain-Tariff Treatment of Unroasted Coffee (11 June 1981), BISD 28S/102, the government’s differential tariff treatment of “mild” coffee and other varieties of coffee was found to be discriminatory. In European Economic Community-Imports of Beef from Canada (10 March 1981), BISD 28S/92, the only agency authorized by the European Communities regulation to certify beef as high-quality beef was a United States Government agency the mandate of which was limited to certification of United States beef. Also, Japan miscites the Reformulated Gasoline case<sup>368</sup> as standing for the proposition that measures violate Article I if they “introduce” discrimination. This characterization is incorrect. Rather, the decision declares that United States authorities must have foreseen that the two separate regulatory regimes that they had established were discriminatory.

7.77 In each of the three above-cited cases, despite the absence of explicit discrimination, a particular result was mandated by government action. In none of them was the choice of supplier made by the private-party recipient of the subsidy found to constitute government-mandated de facto discrimination.

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<sup>364</sup> As demonstrated in Section III, above, there can be no violation of Article I with respect to the June 1996 programme since it expired on 30 June 1997. However, even if the programme were still in effect (which it is not), it would not be inconsistent with Article I for the reasons set out in this section.

<sup>365</sup> See Sections VII.A and B. See also Indonesia’s Statement to the Committee on Subsidies and Countervailing Measures in response to questions posed by Japan (G/SCM/Q2/IDN/9 (23 May 1997) at p. 3).

<sup>366</sup> Indonesia Exhibit 4.

<sup>367</sup> Indonesia Exhibit 13.

<sup>368</sup> Report of the Appellate Body, United States-Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R (29 April 1996).

7.78 Even if certain Government officials were aware of TPN's corporate intention to use Kia as a supplier, the legal structure of the national car programme did not compel or lead to this private-party decision or to imports from Korea. The essential fact remains that a private-sector choice, not government direction, was the reason why there were imports from Korea. Such a private choice is not within the scope of Article I of the General Agreement.

- (c) The Timor S515 and components and parts imported for it are not "like" any passenger vehicles, components or parts imported from the territories of complainants

7.79 The "like product" concept is used in several GATT articles. As confirmed by drafting history, precedent and legal scholars, the meaning of the phrase depends on the context in which it appears. With regard to its use in Article I, the world's leading GATT scholar, Professor John Jackson, states:

[T]here were scattered discussions in the preparatory meetings that yielded some illustrations of the meaning of like products, particularly as used in the MFN clause. At one point it was asked whether "all cereals would be considered 'like products' or only wheat?" and an answer given was that only wheat "would be considered as a 'like product.'" At a later conference, it was asked whether autos under 1,500 kilograms would be like products to those over 1,500 kilograms, in the case of a tariff classification that drew this distinction, and the inquirer was assured that this would not be the case.

The term "like products," as used in Article I (MFN), can probably be considered in the light of the above preparatory concepts.<sup>369</sup>

7.80 The narrow scope of the "like product" concept in Article I is emphasized by The Australian Subsidy on Ammonium Sulphate and the EEC - Measures on Animal Feed Proteins panel reports, which note that, unlike Article III:2, in which effects on both "like products" and "directly competitive or substitutable products" are relevant, the MFN obligation of Article I is limited to "like products".<sup>370</sup>

7.81 Passenger vehicles are highly differentiated; numerous physical and nonphysical characteristics determine each model's properties, nature and quality and, thus, consumers' tastes, habits and preferences. These defining characteristics include quality, reputation, price, ride and comfort, standard features, safety features, available options, exterior size, interior space, engine size, technology, fuel type and fuel efficiency. Complainants have failed to establish that there is any "like product" to the Timor S515 in their unsuccessful efforts to establish serious prejudice, and they must also fail in the context of Article I. There simply is no car that matches the requisite physical and nonphysical characteristics of the Timor S515 to be considered a "like product" to it.

7.82 The same failing is true with regard to Complainants' arguments regarding automotive components and parts. Government experts have calculated that 93 per cent (by value) of the components and parts of the Timor are tailor-made to the specifications of that brand. The same is true (likely with slight variations in the percentage) with respect to all brands and types. (One does not and cannot, for example, use GM components in BMW sedans or Mercedes components in

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<sup>369</sup> John Jackson, World Trade and the Law of GATT (1969) § 11.4 (emphasis added)(footnotes omitted).

<sup>370</sup> Report of the Working Party on The Australian Subsidy on Ammonium Sulphate (3 April 1950), BISD II/188 (para. 8 at p. 191). Report of the Panel on EEC - Measures on Animal Feed Proteins (14 March 1978), BISD 25S/49 (para. 4.20 at p. 68).



Toyota sedans.) Tailor-made components and parts that cannot be used in other makes and models are not “like products”. Indeed, they are not even “directly competitive or substitutable”. Thus, for assembled Timors and Timor components and parts, there can be no violation of GATT Article I since there are no “like products” which are discriminated against.

3. The June 1996 Programme was a subsidy that expired and, therefore, there is no violation of Article I of GATT 1994

(a) The June 1996 Programme Has Expired and Will Not Be Renewed

7.83 As Indonesia has stated *ad nauseam*, the June 1996 Programme has expired and will not be renewed. One would think these statements would suffice. But Japan, ignoring Indonesia’s numerous, direct pronouncements, insists that, during the consultations, Indonesia stated that the “June 1996 Presidential Decree ‘is still in effect ...’”. Well, of course that is what Indonesia said. All of the consultations occurred well before 30 June 1997, the date the measure terminated. The June 1996 subsidy has ended and all of Complainants’ argumentation regarding it is moot.

(b) As to Unsold Timors, the Fact That the Luxury Tax Is Not Forgone Until Sale Is a Subsidies Agreement Issue, Not an Article I Issue

7.84 In June 1996, pursuant to Presidential Decree No. 42/1996<sup>371</sup>, TPN received a one-year subsidy for national cars made overseas. This treatment was necessary because TPN needed to import built-up Timors to establish the required marketing network and introduce a national car to the Indonesian buying public prior to the time that domestic production feasibly could begin.

The policy contained one quantity and two temporal limitations:

- the subsidy was granted only for the quantity of autos specified by the Minister of Industry and Trade (45,000 units);
- the subsidy was limited to one year; and
- the subsidy was granted only once.

7.85 Complainants accurately repeat Indonesia’s report that not all of the Timors imported under the June 1996 subsidy have yet been sold.<sup>372</sup> They note that the Government does not forgo the luxury tax until each car is sold. This also is true.

7.86 The problem with complainants’ arguments is that they fail to accept that the June 1996 measure is a subsidy. Thus, regardless of whether or not it still is in effect (it is not in effect), it is a subsidy and, as such, is subject to the Subsidies Agreement, not Article I.

7.87 **Indonesia**, in response to a question from the panel, subsequently further argued as follows regarding the process of importation and customs clearance<sup>373</sup>:

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<sup>371</sup> Indonesia Exhibit 6. See also Decree of the Minister of Industry and Trade No. 142/MPP/Kep/6/1996 (Indonesia Exhibit 7), dated 5 June 1996 and, per Article 5 thereof, effective on that date. This decree was published promptly in the State Gazette, as is true regarding all decrees of the Minister of Industry and Trade.

<sup>372</sup> The Government’s most current data is that, as of 31 October 1997, only 17,507 Timors imported under the subsidy remained unsold.

7.88 Article 2 of Customs Law No. 10/1995<sup>374</sup> provides that a product is considered "imported" when it arrives in the customs territory of Indonesia (i.e. the territory of the Republic of Indonesia). A translation of the relevant sections of the Customs Law is attached.

7.89 The importer of the product is responsible for payment of the appropriate customs import duties, VAT, sales luxury tax, and advance payment of income tax at the moment of importation. In this case, the importer is TPN.

7.90 The importer is entitled to customs clearance upon presentation to the customs authorities of a customs declaration and proof of payment of the duties and taxes owing. Under Article 42 of the Customs Law, this obligation may be satisfied by payment of cash or deposit of security acceptable to Customs. In this case, under authority of Minister of Finance Decree No. 404 and Government Regulation No. 36, TPN was required to deposit a guarantee to cover the value of the customs import duties and luxury sales tax from which it would be exempt if it satisfied the requirements of the National Car Programme. TPN also was obligated to payment, in cash, of the VAT and income tax.

7.91 After importation and before completion of the customs clearance procedure, a product may be kept in "bonded storage". (See Article 44 of the Customs Law.) Bonded storage areas are operated by private entities, the importer or someone else with whom the importer has made a commercial arrangement, but they are under the control of Customs. The private party pays all costs associated with the facility and storage of the goods there. (In this case, then, TPN is incurring all costs associated with storage of the imported CBU's which have not received customs clearance.)

(c) Even if the Panel finds that Article I does apply, TPN, and Not Kia, was the beneficiary of the import duty exemption, the programme was not country-specific and complainants import no like product, so Article I was not violated

(1) TPN, and Not Kia, was the beneficiary of the June 1996 Programme

7.92 As Indonesia has demonstrated, TPN was the beneficiary of the June 1996 subsidy. TPN was the importer of record for all of the Timors. TPN is a 100 per cent Indonesian-owned entity. Kia received no benefit from the Programme, other than being paid by TPN as one of its suppliers. Thus, even if the Panel finds that Article I does apply, no country was "advantaged" or "favoured" within the meaning of Article I.

(2) The June 1996 Programme Was Not Country Specific

7.93 Complainants concede that nothing in the regulations or decrees establishing the February and June 1996 programmes mandates or even expressly provides for preferential treatment of imports from a particular country. They claim, though, that Indonesia's anticipation that TPN would associate with Kia transforms the otherwise benign Programme into one that violates Article I because the Government, they assert, knew that the benefits would go to Kia, a Korean company.

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<sup>373</sup> **Indonesia** made the following additional arguments on this point: "Also with respect to claims under Article I of GATT 1994, the complainants argued that the June 1996 measures were still in effect because the luxury tax would not be foregone on the unsold cars until they were sold. This is not correct. The tax is due when the duties are due and then the consumer reimburses the company at the time of sale (TPN, of course, was exempt from this requirement). Secondly, TPN failed the Sucofindo audit (See Section X) and, thus, none of the remaining cars will receive the luxury tax exemption. So, even accepting complainants' position, the June 1996 measures have terminated. Thus, the Panel should reject complainants' Article I arguments."

<sup>374</sup> Indonesia Exhibit 50.

7.94 This argument is flawed for many reasons, as a glimpse through the prism of commercial reality makes clear. First, complainants' assertions reduce to the understandable claim that they lost a contest. TPN could have and likely would have preferred to select any of complainants' producers for this venture, including companies such as Fiat, Renault or Mazda. TPN needs technology and stability in the National Car Programme, two attributes which Kia lacks. So, in addition to having a huge incentive to select one of complainants' makers, TPN had several disincentives to select Kia. Why, then, did it select Kia? It selected Kia for one reason and one reason only: unlike complainants' makers, which guard even their cast-off technologies, Kia was willing to transfer technology (including production technology and training) to TPN, and to do so for a commercially reasonable price.

7.95 The United States stoutly states that "the irony of this dispute is that the United States auto manufacturers sought to help Indonesia achieve its objective, but have been precluded from doing so" by the National Car Programme. This is utter nonsense. Had a single United States manufacturer come up with a reasonable offer, the Indonesian firms seeking pioneer status would have jumped at the chance to have an arrangement with such a prestigious partner.

7.96 The same is true of Japan and the European Communities. Each of the three complainants now complains about losing a contest it never even entered in earnest.

7.97 Second, of course Indonesia knew that TPN had a technical services arrangement with Kia. Well aware of the lack of technology and know-how in Indonesia, the Government of Indonesia would not have favourably entertained TPN's application if it were not advised of the technical and technological support for which TPN had contracted. Without the checks and balances complainants criticize, the Government could not ensure the legitimacy and strength of the proposed development. Indonesia needs a real national car industry making real cars that the majority of Indonesians can afford. The lack of project oversight complainants advocate is simply irresponsible.

7.98 As discussed above, TPN could have selected any company it wished to develop a national car; it made a commercial decision to select Kia. Complainants have not and cannot counter these facts.

(3) Complainants import no like product

7.99 Complainants concede that Article I is violated only if, among other things, complainants' like products are disadvantaged or disfavoured. Here, there can be no violation of Article I because, among other reasons, complainants import no like product, as discussed above.

E. Rebuttals to Indonesia's response

1. Rebuttal Arguments made by Japan

7.100 The following are **Japan's** rebuttal arguments to Indonesia's responses to the claims under Article I:1 of GATT 1994:

7.101 The February 1996 Programme and the June 1996 Programme provide benefits to certain Korean automotive parts and components and to certain Korean CBUs, respectively, that are not provided to like Japanese products, in violation of the most-favoured-nation obligation of GATT Article I:1.

- (a) Indonesia's actions in structuring, adopting, and expanding the National Car Programme ensures that Korean products receive tax and tariff benefits denied to Japanese Products and, thus, constitute the violation of GATT Article I
- (1) New evidence strengthens the Government of Japan's position that Indonesian Government measures deny MFN Treatment to Japanese products

7.102 Indonesia argues that the National Car Programme does not explicitly discriminate between Korean products and other imports, and that any advantage given to Korean products results from a private commercial arrangement and not from governmental action.

7.103 The Indonesian argument is wrong as a factual matter, because it is the Indonesian regulatory regime which created the discrimination against Japanese products. It is irrelevant for these purposes that the discrimination is not express on the face of Indonesian Government documents. The discrimination is plainly evident upon examination of the governmental measures and is an integral part of the National Car Programme. In receiving PT Timor's several applications, responding to them, and developing, implementing, and expanding the National Car Programme, Indonesia has not only known that the Programme would benefit Korean products and no other imports, but has also ensured that this would happen.

7.104 The Indonesian Government's central and essential role in the discriminatory measures has already been shown (See Section VII.A). The Japanese argument has been further strengthened by new evidence that has come to light.

7.105 The February 1996 Programme was designed and intended to accord benefits exclusively to PT Timor and Kia products. This was clear from PT Timor's application for Indonesian Government assistance in October 1995 and from subsequent correspondence between PT Timor and the State Minister for the Mobilization of Investment Coordinating Board.<sup>375</sup>

7.106 In particular, the "National Car Programme" began to be discussed at the latest in October 1995.<sup>376</sup> In particular, these proceedings have shown that Mr. Hutomo Mandala Putra, president director of PT Timor, sent a letter to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board on 12 December 1995 and requested import duty and luxury tax exemptions for PT Timor.<sup>377</sup> To this request, Minister Sanyoto Sastrowardoyo responded by letter of 27 December 1995 "we fully support your plan to immediately realize the project."<sup>378</sup> It is made even

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<sup>375</sup> See Application Letter dated 19 October 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board. (English translation) (Japan Exhibit-33, Indonesia Exhibit 25); Letter dated 12 December 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Coordinating Board. (English translation) (Japan Exhibit 34); Letter dated 27 December 1995 from Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board to Mr. Hutomo Mandala Putra, President Director of PT. Timor Putra Nasional. (English translation) (Japan Exhibit 35).

<sup>376</sup> Application Letter dated 19 October 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board. (English translation) (Japan Exhibit 33).

<sup>377</sup> Letter dated 12 December 1995 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board. (English translation) (Japan Exhibit 34).

<sup>378</sup> Letter dated 27 December 1995 from Mr. Sanyoto Sastrowardoyo, State Minister for the Mobilization of Investment Coordinating Board to Mr. Hutomo Mandala Putra, President Director of PT. Timor Putra Nasional. (English translation) (Japan Exhibit 35).

more clear by the State Minister's "Domestic Investment Approval" of 9 November 1995 (No.607/I/PMDN/1995 (11/09/95)), which the Government of Indonesia provided to the Panel.<sup>379</sup> That document, and its attachments, reveal that the Government of Indonesia approved PT Timor's production of automobiles in Indonesia more than three months before the announcement of the February 1996 Programme and expressly stated that "Kia technology [was] to be developed into local technology".

7.107 Another result of the advance coordination between PT Timor and the Indonesian Government is that only PT Timor was in a position to apply in a timely manner for Pioneer status under the February 1996 Programme. PT Timor applied for Pioneer status on 28 February 1996<sup>380</sup>, just one day after the Government of Indonesia enacted Decree of the State Minister for Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board No. 01/SK/1996<sup>381</sup>, which formally established the February 1996 Programme. On the same day, the Government of Indonesia first disclosed the February 1996 Programme by way of press release to the public and other automobile companies.<sup>382</sup> At the first Panel meeting, the Government of Indonesia revealed for the first time the decree granting Pioneer status to PT Timor (Ministry of Industry and Trade decree No.002/SK/DJ-ILMK/II/1996), which, oddly, was dated 27 February 1996, one day before PT Timor's application. Although the Government of Indonesia submitted the cover letter of the PT Timor's application as Attachment No. 14 of its First Submission, it failed to include the attachments thereto, which, according to the cover letter, set forth the details of PT Timor's working proposals, which cover such matters as share ownership, design and engineering, source of technology, development of production facilities, use of components, etc.<sup>383</sup> The Panel should infer from Indonesia's failure to submit PT Timor's working proposals that they further confirm that, from the beginning, the Indonesian Government and PT Timor worked hand-in-hand to develop measures that would funnel benefits exclusively to PT Timor and imports from Korea.

7.108 The June 1996 Programme was also designed and intended to accord benefits exclusively to PT Timor and Kia. The Government of Indonesia essentially concedes this point in its First Submission, admitting that the June 1996 Programme "was necessary because [PT Timor] needed to import built-up Timors to establish the required marketing network and introduce a national car to the Indonesian buying public prior to the time that domestic production feasibly could begin". (See Section II.B.2). Even more to the point, Indonesia has submitted a letter dated May 28, 1996, from PT Timor to the Indonesian Minister of Industry and Trade, which clearly states that PT Timor applied for the production of "motor vehicles under Timor S515 trade mark at Kia Motors Co. South

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<sup>379</sup> Indonesia Exhibit 15.

<sup>380</sup> See Letter (No.071/PD/TPN/II/96) dated 28 February 1996 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to State Minister for the Mobilization of Investment Funds / Chairman of the Capital Investment Co-ordinating Board. (Indonesia Exhibit 14).

<sup>381</sup> Japan Exhibit 29.

<sup>382</sup> Indonesian Observer, "Govt unveils new national car programme" (29 February 1996) (Japan Exhibit 70); The Asian Wall Street Journal, "Suharto Project For National Car shocks Industry - version of a Kia Sedan to be Called Timor, Son's Firm Benefits" (29 February 1996) (Japan Exhibit 71); Jakarta Post, "PT Timor given tax exemptions" (29 February 1996) (Japan Exhibit 40); Indonesian Observer "Car Producers 'surprised' by new govt ruling (29 February 1996) (Japan Exhibit 41); and Bisnis Indonesia, "Tunky: PT. Timor has Adapted Impres 02/1996, (29 February 1996). All of these news articles indicated that the press release announcing this programme was made on 28 February 1996. On 27 February 1996, two days before, a newspaper article reported the production of Kia- Timor cars in Indonesia, but this article did not refer to the National Car Programme at all. (Jakarta Post, Kia of S. Korea to produce cars in Indonesia (27 February 1996) (Japan Exhibit 72).

<sup>383</sup> **Indonesia** submitted the working proposals on 12 January 1998, in response to a request from **Japan**. (Indonesia Exhibit 46).

Korea, to be shipped to Indonesia, totalling 65,000 units of motor vehicles for 1996-1997."<sup>384</sup> The Government of Indonesia, under Ministry of Industry and Trade's Recognition as Registered Importer/ Sole Agent (IT/AT) of Motor Vehicles (Number: 1410/MPP/6/1996) dated 7 June 1996, approved PT Timor's request, specifically designating the Timor S515, with detailed specifications in its attachment, as the car that could be imported and sold free of duties and luxury taxes.<sup>385</sup> In taking this action, the Indonesian Government fully knew that the designated model was and would be manufactured solely at the Kia facilities in Korea and established a legal regime that ensured that only Korean products would benefit from the June 1996 Programme.

(2) The National Car Programme denies unconditional MFN treatment to Japanese products and ensures that Korean products receive tax and tariff benefits denied to Japanese products

7.109 The Indonesian argument is also wrong as a matter of law. Certain Korean automobiles and automotive parts and components have been imported into, and sold in, Indonesia at favourable tariff and tax rates that are not available to other imports under Indonesian law. That is the very definition of a denial of MFN treatment.

7.110 The Indonesian argument that the discrimination results from decisions of PT Timor is clearly wrong, because it is the government, not a private company, that sets the discriminatory tariff and luxury tax rates. PT Timor operates in the discriminatory environment created by the Indonesian Government. Moreover, it is clearly the Government of Indonesia, not PT Timor, that established the Presidential Decree that accords advantages to imported automobiles on the conditions that the exporting enterprise purchase certain amounts of Indonesian parts and components and employ Indonesian workers. As discussed (See Section VII.A), GATT Article I:1 requires any advantage to be accorded unconditionally. As the precedent cases show<sup>386</sup>, granting this kind of advantage conditioned upon certain requirements is clearly a "conditional" advantage within the meaning of GATT Article I:1. This means that, even if the advantage accorded to products from Korea were an advantage available to like products from all other WTO Members, subject to the same conditions, the National Car Programme would still violate GATT Article I:1.

(3) The Precedent GATT/WTO Cases Support Japan's Argument

7.111 Indonesia alleges that the precedent panel cases do not support Japan's argument that such governmental actions constitute a violation of GATT Article I:1. In reality, the GATT and WTO precedents also undercut the Government of Indonesia's position.

7.112 First, it should be noted that Indonesia itself concedes that previous panels have found violations of Article I:1 in circumstances where "despite the absence of explicit discrimination, a particular result was mandated by government action" or where a legal structure "in fact compelled or led to a particular result." As demonstrated (See Section VII.A), the National Car Programme provides exactly such a legal structure that compels or leads to a particular result, namely, granting

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<sup>384</sup> Letter dated 28 May 1996 from Mr. Hutomo M.P., President Director of PT. Timor Putra Nasional to Minister of Industry and Trade of the Republic of Indonesia (Indonesia Exhibit 18).

<sup>385</sup> The recognition of registered importer/sole agent (IT/AT) of motor vehicle (number: 1410/MPP/6/1997) and its attachment (Indonesia Exhibit 13).

<sup>386</sup> Panel Report on Belgian Family Allowances, G/32, adopted on 7 November 1952, BISD IS/94. Working Party Report on Accession of Hungary, adopted on 30 July 1973, BISD 20S/34.

advantages only to Korean products. Therefore, in its attempt to rebut Japan's arguments, Indonesia has instead conceded the point.<sup>387</sup>

7.113 It should be also recalled that the Appellate Body recently reconfirmed the importance of de facto as well as de jure non-discrimination. In Bananas III, the Appellate Body explicitly stated, "Article I and II of the GATT 1994 have been applied, in past practice, to measures involving de facto discrimination," referring to the panel report in European Economic Community - Imports of Beef from Canada.<sup>388</sup>

- (b) Indonesia's bizarre assertion that no goods are like Timors or parts and components for Timors is simply wrong

7.114 Indonesia contends that the complainants, including Japan, have failed to establish for purposes of Article I that there are any like products to the Timor sedans and the automotive parts and components used to assemble them. Indonesia's discussion of both the factual similarities and the relevant legal precedent is misleading and incorrect.

- (1) Japanese companies produce cars like imported National Cars from Korea

7.115 As discussed (See Section V.A.1), it is also virtually meaningless to discuss "likeness" in this case. The National Car Programme discriminates between certain Korean goods and all other imports based on whether or not they could be qualified as "National Cars," thus favouring only Korean products, and does not base its discrimination on any other characteristics of the products. Even if a product that is manufactured in Japan is identical to a product manufactured in Korea in connection with the National Car Programme, the Korean product would receive more favourable tariff and internal tax treatment than the Japanese product. Identical products are unquestionably like products, so there is no reason for further analysis of what characteristics make products like, when the measure at issue even discriminates between identical products.

7.116 Indonesia attempts to obfuscate the very clear discrimination embedded in its National Car Programme by arguing for a novel and extraordinarily narrow definition of "like product." Indonesia would have this Panel believe that the Timor S-515 sedan is so unique as to be "unlike" every other automobile in the world. If that position were adopted, Indonesia would be free to impose any discriminatory taxes or other discriminatory policies it saw fit against imported automobiles.

7.117 Indeed, the logic of the Indonesian position is that every car model is unique, so each and every WTO Member would be free to discriminate against any and all imported models. That position would effectively eliminate the core GATT disciplines of MFN treatment and national treatment from the automotive sector. Such a narrow view of "likeness" could also drastically limit the application of those GATT disciplines to all other manufactured products.

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<sup>387</sup> The Government of Indonesia also states that Japan "miscites" the US - Gasoline case, since "the decision declares that United States authorities must have foreseen that the two separate regulatory regimes that they had established were discriminatory." It further states, "[e]ven if certain Government officials were aware of TPN's corporate intention to use Kia as a supplier, the legal structure of the national car programme did not compel or lead to this private-party decision or to imports from Korea." However, again, it has already been fully demonstrated that the Indonesian authorities must have foreseen the discriminatory results and also that the legal structure of the National Cars Programme did compel and lead to the results. Therefore, the Government of Indonesia essentially admits its violation of GATT Article I.

<sup>388</sup> Appellate Body Report on Bananas III, para. 232.

(2) Japanese companies produce automotive parts and components like those imported from Korea for assembly of National Cars

7.118 Indonesia even goes so far as to claim that "there are no 'like products'" to "Timor components and parts." This claim is based on Indonesia's theory that no product can be like a customized component. The mere fact that a part or component is customized for assembly in a particular car model does not mean that it is *ipso facto* unlike other automotive parts and components. The reality is that a part or component may be customized only in a very minor respect and that a manufacturer can readily adapt a single standard part or component to customize it for a variety of car models.

7.119 Based on the Government of Japan's general understanding of the nature of automotive parts and components, it is true that automobile makers very often provide specifications for parts and components that are applied only for one model. Among automobiles of the same type or in the same class, however, power-related parts and components (such as engines, transmissions, and brakes), tires, batteries, wheels, lamps, seats, etc. are often interchangeable with only minor adjustments. Accordingly, when the specifications for the parts and components for particular models are determined, a single manufacturer may produce and supply parts and components adapted to the specific needs of a variety of models.

7.120 Under these circumstances, it is clear that, regardless of whether parts or components are "tailor-made" for a particular model, there often are many "like" products within a category of parts and components (such as engines, transmissions, brakes, etc.) that are produced by the same or other manufacturers for other models.

7.121 The Government of Indonesia may argue that the parts and components used for the assembly of Timors are different from this general characterization and are not interchangeable with minor adjustments from parts and components used in other models. Even if that were true, however, it would not mean that such products are necessarily "unlike" all other products within the meaning of GATT as alleged by Indonesia. Moreover, it would confirm Japan's argument that *de facto* the National Car Programme only benefits those parts and components imported from Kia Motors in Korea.

7.122 Thus, Japanese manufacturers may produce and ship the exact same parts and components with the necessary customization. However, the Indonesian measures would nevertheless provide less favourable treatment to the Japanese products, which cannot be used for assembling National Cars, than they accord to certain Korean products. In any event, the Government of Indonesia's theory regarding customized parts and components must fail to excuse all of the discrimination against imports, because by Indonesia's own admission the Timor S-515 does use some non-customized parts and components. (See Section VII.D.)

(3) Indonesia's Extremely Narrow View of "Like Products" Has No Support in the GATT/WTO Precedents

7.123 Indonesia offers no serious support for its extremely narrow conception of likeness. The only two GATT Panel decisions cited are wholly irrelevant. The Government of Indonesia cites Australian Subsidy on Ammonium Sulphate and EEC - Measures on Animal Feed Proteins<sup>389</sup>, for the proposition that the Article I concept of "like products" is narrower than the Article III concept of

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<sup>389</sup> Panel Report on Australian Subsidy on Ammonium Sulphate, adopted on 3 April 1950, GATT/CP.4/39; and Panel Report on EEC - Measures on Animal Feed Proteins, L/4599, adopted on 14 March 1978, 25S/49.



"like" or "directly competitive or substitutable products," which is perfectly obvious and has nothing to do with the scope of the "like products" concept itself. Thus, those cases dealt with completely different situations from the instant case.

(4) The limited sales of foreign CBUs in the Indonesian Market Do Not Justify Indonesia's discriminatory measures

7.124 Indonesia indicates that sales of foreign CBUs are limited in the Indonesian market, and thus Japan has no grounds for claiming harm. (See Section VII.D.) However, in fact, all that the sole data indicates is how effective Indonesia's measures have been in impeding the entry of imported sedans to Indonesia. Indonesia banned all sedan imports until 1993. The current tariff rate on CBU's is still prohibitive at 200 per cent ad valorem.

7.125 Needless to say, Japanese car manufacturers do produce, and have the capacity to export, various types of sedans which are almost the same as, and certainly "like", the Timor in every relevant respect, including engine displacement, dimensions, maximum power and so on.

7.126 It is true that few of these products were exported to Indonesia as of 1997, which is quite rational considering Indonesia's protective trade policies, such as the 200 per cent tariff rate. If ever the Government of Indonesia should stop imposing prohibitively high import tariffs and luxury taxes on these imported sedans, as it actually does for certain Korean sedans under the June 1996 Programme, Japanese car manufacturers can and will certainly start exporting them to Indonesia.

7.127 This means that the small number of like imported products has been created by the Government of Indonesia itself. In other words, what the Government of Indonesia is attempting to do in its submission is to justify its discriminatory National Car Programme by virtue of the small volume of imports, when that circumstance has been caused by the Government of Indonesia's own long-standing protective trade policies. Under Indonesia's reasoning, a WTO Member that maintains an import ban would be allowed to maintain it forever, because there would be no imports and so no other Member would have legal standing to challenge the import ban.

7.128 As a matter of course, previous Panels under GATT or WTO have never permitted this kind of justification. GATT Panels have held that a "demonstration that a measure inconsistent with [GATT Articles] has no or insignificant effects would ... not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired"<sup>390</sup>, which has been reaffirmed by the Appellate Body in the Bananas III case.<sup>391</sup> Moreover, in the Canada-Periodicals case where a tax policy was examined under GATT Article III:2, but imports of like products did not exist in the market because of the import prohibition, the Appellate Body, as well as the Panel, found that "hypothetical imports ... have to be considered."<sup>392</sup> The only alternative was to decline to examine the GATT Article III issue because of the non-existence of imports.

7.129 In the present case, it is quite apparent that a "hypothetical" viewpoint should also be taken for the sake of examining GATT Article I, instead of allowing trade-impeding measures to help GATT-inconsistent measures to evade WTO review.

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<sup>390</sup> See, in particular, Panel Report on United States - Taxes on Petroleum and Certain Imported Substances, L/6175, adopted on 17 June 1987, BISD 34S/136, para. 5.1.9.

<sup>391</sup> Appellate Body Report on Bananas III, paras. 252-253.

<sup>392</sup> Panel Report on Canada - Periodicals, para. 5.23. Appellate Body Report on Canada - Periodicals, p.19.

7.130 Finally, it should be also noted that Indonesia's argument is irrelevant with respect to automotive parts and components, as Japanese companies export substantial quantities of those products to Indonesia.<sup>393</sup>

(c) The June 1996 Programme is still valid and effective and can and should be reviewed by the Panel

7.131 **Japan** makes the following arguments, which are not limited to the context of Article I:1, but rebut Indonesia's arguments in general.

7.132 Indonesia seeks to remove the entire June 1996 Programme from the Panel's scrutiny by claiming that the Programme has expired. While Indonesia contends that the June 1996 Programme as a whole ended on 30 June 1997, the facts are clear that only the authorization to PT Timor to import National Cars duty free expired then. The Programme itself, including the luxury tax exemption for customers of PT Timor, remains in full force and effect, with the Government of Indonesia free at any time to make further authorizations. Moreover, even if the Programme actually expired at the end of June as alleged, this Panel has full authority to address the Government of Japan's challenges to the Programme. The Panel should exercise its authority, because not ruling here would encourage WTO Members to enact "one-time" measures, or declare that general measures have expired, to escape WTO review.

(1) The June 1996 Programme is still in full force and effect

7.133 Indonesia has conceded that Presidential Decree No.42 and Decree of Minister of Industry and Trade No.142/96 "have not been repealed by [any] positive action of the Indonesian Government". According to Indonesia's admission, these decrees "were drafted in general terms and applied to any national car company". A simple review of the decrees confirms that they have not expired by their terms, so they must remain in effect until "repealed by [a] positive action".

7.134 Even with respect to PT Timor, the measures still remain in effect. Because the luxury tax is collected at the time of sale, not at the time of importation, admitted by the Government of Indonesia, PT Timor will continue to benefit from the luxury tax exemption for its customers at least until such time as all 40,000 Imported National Cars have been sold. To the best knowledge of the Government of Japan, there are still thousands of Imported National Cars which remain unsold.

7.135 Further, the June 1996 Programme also should be regarded as remaining in effect from the viewpoint that the Government of Indonesia has not completed its compliance audit for the Programme, according to its admission at the first Panel meeting.<sup>394</sup>

7.136 In short, the June 1996 Programme is still operational and has not expired, contrary to the Government of Indonesia's recent allegation.

7.137 Indonesia alleges that its own previous statement that the "June 1996 Presidential Decree is still in effect ..." is irrelevant because it was made before 30 June 1997. That argument is wrong. Perhaps Indonesia has forgotten that it made this statement on 15 September 1997 - nearly three months after Indonesia now claims that the programme expired.

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<sup>393</sup> Japan Exhibit 76.

<sup>394</sup> As indicated in Section X.A, **Indonesia** has submitted evidence alleged to demonstrate that TPN failed the audit. (Indonesia Exhibit 47).

7.138 Even more striking, Indonesia has made an admission that completely undercuts its own argument. By conceding that over 17,000 Timors imported from Korea remain to be sold and that "the Government does not forego the luxury tax until each car is sold," Indonesia has admitted that the June 1996 Programme, at least in the context of the luxury tax exemption, is still in effect today.

(2) Even if the June 1996 Programme expired at the end of June 1997, the Panel can and should rule on it

7.139 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.<sup>395</sup>

7.140 This Panel was established on 12 June 1997, and the terms of reference were determined on the same date, in accordance with the requests of the Government of Japan and the European Communities. The Government of Japan's request for the establishment of a panel specifically referred to the June 1996 Programme and Indonesia has never expressed any objection to the terms of reference of this Panel. Although the terms of reference were slightly revised in July 1997, that revision was made only to accommodate the participation of the United States, and that revision does not affect the terms of reference of this Panel as far as the specific measures referred to by the Government of Japan are concerned.

7.141 Therefore, even if the June 1996 Programme expired on 30 June 1997, as Indonesia newly alleges, it is undisputed that the Programme was in effect when the Panel's terms of reference were fixed on 12 June 1997. Therefore, the Panel can and should rule on the Programme's inconsistency with Indonesia's WTO obligations.

(3) None of the precedent cases cited by Indonesia supports its argument

7.142 Indonesia cited three GATT Panel decisions in support of its contention that the Panel may not rule on "expired" measures. However, its citations are both misleading and inaccurate.

7.143 Indonesia cites EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile and Norway - Procurement of Toll Collection Equipment for the City of Trondheim<sup>396</sup> for its contention

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<sup>395</sup> Several panels have adjudicated claims involving measures that had expired or were no longer being applied, but that had been applied when the panel's terms of reference were fixed. See, Panel Report on United States - Measures Affecting Imports of Woven Wool Shirts and Blouses, WT/DS33/R, upheld by the Appellate Body, WT/DS33/AB/R, adopted on 23 May 1997 (ruling on a measure that was revoked after the Panel was established); Panel Report on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49 (ruling on discontinued measures that had terminated after the terms of reference of the Panel had already been agreed); Panel Report on United States - Prohibitions on Imports of Tuna and Tuna Products from Canada, adopted on 22 February 1982, BISD 29S/91, 106, para.4.3. (ruling on the GATT consistency of a measure withdrawn after establishment of the Panel but before agreement on the Panel's terms of reference); and Panel Report on EEC - Restrictions on Imports of Apples from Chile, adopted on 10 November 1980, BISD 27S/98 (ruling on a measure which had terminated before agreement on the Panel's terms of reference but was specifically included in the terms of reference). All these cases show that the Panel may rule on the consistency with WTO agreements of the measures that expired after the establishment of a Panel. The US - Gasoline Panel also supports this position by stating "it had not been the usual practice of a panel established under the General Agreement to rule on measures that, at the time the panel's terms of reference were fixed, were not and would not become effective," at para. 6.19. (Emphasis added).

<sup>396</sup> Panel Report on EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile (Dessert Apples)), L6491, adopted on 22 June 1989, 36S/93. Norway - Procurement of Toll Collection Equipment for the City of Trondheim ("Trondheim"), (GPR.DS2/R) adopted by the Committee on Government Procurement on 13 May 1992.

that Panels may not review the WTO consistency of expired measures. In fact, both Panel decisions flatly contradict the Government of Indonesia's position. Both Panels reviewed the expired measures and concluded that such measures violated obligations under GATT and the Agreement on Government Procurement, respectively. It should be especially noted that the Trondheim Panel stated:

[T]he panel also believed that, in cases concerning a particular past action, a panel finding of non-compliance would be of significance for the successful party: where the interpretation of the Agreement was in dispute, panel findings once adopted by the Committee, would constitute guidance for future implementation of the Agreement by Parties.

It was only after reaching these conclusions that the Panels declined to recommend compensation for the expired measures. But compensation is not at issue here. Rather, what Japan is asking this Panel is, like the Dessert Apples and Trondheim Panels, to find that Indonesia's measures are inconsistent with its WTO obligations.

7.144 The other Panel Report cited by Indonesia, Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes,<sup>397</sup> also fails to support its position. The passage cited by Indonesia does not discuss the issue of whether a Panel may review such measures. Instead, in circumstances where a Member repealed its GATT-inconsistent mandatory legislation, while leaving discretionary legislation that may be applied in a GATT-inconsistent manner, the Panel declined to find the discretionary legislation to be inconsistent with GATT as long as it was not applied in a GATT-inconsistent manner. The Panel did not reach any decision with respect to the expired legislation. But that is completely different from Indonesia's assertion that panels cannot or should not review expired measures.

7.145 In sum, none of the GATT panel precedents cited by Indonesia support its position.

(4) Indonesia's attempt to circumvent this Panel's review should not be allowed

7.146 Finally, the Panel should reject Indonesia's attempt to escape its review by recasting the June 1996 Programme as a one-time-only measure that has expired. Otherwise, the disciplines established through the past fifty year effort to liberalize global trade would be severely weakened. If a panel could not rule on the WTO consistency of a measure that was in effect when the panel's terms of reference were established merely because a Member informed the panel that the measure had "expired", without so much as formally revoking it, the ability of WTO members to evade WTO review is all too obvious. If this sort of evasion is tolerated, the Uruguay Round's historic effort to create an effective system for resolving trade disputes will be crippled, the WTO disciplines themselves will be gravely weakened, and the goals of the WTO will be frustrated.

## 2. Rebuttal Arguments made by the European Communities

7.147 The following are the **European Communities'** rebuttal arguments to Indonesia's responses to the claims under Article I:1 of GATT 1994:

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<sup>397</sup> Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, DS10/R, adopted 7 November 1990, 37S/200.

- (a) The fact that the authorisation granted to PT TPN expired in June 1997 does not prevent the Panel from ruling on the compatibility of that measure with Article I:1

7.148 According to Indonesia, the authorisation granted to PT TPN for importing duty free and tax free 45,000 passenger cars from Korea expired as of 30 June 1996. On that ground, Indonesia has requested the Panel to refrain from ruling on the compatibility of that measure with GATT Article I:1. The European Communities opposes that request and respectfully urges the Panel to rule on this claim, like on all the other claims contained in its terms of reference.

7.149 Although the above mentioned authorisation has expired, Presidential Decree 42/96, on the basis of which that authorisation was issued, still remains in force. Furthermore, both Presidential Decree 42/1996 and its implementing measure Decree 142/1996 are generally applicable regulations. Therefore, new authorisations may be granted in respect of other National Cars.<sup>398</sup>

7.150 Indonesia claims that “no comparable programme has been or will be authorised”. Yet, the wording of Presidential Decree 42/96 and Decree 142/1996 suggests that the Indonesian Government has no discretion to deny this benefit once a car has been certified as a National Car.<sup>399</sup> Moreover,

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<sup>398</sup> Indonesia disclosed the existence of a letter from the Ministry of Industry and Trade “denying National Car benefits for a Sportage-type vehicle”. (See Section VII.)

The basis for that decision is doubtful. It would appear that a Pioneer Company is not required to have each of its models recognised as a National Car by means of a specific decision. At the very least, Indonesia has not disclosed any such decision recognising the Timor S-515 as a National Car. The record only contains a decision of the Director General for Metal, Machinery and Chemical Industries No 002/SK/DJ-Ilmk/II/1996 (Indonesia Exhibit 41) appointing PT TPN as a Pioneer Company and a subsequent decision of the State Minister for Mobilisation of Investment Funds (Decree 02/SK/1996, EC Exhibit A-11) confirming that appointment.

Indonesia has admitted that no formal decision recognising the Timor S-515 as a National Car had been issued. Nevertheless, Indonesia made the extraordinary argument that the decision to limit the grant of National Car status to the Timor S-515 is “inherent” in the title of Decree 02/SK/1996 which, according to the translation of that decree provided by Indonesia, reads “The determination of PT Timor Putra Nasional to Establish and Produce A National Car”. In this regard, it is worth noting that according to the translation of that Decree submitted by the European Communities (Exhibit EC A-11), which was made *in tempore non suspecto* by what Indonesia describes elsewhere as a “private entity”, the title of Decree 02/SK/1996 is “Stipulation of PT Timor Putra Nasional to develop and produce National Cars”. Identical formula is used in Article 1 of the same Decree. Note also that Indonesia’s own description of the document in the Index of Attachments of its First Submission reads “Confirmation of PT Timor Putra Nasional as the Company to Develop and Produce National Automobiles.”

Even if the Sportage was not granted National Car benefits, other models produced by PT TPN or by Bimantara (whose application for Pioneer status is still under consideration) can still be granted those benefits.

<sup>399</sup> Article 1 of Presidential Decree 42/96 reads as follows:

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

This wording only leaves discretion to the Minister of Industry and Trade for stipulating the level of local content. There is no indication that the Indonesian authorities may refuse the benefit to a car previously certified as a National Car (assuming that such certification is necessary. See the previous footnote)

Article 2 of Presidential Decree 42/1996 is also drafted in mandatory terms:

“The equal treatment contemplated in Article 1 is granted only once for a maximum period of one year and for amounts to be stipulated by the Minister of Industry and Trade”

Again, the Minister of Industry and Trade is left discretion to stipulate the “amounts”, but there is no indication that the benefit can be refused. The term “once” is ambiguous. It could mean that the benefit is granted only once in respect of each National Car or only once to each Pioneer Company. The interpretation now made by Indonesia, according to which “once” means that the Government of Indonesia will grant no new authorisation to import National Cars duty and tax free is contrived and unconvincing. It suffices to note that the last day of the one-year period (30 June 1997) was not specified in Presidential Decree 42/1996

these assurances appear to be contradicted by the fact that neither Presidential Decree 42/96 nor Decree 142/1996 have been repealed.

7.151 Furthermore, it is important to note that, in accordance with Article 2 of Decree 42/96 any further authorisations will have, like the one granted in respect of the Timor S-515, a duration of only one year. Therefore, any such authorisation will have expired before a new Panel has time to rule on it.

7.152 The European Communities's request that the Panel rule on the expired measure is supported by prior Panel decisions. Under GATT 1947, several panels<sup>400</sup> considered measures that were no longer in force in cases where, as in the present case, the measures were still in force at the time the Panel was established<sup>401</sup> and the terms of reference set and/or where there was a threat of recurrence.

7.153 This practice has continued under the WTO Agreement. In US - Standards for Reformulated Gasoline<sup>402</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 decided 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 United States restraint"<sup>403 404</sup>

(b) It is irrelevant that the Indonesian Government did not mandate expressly PT TPN to import automobiles or parts originating in Korea

7.154 There is ample and indisputable evidence that the Indonesian Government (and not merely "certain officials") (See Section VII:D) was perfectly aware that PT TPN would take advantage of the

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or in any other generally applicable measure known to all potential beneficiaries of Presidential Decree 42/1996 but only in the import authorisation given to PT TPN in the "Recognition of Registered Importer/Sole Agent, file number 1410/MPP/6/1996".

<sup>400</sup> See for instance the Panel Report on EEC - 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.

Although the defendant claims that "prior Panel decisions support the refusal to rule on an expired Measure", it can point but to a single instance where a Panel decided not to rule on a measure withdrawn after the establishment of the Panel, namely the Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, adopted 7 November 1990, BISD 37S/200. That Panel report stands out as an aberration and subsequent decisions by WTO Panels dealing with the same issue do not refer to it.

<sup>401</sup> The Panel requested by the European Communities was established by the DSB at its meeting of 12 June 1997 (see WT/DS55/7, WT/DS64/5 and WT/DS54/7).

<sup>402</sup> Panel report on United States - Standards for Reformulated Gasoline, WT/DS2/R, adopted on 20 May 1996, para 6.19

<sup>403</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>404</sup> In Argentina - Certain measures affecting Imports of Footwear, Textiles, Apparel and Other Items (WT/DS56/R, at pp 83-86, unadopted) 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 Panel was established. The Panel also noted that there was no evidence that the measure would be re-introduced.

measures in dispute to import the Timor S-515 (and subsequently parts and components thereof) from Korea, and not any other passenger car from any other Member:

- the sole owner of PT TPN had set up a joint venture with KIA to assemble KIA cars in Indonesia already in 1993. That joint venture obtained an investment permit from the Indonesian Government.<sup>405</sup>
- the investment approval issued to PT TPN by the Indonesian Government on 9 November 1995 states expressly that the passenger cars to be assembled at Karawang Plant "will use KIA technology to be developed into local technology".<sup>406</sup>
- by letter addressed to the State Minister for the Mobilisation of Investment Funds on 12 December 1995, PT TPN requested approval of a programme "to realise the national automobile project". That programme envisaged *inter alia* the importation of motor vehicles manufactured by KIA in Korea as well as the importation, at a subsequent stage, of parts and components supplied by KIA for the assembly of cars in Indonesia.<sup>407</sup>
- by letter dated 28 May 1996, PT TPN requested authorisation to "produce motor vehicles under Timor S-515 trade mark at KIA Motor Co. South Korea, to be shipped to Indonesia ..." <sup>408</sup>
- the "Recognition of Registered Importer/Sole Agent"<sup>409</sup> issued to PT TPN on 7 June 1996 does not specify the source of the imports. Nevertheless, that recognition was issued in response to PT TPN's letter of 28 May 1997. Moreover, the specifications attached to the Recognition correspond to those of the KIA Sephia.

7.155 It is of course impossible for the European Communities to ascertain whether, in addition to being aware of PT TPN's choice and of its consequences, the Indonesian Government directed or influenced that choice. Given the importance attached by the Government of Indonesia to the National Car Programme, it is hard to believe that it had no saying in such a crucial issue as the choice of KIA. Furthermore, the facts of this case which have been disclosed until now by Indonesia evidence that throughout the process of conception and implementation of the National Car Programme, private and government action have been so timely and harmoniously concerted as to be almost indistinguishable. PT TPN requested approval for developing a National Car before such a programme existed.<sup>410</sup> When the National Car Programme was eventually approved, it provided benefits which corresponded precisely to those requested by PT TPN several months before. Even more extraordinary, PT TPN was granted Pioneer Status by the Ministry of Industry and Trade<sup>411</sup> just a few days after the adoption

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<sup>405</sup> The European Communities has never referred to PT TPN as a joint venture with KIA. The European Communities notes that Mr Hutomo Mandala, the sole owner of PT TPN, and KIA had established a joint venture in 1993 called PT Indauda Putra Nasional Motors. During the first meeting with Panel, the Government of Korea admitted the existence of some kind of joint venture arrangement between KIA and PT TPN. (See Section XII.B).

<sup>406</sup> Indonesia Exhibit 15.

<sup>407</sup> Indonesia Exhibit 24

<sup>408</sup> Indonesia Exhibit 18.

<sup>409</sup> Indonesia Exhibit 13

<sup>410</sup> Indonesia Exhibit 24

<sup>411</sup> Indonesia Exhibit 41. This decision was disclosed by Indonesia only during the First Meeting with the Panel. According to Indonesia, it was "overlooked including it in the list of translated documents". In fact, however, the existence of this decision had not been mentioned by Indonesia. Indonesia instead said that PT TPN was designated as a Pioneer Company on 5 March 1997 by means of Decree 02/SK/1996.

of the Programme<sup>412</sup> and before PT TPN had time to file its formal request.<sup>413</sup> A similar sequence of facts took place in May/June 1996. On 28 May 1996 PT TPN asked authorisation to “produce” National Cars in Korea.<sup>414</sup> On 6 June 1996, the Government approved Presidential Decree 42/96 creating that possibility. The next day, the Ministry of Trade and Industry granted PT TPN’s request of 28 May 1996.<sup>415</sup>

7.156 In any event, whether or not PT TPN’s choice was free or was influenced by the Indonesian Government is ultimately irrelevant. The measure attacked by the European Communities is not PT TPN’s choice but the legal consequences knowingly and willingly attached by the Indonesian Government to that choice. The existence of a de facto violation of GATT Article I:1 is not dependent upon the content of PT TPN’s choice. If instead of teaming-up with KIA, PT TPN had chosen a Japanese partner, the scheme put in place by the Indonesian Government would still have led necessarily to the same consequence that only imports from a Member would have benefited from the tariff and tax preferences.<sup>416</sup>

(c) The automobiles and parts covered by the measures are like any other automobiles and parts

7.157 Indonesia’s allegation that the Timor S-515 is not like any of the cars imported from the European Communities is not only factually incorrect (See Section V.A.2) but also totally irrelevant. In order to establish a violation of GATT Article I:1 the European Communities is not required to show that the measure concerned has had any actual effects on its exports to Indonesia. Instead, it is sufficient for the European Communities to show that if a “like” product had been exported from the European Communities it would have not benefited from the same advantages as the Timors S-515 imported from Korea.

7.158 The tariffs and tax benefits granted by Indonesia to the Timors S-515 imported from Korea are based on three conditions:

- first, the cars must be National Cars manufactured by, or at least for, a Pioneer company;
- second, they must have been manufactured with the participation of Indonesian nationals;
- third, they must incorporate a certain percentage of counter-purchased parts and components imported from Indonesia.

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<sup>412</sup> In contrast, Bimantara’s application is still awaiting a formal reply, more than one year after it was filed. PT Multimotor France’s request was never answered.

<sup>413</sup> Indonesia Exhibit 14

<sup>414</sup> Indonesia Exhibit 18

<sup>415</sup> Indonesia Exhibit 13

<sup>416</sup> Indonesia’s attempt to distinguish the present case from EC - Imports of Beef from Canada (adopted 10 March 1981, BISD 28S/92) and Spain - Tariff Treatment of Unroasted Coffee (adopted on 11 June 1981, BISD 28S/102) fails. It is obvious that “in none of them was the choice of the supplier made by the private party recipient of the subsidy found to constitute government-mandated de facto discrimination”, since none of those two cases involved any subsidy! Instead, it is more relevant to note that the Spanish Government did not have more “direction” over the varieties of coffee grown by the favoured Colombian producers than the Indonesian Government had over PT TPN’s allegedly private choice. In both cases, the Government relied on a fact which was not under its control but which was known to it in order to apply a measure that had the necessary result of benefiting only imports from a certain source.



7.159 It is obvious that none of the above three conditions affects *per se* the physical characteristics of the National Cars, nor therefore makes those cars unlike any other cars which are or may be exported from the European Communities. A passenger car manufactured in the European Communities which is identical in all respects (and therefore indisputably “like”) to the Timors S-515 imported by PT TPN would still be refused the tariff and tax exemptions provided by presidential Decree 42/1996, simply because it is not a National Car manufactured by/for PT TPN.

7.160 Indonesia also alleges that 93 per cent of the parts for the Timor S-515 are tailor made for that model. Hence, according to Indonesia, they are not “like” parts for other cars, which are also customised. This argument cannot be accepted. It would lead to the absurd result that even if two cars were “like” when imported in assembled state, their individual parts and components could never be considered as “like” when imported separately. If upheld, Indonesia’s argument would make possible for a Member to apply as many different import duty rates on a certain type of parts as models of cars are assembled within its territory. Carried to its logical conclusion, Indonesia’s reasoning would have the effect of placing all the trade on customised parts and components beyond the reach of the numerous WTO rules, including some of the most basic ones, which rely upon the notion of “like product”. For that reason, the EC considers that customised parts and components, including those for the assembly of cars, must be deemed “like” if they are sufficiently similar in terms of physical characteristics and end uses, even if they are not interchangeable. For these purposes, two customised parts should be considered as having sufficiently similar end-uses when they are intended for use in products which are themselves “like”.

### 3. Rebuttal Arguments of the United States

7.161 As demonstrated (See Section VII.C) Indonesia violated Article I:1 of GATT 1994 when it authorized, for a period of one year, the importation and sale in Indonesia of completely built-up Kia Sephia sedans free of Indonesia’s 200 per cent tariff and 35 per cent luxury tax.<sup>417</sup> In its first submission, Indonesia offered three arguments in response, none of which has merit.

#### (a) The One-Year Exemption Is Not a "Dead Measure"

7.162 Indonesia’s first argument is that the one-year authorization has expired because TPN may not import any additional tax- and duty-free Sephias. Thus, according to Indonesia, the one-year authorization has expired (or, in trade law jargon, is a “dead measure”) and the Article I:1 claim is moot.

7.163 As a factual matter, this argument is incorrect. Although it may be true that TPN is not authorized to import additional tax- and duty-free Sephias for the moment, this does not mean that the relevant measures are no longer in effect. With respect to the exemption of these Sephias from the luxury tax, there are a host of Sephias that were imported under the one-year authorization, but that remain unsold. In its Annex V response, Indonesia stated that these Sephias would be exempt from the luxury tax when they are sold.<sup>418</sup>

7.164 Likewise, the tariff incentives are still in effect. It has been widely reported that as a condition for receiving the one-year authorization, TPN was required to satisfy the first-year 20 per cent local content requirement of the National Car Programme.<sup>419</sup> In addition, TPN was required to post a bank guarantee to the Direktorat General of Customs to guarantee repayment of the foregone

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<sup>417</sup> The United States noted that with respect to Indonesia’s violation of Article I:1, the United States, at the second meeting of the Panel, agreed with the points made by Japan and the European Communities.

<sup>418</sup> AV/15, United States follow-up question #12/27, and Indonesia’s response thereto in AV/16.

<sup>419</sup> US Exhibit 23.

duties if the Kia Timor venture failed to meet the 20 per cent requirement. These reports are consistent with Decree 82/1996 and Decree 36/1997, both of which refer to possible repayment by the national car company if local content levels are not met and to a requirement to submit a bank guarantee to Indonesia authorities to ensure such repayment.<sup>420</sup>

7.165 A statement in Indonesia's initial Annex V response refers to the bank guarantee, and states that "the subsidy will be granted after the auditing of local content [is] achieved."<sup>421</sup> In addition, at the first meeting of the Panel, the Indonesian representatives confirmed that the audit had not been completed. What this means is that as of December 4, 1997, well after this Panel was established, the one-year tariff incentives conferred on TPN remained conditional, and could be recouped by the Government if TPN and Kia Timor failed the audit.

7.166 In short, the measures authorizing the one-year tax- and tariff-incentives are still operational and have not expired.

7.167 Moreover, Indonesia's assertion that it will not grant such exemptions in the future is carefully worded. In its responses to questions 3(1) and 3(2) from Japan (Indonesia Exhibit 43), Indonesia says that it will not grant any future tariff and tax exemptions under Presidential Decree No. 42/96. These responses do not rule out the authorization of future tariff and tax exemptions new decrees. Given the apparent ease with which such decrees can be issued, the Panel should rule on the complainants' Article I claims to ensure that Indonesia is put on notice that the authorization of similar exemptions in the future constitutes a violation of Article I.

7.168 Moreover, as a legal matter, previous panels have reviewed the consistency of measures that ceased to be effective after the date on which a panel and its terms of reference were established.<sup>422</sup> In this case, the measures in question continue to be effective well after the date on which this Panel and its terms of reference were established.

(b) Indonesia conferred an advantage to a country

7.169 Indonesia also argues that it did not violate Article I:1 because it allegedly did not grant an advantage to automobiles originating in Korea. Instead, according to Indonesia, TPN was free to import duty- and tax-free cars from whatever source it chose.

7.170 This assertion simply is contradicted by the facts. The document authorizing these importations, Decree No. 1410/MPP/6/1996, did not permit TPN to import any passenger car it chose, but instead expressly authorized only the importation of the "TIMOR Sedan/S515 - 1500cc.". Moreover, as Indonesia admits:

This treatment was necessary because TPN needed to import built-up Timors to establish the required marketing network and introduce a national car to the Indonesian buying public prior to the time that domestic production could begin.<sup>423</sup>

This objective could be accomplished only by the importation of Kia Sephias from TPN's joint venture partner, Kia Motors of Korea. It could not have been accomplished by importing and selling, for example, GM Opels, Ford Escorts, or Chrysler Neons. To paraphrase Indonesia's own statement

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<sup>420</sup> Indonesia Exhibits 21 and 9.

<sup>421</sup> AV/14, Attachment U-16/1.

<sup>422</sup> United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India, WT/DS33/R, Report of the Panel adopted on 23 May 1997, para. 8.1; and EEC - Measures on Animal Feed Proteins, Report of the Panel adopted on 14 March 1978, BISD 25S/49.

<sup>423</sup> See section VII.D.3(b).

regarding the Reformulated Gasoline case, the Indonesian authorities must have foreseen that the regime they were establishing was discriminatory.

7.171 In this regard, the Appellate Body recently reaffirmed the importance of the principle of de facto, as well as *de jure*, non-discrimination. In Bananas III, the Appellate Body stated the following in connection with the MFN obligation under Article II of GATS: “Moreover, if Article II was not applicable to de facto discrimination, it would not be difficult ... to devise discriminatory measures aimed at circumventing the basic purpose of that Article.”<sup>424</sup> Here, Indonesia has attempted to circumvent the basic non-discrimination principle of Article I of GATT 1994.

7.172 One issue that Japan and the European Communities did not address is Indonesia's argument that TPN, not Kia, was the beneficiary of Decree No. 42/96, and that Kia received no benefit other than being paid by TPN as one of its suppliers. First, the United States would note that Article I applies to products, not business entities. Nevertheless, in the view of the United States, being paid for products one supplies constitutes an advantage, favour, or privilege within the meaning of Article I:1, particularly when the ability to be paid is attributable to a special exemption from tariffs and taxes that is not extended to suppliers from other countries. Accepting Indonesia's arguments would open up a tremendous loophole in Article I, because one always could argue that those advantaged by non-MFN behaviour are importers rather than suppliers.

(c) The passenger cars in question are like products to the Kia Sepia Sedan

7.173 Finally, Indonesia asserts that the complainants have failed to establish for purposes of Article I that there is any “like product” to the Timor Kia Sephia sedan. Arguing that passenger vehicles are highly differentiated, Indonesia asserts that: “There simply is no car that matches the requisite physical and nonphysical characteristics of the Timor S515 to be considered a ‘like product’ to it.” (See section VII.D.2(c).)

7.174 To the contrary, the United States provided more than enough evidence in its first submission to establish that GM Opels, Ford Escorts, and Chrysler Neons are “like products” to the Timor Kia Sephia. Indonesia has not provided any evidence to the contrary, but simply has asserted that there is no passenger car “identical” to the Sephia. However, product identity is not required for purposes of a “like product” analysis under Article I, especially in the case of consumer products, such as passenger cars, that by their very nature will be differentiated from one another for reasons of product competition. If product identity were required, Article I would be a dead letter in the case of consumer products.<sup>425</sup>

## VIII. CLAIMS UNDER THE SCM AGREEMENT

8.1 The **European Communities** and, in its request for the establishment of a panel, the **United States**, both claim that the measures under the 1993 programme and the National Car programme cause serious prejudice to their interests in the sense of Article 6 of the SCM Agreement. However, in its first submission, the United States clarified that it was limiting its claim of serious prejudice to subsidies provided under the National Car programme. In addition, the **United States**

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<sup>424</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. 233.

<sup>425</sup> In this regard, in Japan - Taxes on Alcoholic Beverages, WT/DS8/AB/R, Report of the Appellate Body adopted 1 November 1996, p. 24, the Appellate Body affirmed the panel's finding that shochu and vodka are “like products” for purposes of Article III:2, first sentence, a provision that the Appellate Body stated should be narrowly construed. Anyone who has tasted shochu and vodka knows that those two beverages are not “identical.”

claims that, in modifying the 1993 programme, and adopting the National Car programme, Indonesia has violated Article 28.2 of the SCM Agreement.

8.2 In this dispute, all parties making arguments concerning serious prejudice (i.e., the **European Communities** and the **United States** in their claims, and **Indonesia** in its responses) agree that the tariff and tax measures under the 1993 programme and the National Car programme are specific subsidies. The **United States** and **Indonesia** disagree as to whether the \$690 million loan is a specific subsidy. The following are the parties arguments in this regard:

A. Existence of specific subsidies

1. The measures at issue are subsidies

(a) Arguments of the European Communities

8.3 The following are the **European Communities'** arguments that the measures at issues are "subsidies" within the meaning of Article 1 of the SCM Agreement:

8.4 Article 1.1 of the SCM Agreement states in the relevant part that:

For the purposes of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a Government or any public body within the territory or any body within the territory of a Member .... i.e. where:

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);

and

(b) a benefit is thereby conferred

8.5 The measures at issue provide for the granting of three types of incentives:

- customs duty relief for parts and components intended for assembly into National cars;
- exemption from the Sales Tax on Luxury Goods for National Cars; and
- customs duty relief for National Cars imported from Korea.

8.6 Both the customs import duties and the Sales Tax on Luxury Goods are imposed, collected, and appropriated by the Indonesian Government. Accordingly, they constitute "Government revenue".

8.7 The importation into Indonesia of motor vehicles and of parts and components thereof is legally subject to the payment of customs duties. Likewise, sales of passenger cars are legally subject to the payment of the Sales Tax on Luxury Goods. Thus, by granting the incentives under consideration, the Government of Indonesia is "foregoing revenue" that would otherwise be "due".

8.8 The measures provide a direct "benefit" to those persons and entities that, in the absence of the incentives, would be responsible for the payment of the duties/taxes, i.e. to PT TPN. For the

above reasons, it must be concluded that the incentives provided under the National Car Programme constitute “subsidies” in the sense of Article 1 of the SCM Agreement.

(b) Arguments of the United States

8.9 The **United States** argues that the tariff and tax incentives and the government-directed \$690 million loan under the National Motor Vehicle programme constitute subsidies within the meaning of Article 1.1 of the SCM Agreement. The following are the **United States'** arguments in this regard:

8.10 The tariff and tax incentives and the government-directed \$690 million loan to TPN under the National Motor Vehicle programme constitute subsidies within the meaning of Article 1.1 of the SCM Agreement, because they each entail (1) a financial contribution; and (2) the conferral of a benefit.

8.11 With respect to the tariff and tax incentives, the Government of Indonesia admits that these incentives constitute subsidies. (See e.g., Section VII.C.) However, independent of this admission, these tariff and tax incentives meet the definition of a subsidy under Article 1.1. The exemption from import duties on parts used to produce the “national motor vehicle” (the Timor Kia Sephia sedan), the one-year exemption from duties of CBU Kia Sephia sedans imported from Korea, and the effective exemption from the luxury tax on sales of Timor Kia Sephia sedans (whether imported in CBU form from Korea or assembled in Indonesia) clearly constitute “government revenue that ... is foregone” within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. As such, they constitute a “financial contribution.” Moreover, they confer a benefit by lowering the recipient’s costs and allowing the product in question, the Timor Kia Sephia sedan, to be sold at a lower price than would be the case absent the tariff and tax exemptions.

8.12 With respect to the government-directed \$690 million loan, the loan falls under Article 1.1(a)(1)(iv), which defines a “financial contribution” as existing where:

a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments ... . (emphasis added).

As described above, the evidence is overwhelming that the Government of Indonesia directed the consortium of government-owned and private banks to provide the \$690 million loan to TPN. In so doing, the Government was directing a private body to carry out the function illustrated in Article 1.1(a)(i); i.e., to provide a concessional loan. Such concessional financing normally is provided by government lending institutions or other public bodies.

8.13 Finally, the government-directed loan conferred a benefit on TPN. By ordering the banks to lend to TPN, the Government conferred two types of benefits on TPN: (a) TPN received financing that it otherwise would not have been able to obtain; and (b) even assuming that TPN could have received financing of a comparable size, the terms of the financing were more favourable than the terms that TPN would have received absent the Government’s involvement. (See Section V.C.3).<sup>426</sup>

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<sup>426</sup> Indonesia disputes the fact that the \$690 million government-directed loan to TPN is a subsidy, but has not provided any evidence that the loan is not a subsidy. Instead, Indonesia makes the bare assertion that the GOI had no role in the granting of the loan, but that the GOI since has done an independent investigation and determined that the loan was granted on commercial terms. However, Indonesia does not offer any evidence to support its assertions or to rebut the evidence provided by the United States in its first submission.

(c) Arguments of Indonesia

8.14 **Indonesia** also argues that the measures at issue are subsidies in the sense of Article 1 of the SCM Agreement. These arguments are set forth in part in Section V.D. See also Indonesia's further arguments in this regard in Section VIII.A.3, below.

2. The measures at issue are specific

(a) Arguments of the European Communities

8.15 The **European Communities** argues that the subsidies are contingent upon compliance with local content requirements and, accordingly, are "specific" in the sense of Article 2 of the SCM Agreement. The following are the **European Communities'** arguments in this regard:

8.16 Article 1.2 of the SCM Agreement stipulates that:

A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

8.17 According to Article 2.3 of the SCM Agreement,

Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

8.18 Article 3.1 of the SCM Agreement then states that:

3.1 .... the following subsidies within the meaning of Article 1, shall be prohibited:

(b) subsidies contingent, whether solely or as one of several other conditions upon the use of domestic over imported goods

8.19 The grant of duty relief on imports of parts and components is contingent upon the finished vehicle or the parts and components into which the imported goods are assembled reaching a minimum local content percentage. Similarly, the grant of the exemptions from the Sales Tax on Luxury Goods is conditional upon the motor vehicles concerned meeting certain local content requirements. Finally, the grant of duty relief for imports of National Cars is conditional upon the overseas manufacturer of the cars purchasing a certain amount of Indonesian parts and components and incorporating them into the products exported to Indonesia.<sup>427</sup> Thus, three types of incentives at issue are "contingent upon the use of domestic over imported goods" within the meaning of

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In this regard, while the Panel has ruled that the US claims concerning the loan are inadmissible, the loan remains relevant to this case. Cf., Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, WT/DS56/R, Report of the Panel issued 25 November 1997, para. 6.15. Indonesia asserted at the first meeting of the Panel that after TPN's start up phase, the "market will determine the winners and the losers, as it should". Indonesia Statement to the Panel, page 2. This statement is simply contradicted by the fact that the GOI ordered a consortium of banks to provide a \$690 million loan to TPN on preferential terms. The loan is a subsidy, and, with a 10-year term, has a 10-year allocation period. In other words, TPN will be deemed to be receiving subsidies from the loan for the next ten years. The existence of the loan belies Indonesia's claim that, as of 1999, the "market" will determine the winners and losers. Moreover, Indonesia's claim that the GOI played no role in the provision of the loan is so at odds with the reported facts that it calls into question the credibility of other factual assertions made by the GOI in this case.

<sup>427</sup> This incentive could also be characterised as a subsidy contingent upon export performance of the type prohibited by Article 3.1 (a) of the SCM Agreement.

Article 3.1 (b) and, accordingly, must be deemed “specific” in the sense of Articles 1.2 and 2 of the SCM Agreement.

8.20 Even if the subsidies at issue were not contingent upon the use of domestic over imported goods, they would still be “specific” pursuant to Article 2.1 of the SCM Agreement, since eligibility is limited to certain enterprises belonging to a certain industry and which meet certain non objective criteria. Furthermore, the decision whether to grant the subsidies is a discretionary one and, in practice, the benefits have been granted to only one enterprise: PT TPN.

8.21 Indonesia does not dispute that the measures are “specific subsidies” subject to the provisions of the SCM Agreement. Indeed, the measures were notified by Indonesia pursuant to Article XVI:1 of the GATT and Article 25 of the SCM Agreement on 28 October 1996, simultaneously with Indonesia’s withdrawal of its previous notification of some of the measures under the TRIMs Agreement.<sup>428</sup> Furthermore, in connection with this dispute, Indonesia admits that the measures at issue constitute subsidies contingent upon local content.

8.22 The **European Communities** also argues that Indonesia admitted during consultations that the June 1996 programme as well as the February 1996 programme are specific subsidies.<sup>429</sup>

(b) Arguments of the United States

8.23 The **United States** argues that the tariff and tax benefits and the government-directed \$690 million loan under the National Motor Vehicle programme are specific within the meaning of Article 2 of the SCM Agreement. The following are the **United States'** arguments in this regard:

8.24 Under Article 1.2 of the SCM Agreement, in order for a subsidy to be actionable under Part III of the SCM Agreement, the subsidy must be “specific in accordance with the provisions of Article 2”. The tariff and tax subsidies and the government-directed \$690 million loan under the National Motor Vehicle programme meet the specificity requirements of Article 2.

8.25 First, each of these subsidies is specific under Article 2.3, which provides: “Any subsidy falling under the provisions of Article 3 shall be deemed to be specific”. Because the tariff and tax subsidies under the National Motor Vehicle programme are contingent on satisfying the local content requirements for a “national motor vehicle”, these subsidies fall under Article 3.1(b) of the SCM Agreement, which refers to “subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods”. Likewise, the government-directed \$690 million loan also falls under Article 3.1(b), because the evidence overwhelmingly demonstrates that the Government ordered the provision of the loan due to TPN’s status as a participant in the production of

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<sup>428</sup> G/SCM/N/16/IDN. See also G/SCM/Q2/IDN/9 dated 23 May 1997

<sup>429</sup> Thus, for instance, in reply to a written question from the Community, Indonesia stated that:

Under both the February 1996 and the June 1996 decrees, instructions and regulations, companies that satisfy the designated criteria are exempted from the luxury tax and customs import duties. All of the requisite elements of a subsidy are involved: a financial contribution by the government by virtue of revenue foregone; a benefit to the recipients by virtue of exemption from the luxury tax and customs import duties, and specificity, by virtue of limitation of the subsidy to those companies that meet the criteria of the February 1996 and the June 1996 decrees, instructions and regulations. Among the criteria for receipt of subsidies under the February 1996 and the June 1996 decrees, instructions and regulations is the obligation to achieve designated rates of local content. This constitutes ‘subsidies contingent .... upon the use of domestic over imported goods’ within the meaning of Article 3.1 (b) of the SCM Agreement. See also Indonesia’s replies to questions from the Community, dated 25 November 1995, at points 2.a, 5.h, 5.I, and 6.I. (EC Exhibit B-4)

a “national motor vehicle.” This status, in turn, was contingent on the satisfaction of the local content criteria of the National Motor Vehicle programme.

8.26 Second, these subsidies also are specific under Article 2.1 of the SCM Agreement, which sets forth criteria for determining specificity with respect to subsidies other than prohibited subsidies and regional subsidies.<sup>430</sup> Article 2.1 provides as follows:

In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as “certain enterprises”) within the jurisdiction of the granting authority, the following principles shall apply:

- (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.
- (b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.
- (c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation. (footnotes omitted).

8.27 With respect to the tariff and tax subsidies, these are specific under paragraph (a), because Presidential Instruction No. 2/1996 and the various implementing decrees and regulations limit access to these subsidies to producers of motor vehicles. In other words, the subsidies are limited to a single industry, the automotive industry.

8.28 Finally, the tariff and tax subsidies are specific under paragraph (c). These subsidies are used only by Kia Timor and TPN, which clearly constitute “a limited number of certain enterprises” within the meaning of paragraph (c), second sentence. Moreover, the decision to limit these subsidies to Kia Timor and TPN constitutes the exercise of discretion within the meaning of paragraph (c), second sentence. The only explanation given for limiting these subsidies to Kia Timor and TPN is that it is the Government of Indonesia’s policy to do so. If true, this type of exercise of a government’s policy prerogatives is the paradigm of a discretionary decision.

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<sup>430</sup> Regional subsidies are dealt with in Article 2.2.



8.29 With respect to the government-directed \$690 million loan, the evidence demonstrates that this loan was "special credit" provided to a single firm, TPN.<sup>431</sup> At a time when the Government of Indonesia was clamping down on credit and cancelling other large projects<sup>432</sup>, TPN was able to obtain a massive loan package on very favourable terms that would not have been available to similarly situated firms. Clearly, the provision of this loan is specific within the meaning of Article 2.1(c).

8.30 Moreover, putting aside the evidence the United States has provided, it should be emphasized that, in the Annex V process, Indonesia refused to provide information that would have permitted a more thorough analysis of the specificity of the loan under Article 2.1(c). In Question 29(b) of AV/15, the United States sought information relating to the specificity of the government-directed \$690 million loan. In particular, the United States asked the following: "Please describe other recent projects financed by state bank-led consortia, including the amount of financing provided and the terms of the financing." Indonesia refused to respond, stating that it "question[ed] the relevance of this request to the Annex V process."<sup>433</sup>

8.31 Clearly, information relating to the specificity of a subsidy is relevant to the Annex V process, which, pursuant to paragraph 2 of Annex V, is aimed at obtaining "such information from the government of the subsidizing Member as necessary to establish the existence and amount of subsidization . . ." In light of Indonesia's non-cooperation with respect to information concerning the loan, the Panel should draw an adverse inference pursuant to paragraph 7 of Annex V and find the government-directed \$690 million loan to be specific.

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<sup>431</sup> "Analysts Warn About Loans for Timor Car", Jakarta Post, 13 August 1997 (US Exhibit 14, pp. 163-165).

<sup>432</sup> The decision to grant the \$690 million loan package came at a time when the Government of Indonesia, due to the depreciation of the rupiah and overly aggressive lending by banks, was clamping down on credit and canceling large projects, thereby making the loan to TPN all the more extraordinary. 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).) 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." ("Timor Car Project Not to Be Rescheduled in Face of Currency Crunch," Agence France Presse, 20 Aug. 1997 (US Exhibit 14, pp. 170-171)). It was further 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.

("Timor Car Project Won't Be Rescheduled," Jakarta Post, 21 August 1997 (US Exhibit 14, pp. 172-173); 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).) As a 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 programs will not be axed." 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." ("Ministers Review Projects Rescheduling," Business Daily, 8 Sept. 1997 (US Exhibit 14, pp. 174-175).) This followed an earlier statement by the Coordinating Minister that "Everyone must support the [national car] program." ("13 Banks Ordered to Finance Timor Car Project," The Jakarta Post, 7 May 1997, p. 12 (US Exhibit 14, pp. 112-114)).

<sup>433</sup> AV/16, p. 3.

(c) Arguments of Indonesia

8.32 **Indonesia** also argues that 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 are specific in the sense of Article 2 of the SCM Agreement. These arguments are set forth in part in Section V.D. See also Indonesia's further arguments in this regard in the following section.

(3) Indonesia's arguments that the measures are specific subsidies

8.33 The following are **Indonesia's** further arguments (in addition to those in Section V.D) that the measures at issue are specific subsidies:

8.34 Articles 1 and 2 of the Subsidies Agreement define a specific subsidy. They provide in the 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)(1)(ii)); and

a benefit is thereby conferred that is "specific to an enterprise or industry or group of enterprises or industries" (Article 2.1).

8.35 Under the 1993 incentive programme, the Government foregoes 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.

8.36 The February 1996 national car programme 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, foregoes or does not collect revenue otherwise due from specific enterprises. (See also section V.D.2(a).)

8.37 In addition, the subsidy under the 1993 incentive programme 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. The same is true of the February 1996 programme.

8.38 **Indonesia** also indicates at several points in its arguments that the June 1996 programme is (or was) a specific subsidy. (See, e.g., Section VII.D.3 and Section X.A). See also the arguments of the **European Communities**, above, quoting an Indonesian response to a written question in consultations.

B. Serious Prejudice Claims

1. Summary of claims

8.39 The **European Communities** and the **United States** note that the National Car Programme provides three types of benefits for National Cars in Indonesia: exemption from import duties on parts and components used for the assembly of National Cars; exemption from import duties on National Cars imported from Korea; and exemption from the Sales Tax on Luxury Goods on National Cars,

whether imported from Korea or assembled in Indonesia. These incentives constitute “specific subsidies” within the meaning of Articles 1 and 2 of the SCM Agreement.<sup>434</sup>

8.40 The **European Communities** and the **United States** observe that the subsidies are contingent upon the use of domestic over imported parts and components. As such, they would be prohibited by Article 3.1(b) of the SCM Agreement, were it not because, as a developing country Member, Indonesia benefits from the temporary exception to that prohibition provided in Article 27.3 of the SCM Agreement.

8.41 The **European Communities** and the **United States** claim that, nonetheless, the subsidies cause “adverse effects” to their respective interests in the form of “serious prejudice” within the meaning of Articles 6 and 27 of the SCM Agreement. Specifically, the subsidization of the National Cars has caused serious prejudice by (i) displacing or impeding imports of motor vehicles of European Communities and United States manufacturers into the Indonesian market; and (ii) resulting in significant price undercutting of motor vehicles of European Communities and United States manufacturers in the Indonesian market. Therefore, Indonesia is required, in accordance with Article 7.8 of the SCM Agreement, to withdraw them or to take appropriate steps to remove their adverse affects.

2. Basis for serious prejudice as a cause of action against Indonesia as a developing country

8.42 The **European Communities** and the **United States** argue, and **Indonesia** acknowledges that serious prejudice can be a cause of action against Indonesia in this dispute. The **European Communities** and the **United States** argue that such claims can be raised only if one of the situations described in Article 6.1(a) of the SCM Agreement exists. Indonesia indicates that 6.1(a) situations can be a basis for serious prejudice claims against developing countries, but that serious prejudice as a cause of action against developing countries also can be reached directly where the subsidies in question fall under the provisions of Article 3 of the Agreement. The following are the arguments of the **European Communities**, the **United States**, and **Indonesia** in this regard.

(a) Arguments of the European Communities

(1) The subsidies are actionable under Part III of the SCM Agreement.

The subsidies would be “prohibited” by Article 3.1 (b) of the SCM Agreement but for the temporary exception for developing countries provided in Article 27.3 of the SCM Agreement.

8.43 Article 3.1 (b) of the SCM Agreement prohibits subsidies that are:

“... contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods”.

8.44 This prohibition is subject to the temporary exception provided in Article 27.3 of the SCM agreement, which states that:

The prohibition of paragraph 1(b) of Article 3 shall not apply to developing country members for a period of five years, and shall not apply to least developed country

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<sup>434</sup> The Community considers that the benefits granted for the assembly of other motor vehicles and parts and components thereof under the 1993 Deregulation Package and under the National Car Programme are also “specific subsidies” within the meaning of Articles 1 and 2 of the SCM Agreement. Nevertheless, the Community has decided no to take action against those subsidies under Part III of the SCM Agreement within the framework of the current dispute. The Community reserves its right to do so in the future, if necessary.

Members for a period of eight years from the date of entry into force of the WTO Agreement.

8.45 As shown above, the subsidies at issue are contingent upon compliance with local content requirements and, accordingly, fall within the prohibition laid down in Article 3.1 (b).

8.46 Nevertheless, given Indonesia's status as a "developing country Member", the prohibition of Article 3.1(b) will not apply to the measures in dispute for a period of five years from the entry into force of the WTO Agreement, i.e. until 1 January 2000.

(2) Article 27.3 does not preclude the "actionability" of the subsidies under Part III of the SCM Agreement

8.47 By its own words, Article 27.3 of the SCM Agreement excludes the application of the prohibition contained in Article 3.1(b) only, and of no other provision of the SCM Agreement. Therefore, Article 27.3 does not confer immunity against actions based on other provisions of the SCM Agreement and, in particular, against action under Part III of the SCM Agreement.

8.48 This is further confirmed by the express wording of Article 5 of the SCM Agreement, which provides that:

No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members... [emphasis added]

8.49 Thus, Article 5 applies with respect to all specific subsidies within the meaning of paragraphs 1 and 2 of Article 1 of the SCM Agreement, including those which are prohibited by Article 3. As demonstrated above, the measures at issue are specific subsidies. Consequently, Indonesia is subject in respect of those measures to the disciplines laid down in Article 5 of the SCM Agreement.

(3) The subsidies cause "adverse effects" to the interests of the Community in the form of "serious prejudice"

8.50 Article 5 of the SCM Agreement lists three different types of "adverse effects":

serious injury to the domestic industry of another Member;

nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994, in particular the benefits of concessions bound under Article II of GATT 1994;

prejudice to the interest of another Member.

8.51 Footnote 13 to subparagraph (c) of Article 5 of the SCM Agreement specifies that:

"The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994 and includes threat of serious prejudice".

8.52 The Community claims and will demonstrate below that the subsidies at issue cause "adverse effects" to its interests in the form of "serious prejudice".

(4) The European Communities is not precluded by Article 27.9 of the SCM Agreement from invoking “serious prejudice”

8.53 Article 27.9 of the SCM Agreement provides that, where a subsidy is granted by a developing country Member, “serious prejudice” can only be invoked if the subsidy in question falls within one of the categories “referred to” in Article 6.1 of the SCM Agreement.

8.54 Article 6.1 “refers”, inter alia, to subsidies where the total *ad valorem* subsidization of the product concerned exceeds 5 per cent on the value of sales (or 15 per cent on the value of the total invested funds in the case where the recipient is in a start-up situation). As shown below, in the present case the amount of subsidisation is well above that percentage by any possible measurement. Accordingly, Article 27.9 of the SCM Agreement does not prevent the Community from invoking “serious prejudice” with respect to the subsidies in dispute.

(5) The subsidies would be presumed to cause “serious prejudice” to the Community’s interests but for Indonesia’s status as a developing country Member

8.55 Article 6.1 provides that serious prejudice in the sense of Article 5 © shall be deemed to exist where the total *ad valorem* subsidisation of the products concerned exceeds 5 per cent on the relevant sales value (or 15 per cent on the value of invested funds where applicable). As demonstrated below, in the present case the amount of subsidization exceeds by far that threshold. Thus, in accordance with Article 6.1, the subsidies at issue would have to be deemed to cause “serious prejudice” to the European Communities.

8.56 Nevertheless, Article 27.8 of the SCM Agreement stipulates that the presumption of Article 6.1 shall not apply where, as in the present case, the subsidy is granted by a developing country Member. Article 27.8 further states that, in that case, serious prejudice must be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6 of the SCM Agreement.

(6) The subsidization is massive

8.57 The European Communities have calculated the amount of total *ad valorem* subsidization on the basis of data supplied by Indonesia and in accordance with the provisions contained in Annex IV of the SCM Agreement. The results of that calculation are summarized in the table below:

| <u>Product</u>  | <u>Subsidization rate</u> | <u>Period</u>                          |
|---|---------------------------|--|
| Timor S-515<br>all cars (based on<br>estimated invested funds)                  | 219-225%                  | Start-up period<br>Nov 1995-April 1999 |
| Timor S-515<br>imported from Korea<br>(based on value of sales)                 | 156-460%                  | Oct. 1996-June 1997                    |
| Timor S-515<br>assembled in Indonesia<br>(based on estimated<br>value of sales) | 49-61%                    | May 1998-Dec. 1998                     |
|   | 40-50%                    | 1999                                   |

8.58 A detailed explanation of the calculation of the amount of subsidization is provided below:

(a) Methodology

8.59 In accordance with Paragraph 1 of Annex IV of the SCM Agreement, the amount of the subsidies must be calculated “in terms of cost to the granting government”.

8.60 In the present case, the “cost to the granting government” is the amount of the import duties and of the Sales Tax on Luxury Goods not collected by the Indonesian Government pursuant to the National Car Programme.<sup>435</sup>

8.61 In principle, the rate of ad valorem subsidization must be calculated by expressing the subsidy amount as a percentage of the sales value of the products benefiting from the subsidy. Nevertheless, by way of exception, Paragraph 4 of Annex IV provides that where the recipient firm is in a start-up situation the following rule shall apply instead:

Where the recipient firms is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidisation exceeds 15 per cent of the total funds invested. For purposes of this paragraph, a start-up period is deemed not to extend beyond the first year of production.

8.62 According to Footnote 65, start-up situations include

"instances where financial commitments for product development or construction of facilities to manufacture products benefiting from the subsidy have been made, even though production has not begun".

8.63 The incentives provided in respect of the finished cars imported from Korea and in respect of the cars assembled at Tambun Plant are transitional measures until PT TPN starts its own production at Karawang Plant. In view of this, it may be considered that PT TPN is still in a “start-up situation” in the sense of Paragraph 4, which situation began with the incorporation of PT TPN in November 1995 and will run until one year after production starts at Karawang Plant (i.e. until the end of April 1999). On that assumption, the rate of *ad valorem* subsidisation received by PT TPN would have to be calculated by expressing the total amount of the subsidies to be received by PT TPN during the said start-up period as a percentage of PT TPN’s estimated total invested funds.

8.64 If it was considered that PT TPN is not in a “start-up situation” within the meaning of Paragraph 4, the *ad valorem* subsidisation rate would have to be calculated by expressing the amount of each subsidy as a percentage of the relevant sales value in accordance with the rules contained in Paragraphs 2 and 3 of Annex IV.

8.65 In the case of the exemption from the Sales tax on Luxury Goods, this calculation seems unnecessary. Since the Sales Tax on Luxury Goods takes the form of an *ad valorem* tax on the net sales value of the cars, the *ad valorem* rate of subsidisation may be considered to equal the rate at which that tax is generally applied to the category of products concerned, i.e. 35 per cent.

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<sup>435</sup> In the Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing measures (G/SCM/W/415) it is recommended that:

the cost to the government of tax exemptions, deductions, holidays and any similar measures be calculated as the amount of revenue that the government otherwise would have collected” (recommendation 12, at para A. 1)

8.66 As regards the subsidy in the form of import duty relief, Paragraph 3 of Annex IV provides that where a subsidy is tied to the production or sale of a given product, the relevant sales denominator for the calculation of the rate of *ad valorem* subsidisation shall be:

"the total value of the recipient firm sale's of that product in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted".

8.67 In the present case, however, PT TPN did not sell any motor vehicles in the period preceding the granting of the subsidies. This makes it impossible to establish the sales denominator in accordance with the rule contained in Paragraph 2. In view of this, it is considered appropriate to use instead the sales data made available by Indonesia for the period October 1996-June 1997.

8.68 The generally applicable import duty rate on CBU passenger cars is higher than the applicable import duty rate on imports of parts and components, including CKD kits. Furthermore, it can be expected that the customs value of the CBU Timors S-515 imported from Korea will be higher than the customs value of the parts and components imported from Korea for assembly in Indonesia. As a result, the *ad valorem* subsidisation of the cars imported from Korea by PT TPN and sold during the period October 1996-June 1997 is likely to be higher than the rate of subsidization of the cars assembled at Tambun Plant as from June 1997 and at Karawang Plant as from May 1998.

8.69 For the above reasons, it seems appropriate to calculate separately the subsidization rate of the cars imported from Korea and the subsidisation rate of the cars assembled in Indonesia. Since production at Karawang Plant has not started yet and Indonesia has not made available the necessary data with respect to the production at Tambun Plant, the calculation of the subsidization rate of the cars assembled in Indonesia must necessarily be based on the estimates for the amount of subsidization and for the sales value of the cars to be assembled at Karawang Plant provided by Indonesia in the framework of the Annex V Procedure.

(b) Calculation based on invested funds during the "start-up" period

8.70 According to PT TPN's investment permit, the estimated total investment by PT TPN is Rp. 975,800 million.

8.71 The total amount of subsidization received by PT TPN during the start-up period may be estimated as follows:

|   |                                 |
|---|---------------------------------|
| Subsidies on cars imported from South Korea                             | Rp. 1,914,252 million*          |
| Subsidies on cars assembled at Tambun Plant                             | n.a                             |
| Subsidies on cars to be assembled at Karawang Plant during 1998         | Rp. 104,304-131,904 million**   |
| Subsidies on cars to be assembled at Karawang Plant during Jan-Apr 1999 | Rp. 118,888-148,688 million**.  |
| Total   | Rp. 2,137,444-2,194,844 million |

\*Total amount of uncollected duties as calculated in 3.1+35 per cent of total sales value mentioned under point 3.1

\*\*Based on Attachment A-28

8.72 Thus, on this basis, the *ad valorem* amount of subsidization would be:

$$2,137,444 \text{ million} - 2,194,688 \text{ million} / 975,800 \text{ million} \times 100 = 219 \% - 225\%$$

(c) Calculation based on value of sales

(i) Subsidies on imported passenger cars

8.73 The amount of subsidization of the cars imported by PT TPN from Korea equals the amount of customs duties not collected upon importation into Indonesia plus the amount of uncollected luxury taxes.

8.74 The applicable customs duty on imports of CBU passenger cars is 200 per cent.<sup>436</sup> Thus, the amount of uncollected customs duties will be the amount that results from applying that percentage to the total import value of the cars.

8.75 According to Indonesia's Response to the European Communities Questionnaire in the Annex V Procedure<sup>437</sup>, the import value of the cars was the following:

|                    |                 |
|--------------------|-----------------|
| June-December 1996 | US\$131,242,800 |
| January-June 1997  | US\$237,210,266 |
| Total              | US\$368,453,066 |

8.76 The amount of uncollected import duties may thus be estimated as follows:

|                   |   |
|-------------------|---|
| JuneDecember 1996 | US\$262,485,600 (= Rp. 629,965,440,000 <sup>438</sup> ) |
| JanuaryJune 1997  | US\$474,420,532 (= Rp. 1,138,609,277,800)               |
| Total             | US\$736,906,132 (= Rp. 1,768,574,716,800)               |

8.77 In turn, according to Indonesia's Response<sup>439</sup>, the sales value of the imported cars was the following:

|                        |                     |
|------------------------|---------------------|
| October-December 1996  | Rp. 153,002,850,000 |
| January-June 1997      | Rp. 263,218,585,000 |
| October 1996-June 1997 | Rp. 416,221,435,000 |

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<sup>436</sup> AV/3, at point 23.

<sup>437</sup> Id. at point 21.

<sup>438</sup> All amounts in US\$ have been converted into Rp at the rate US\$1 = Rp. 2,400.

<sup>439</sup> AV/3 at point 22.



8.78 The *ad valorem* subsidisation rate corresponding to the non collection of import duties is thus the following:

|                        |      |
|------------------------|------|
| October-December 1996  | 412% |
| January-June 1997      | 433% |
| October 1996-June 1997 | 425% |

8.79 The total *ad valorem* subsidization rates which result from adding the above percentages to the rate of subsidization corresponding to the exemption from the Sales Tax on Luxury Goods (35 per cent) are:

|                       |      |
|-----------------------|------|
| October-December 1996 | 447% |
| January-June 1997     | 468% |
| Total                 | 460% |

8.80 The above calculation does not make any adjustment for the fact that as of 30 June 1997, 28,391 cars had not been sold yet out of 39,727 cars imported. In view of that, it is perhaps more appropriate to calculate the amount of *ad valorem* subsidization on the basis of the average unit import value for the period June 1996/June 1997 and the average unit sales value for the period October 1996/June 1997.

8.81 On the basis of the data provided in Indonesia's Response, the unit import value for the period June 1996/June 1997 was US\$9,275.

8.82 Accordingly, the uncollected amount of import duties per unit was US\$9,275 x 200% = US\$18,550 (= Rp.44,520,000).

8.83 In turn, the unit sales value for the period October 1996/June 1997 was Rp. 36,716,781.

8.84 On this basis, the *ad valorem* rate of subsidization resulting from the non collection of import duties would be:

$$(44,518,560 / 36,761,782) \times 100 = 121 \%$$

8.85 This percentage, added to the subsidization rate corresponding to the exemption from the Sales Tax of Luxury Good, results in a total *ad valorem* subsidization rate of:

$$121\% + 35\% = 156\%$$

(ii) Subsidies on Passenger cars assembled at Karawang Plant

8.86 In the Attachment A-28 to its Response in the Annex V Procedure (AV/3), Indonesia has estimated the amount of the subsidies to be granted in respect of the assembly of passenger cars at Karawang Plant as follows:

|             | <u>1998</u>             | <u>1999</u>               |
|-------------|-------------------------|---------------------------|
| Import duty | US\$15.99-23.12 million | US\$51.80 - 74.89 million |
| Luxury Tax  | US\$27.47-31.84 million | US\$96.81-110.97 million  |
| Total       | US\$43.46-54.96 million | US\$148.61-185.86 million |

8.87 In the same Attachment, Indonesia gives the following estimate of the sales value of those cars:

|      |                    |
|------|--------------------|
| 1998 | US\$89.56 million  |
| 1999 | US\$373.18 million |

8.88 On the basis of the above estimates, the total rate of *ad valorem* subsidisation would be the following :

|      |            |
|------|------------|
| 1998 | 48.5-61.4% |
| 1999 | 39.8-49.8% |

8.89 In response to a question from the United States, Indonesia has stated that "Items 3 to 8 of Attachment A-28 are also applicable to the Tambun Plant".<sup>440</sup> Accordingly, the above calculation may be considered to constitute also an accurate estimate of the total subsidisation rate of the cars assembled at Tambun Plant.

(b) Arguments of the United States

- (1) Because the subsidies provided under the National Motor Vehicle programme exceed 5 per cent ad valorem, the subsidies fall under Article 6.1(a) of the SCM Agreement and are actionable under Articles 27.8 and 27.9

8.90 For purposes of this dispute, the United States assumes that Indonesia is a developing country. Therefore, under Articles 27.8 and 27.9 of the SCM Agreement, a serious prejudice case may be brought against Indonesia only if the Indonesian subsidies are of a type described in Article 6.1. Article 6.1(a) refers to subsidies where "the total ad valorem subsidization of a product exceed[s] 5 per cent". (Footnote omitted). With respect to the subsidies provided under the National Motor Vehicle programme, the subsidies vastly exceed 5 percent. Therefore, a serious prejudice case may be brought against Indonesia.

- (2) The one-year authorization to import Korean-made Kia Sephia sedans free of Indonesia's 200 per cent tariff on CBU passenger cars, alone, results in a subsidy in excess of 5 per cent

8.91 As shown below, the subsidies provided as a result of Presidential Decree No. 42/1996, alone, are well above the 5 per cent threshold. The authorization to import CBU Kia Sephia sedans free of Indonesia's 200 per cent tariff on CBU passenger cars resulted in a subsidy of 122 percent, assuming that the entire amount of the subsidy is attributed solely to the one-year period in 1996-97 for which the authorization was in effect.<sup>441</sup>

8.92 However, it would not be appropriate to allocate this subsidy solely to this one-year period, because of the tremendous size of the subsidy and the fact that the one-year authorization is a "non-recurring" subsidy. Therefore, this subsidy must be allocated over several years. The United States submits that in the absence of specific guidance in the SCM Agreement regarding the mechanics of subsidy allocation over time, the recommendations made by the Informal Group of Experts

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<sup>440</sup> AV/16 at point 12.28.c

<sup>441</sup> See Table 13.

established under the auspices of the SCM Committee offer a reasonable basis for dealing with this issue.<sup>442</sup>

8.93 By way of background, footnote 14 to Article 6.1(a) provides that "[t]he total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV". Annex IV to the SCM Agreement is entitled "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)". Although Annex IV contains some general principles regarding subsidy calculation, footnote 62 to Annex IV provides: "An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for purposes of paragraph 1(a) of Article 6." To that end, on 13 June 1995, the SCM Committee established an Informal Group of Experts ("IGE") to make recommendations concerning calculation rules for purposes of Annex IV and Article 6.1(a).<sup>443</sup> On 25 July 1997, the IGE submitted to the SCM Committee its recommendations.<sup>444</sup>

8.94 Recommendation 1 of the IGE Report deals with the question of "expensing" (allocating subsidies to the year of receipt) versus "allocating" (allocating subsidies over two or more years). Paragraph 2 of Recommendation 1 states that "non-recurring subsidies should be presumptively allocated ...". The IGE provided the following explanation for this recommendation:<sup>445</sup>

The frequency and size of a subsidy were deemed relevant to the question of expensing versus allocating. Just as it is recommended that recurring and/or small subsidies be expensed, so is it recommended that non-recurring and/or large subsidies generally be allocated. One consideration in this context is that it might be illogical to expense very large subsidies due to the likely substantial impact that such subsidies would have on the recipient companies beyond the year in which they were received. For example, it is likely that non-recurring large subsidies would be used to purchase fixed assets, or even if not so used, would free up a comparable amount of company funds for this purpose.

8.95 The SCM Committee has not yet adopted the recommendations of the IGE, and those recommendations, of course, are not binding on this Panel. However, in light of Annex IV, paragraph 7, as well as the Tokyo Round Committee Guidelines, the IGE's recommendations regarding the allocation of non-recurring subsidies make sense, and should be followed in this case. The one-year tariff exemption provided to TPN on imports of Korean-made Kia Sephia sedans was a huge subsidy, the Government of Indonesia has asserted that this subsidy will not recur, and this tremendous gift of money frees up a comparable amount of TPN's funds to purchase assets for its Indonesian production/assembly facility.

8.96 The next question is how to allocate the one-year tariff exemption over time. In this regard, Recommendation 2, paragraph 1, of the IGE Report states: "As a general principle, the average useful life of assets should be used as the allocation period for subsidies subject to allocation." Paragraph 2 of Recommendation 2 then sets out a hierarchy of bases from which to determine the average useful life of assets, ranging from "Information for the individual firm or firms receiving the subsidy" to

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<sup>442</sup> Although Annex IV does not provide detailed calculation rules on this particular point, it clearly contemplates the allocation of subsidies over time, because paragraph 7 refers to "[s]ubsidies . . . the benefits of which are allocated to future production ... ." In addition, the Tokyo Round Subsidies Code Committee adopted "Guidelines on Amortization and Depreciation" that also called for the allocation of certain subsidies over time. BISD 32S/154.

<sup>443</sup> G/SCM/5 (22 June 1995).

<sup>444</sup> Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415 ("IGE Report").

<sup>445</sup> IGE Report, p. 5, para. 11.

"Information for other firms producing the product outside the country in question." Paragraph 3 of Recommendation 2 sets forth a formula for calculating the average useful life of assets.

8.97 The United States does not have information for the firms in question, and has not been able to develop information based on the formula set forth in paragraph 3 of Recommendation 2. Therefore, as a reasonable surrogate, the United States has used a 12-year allocation period based on the class life of assets for manufacturers of motor vehicles as set forth in the regulations of the US Internal Revenue Service.<sup>446</sup> Using a 12-year, straight line allocation method, this results in a subsidy of 10.18 per cent for the one-year period during which the duty-free authorization was in effect. (See below.) Although this method underestimates the size of the subsidy<sup>447</sup>, the amount is still well in excess of the 5 per cent threshold.

- (3) The inclusion of the other subsidies provided under the National Motor Vehicle programme simply increases the amount by which the total ad valorem subsidization exceeds 5 per cent

8.98 As demonstrated, a consideration of merely one component of the National Motor Vehicle programme establishes that the level of subsidization is in excess of 5 per cent and that a serious prejudice case may be brought against Indonesia. However, for the sake of completeness, the United States notes, as shown below, that the exemption of the Timor Kia Sephia from the luxury tax results in a subsidy of 44 per cent for 1997<sup>448</sup> and an estimated subsidy of 35 percent for 1998 and 1999.<sup>449</sup> The exemption under the National Motor Vehicle programme from import duties on parts results in an estimated subsidy of 14 per cent for 1998 and 9 per cent for 1999.<sup>450</sup> Finally, the government-directed \$690 million loan results in a conservatively calculated estimated subsidy of 7.1 per cent in 1998, 28.95 per cent in 1999, and 5.3 per cent in 2000.<sup>451</sup>

- (4) Calculation of subsidization from the one-year tariff exemption on CBU imports of the Kia Sephia from Korea

8.99 If the subsidy attributable to the one-year tariff exemption on CBU imports of the Kia Sephia from Korea is "expensed" (allocated to the year of receipt), the resulting subsidy is 122.18 per cent ad valorem. This figure is derived as follows:

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<sup>446</sup> See Table 14 and accompanying note.

<sup>447</sup> This method underestimates the subsidy attributable to the one-year tariff exemption, because Recommendation 3, paragraph 1, of the IGE Report provides the following: "It is recommended, where subsidies are allocated over time, that subsidy amounts be adjusted fully for inflation and include a portion of the 'real' interest rate." If this adjustment were made, the amount of the subsidy would increase.

<sup>448</sup> See Table 15.

<sup>449</sup> See Table 16.

<sup>450</sup> See Table 17.

<sup>451</sup> See Table 21.

Table 13

One-Year Tariff Exemption (Expensed)

|        |  |
|--------|--|
| Step 1 | Determine the US\$ value of importations during the one-year period (1996-97). Based on Attachment U-12 to AV/14, this figure is US\$368,453,066.  |
| Step 2 | Multiply the value of importations by 200% to arrive at the total subsidy amount in US\$. ( $368,453,066 \times 200\% = \$736,906,132$ ).  |
| Step 3 | Determine the total sales value during the same period. Based on Attachment U-12, this figure is Rp. 418,221,435,000.  |
| Step 4 | Divide the total sales value by the total number of units sold to arrive at an average sales value in Rp. of cars sold. ( $418,221,435,000 / 11,336 = \text{Rp. } 36,893,210.57$ ).        |
| Step 5 | Multiply the average sales value by the number of units imported to arrive at the total sales value in Rp. of the cars imported. ( $36,893,210.57 \times 39,727 = 1,465,656,576,238.97$ ). |
| Step 6 | Convert the Rp. sales value into dollars by dividing by 2430 (the conversion rate provided by Indonesia in Attachment A-28 to AV/14. ( $1,465,656,576,238.97 / 2430 = \$603,150,854.42$ ). |
| Step 7 | Divide the total subsidy amount by the total sales value to arrive at the subsidy percentage. ( $\$736,906,132.00 / \$603,150,854.42 = 122.18\%$ ).  |

8.100 If the subsidy attributable to the one-year tariff exemption on CBU imports of the Kia Sephia from Korea is "allocated over time", as it should be, the resulting subsidy is 10.18 per cent ad valorem. This figure is derived as follows:<sup>452</sup>

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<sup>452</sup> Note that this calculation does not adjust for the "time value of money". If such an adjustment were made, as the United States believes it should be, the subsidy would increase.

Table 14

One-Year Tariff Exemption (Allocated)

|        |   |
|--------|---|
| Step 1 | The total subsidy amount calculated in Step 2, Table 13 (\$736,906,132) is divided by 12, the number of years over which the subsidy should be allocated. <sup>453</sup> This results in an allocated subsidy amount for 1996-97. ( $\$736,906,132 / 12 = \$61,408,844.33$ ). |
| Step 2 | Divide the allocated subsidy amount for 1996-1997 by the total sales figure to arrive at the subsidy percentage ( $\$61,408,844.33 / \$603,150,854.42 = 10.18\%$ ).   |

(5) Calculation of subsidization from the exemption from the 35 per cent luxury sales tax

8.101 For the period 1996-97, the subsidy attributable to the exemption of the Timor Kia Sephia from the 35 per cent luxury tax is 44.43 per cent.<sup>454</sup> This figure is derived as follows:

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<sup>453</sup> The period of 12 years is based on the class life (in years) for manufacture of motor vehicles set forth in the Class Lives tables of the Modified Accelerated Cost Recovery System of the U.S. Internal Revenue Service. 1997 US Master Tax Guide [CCH], ¶190. Because the United States was unable to develop information concerning the actual life of assets for Kia Timor or for the automotive industry as a whole (either in Indonesia or worldwide), it has used the Class Lives tables as the best information otherwise available to it.

<sup>454</sup> This figure relates to sales of imported CBU Kia Sephias from Korea during the one-year period authorized under Presidential Decree No. 42/1996. Although, after June, 1997, Kia Timor began to assemble Timor Kia Sephias in Indonesia, the data provided by Indonesia in its Annex V responses does not permit the calculation of the precise amount of subsidization attributable to the exemption from the luxury tax of cars assembled in Indonesia during the second half of 1997. However, given the nature of the subsidy, one can assume that the amount was around 35 per cent *ad valorem*.

Table 15

Luxury Tax Exemption (1996-97)

|         |  |
|---------|--|
| Step 1  | Attachment U-12 to AV/14 states that the luxury sales tax is calculated on the basis of cost of goods sold. However, Indonesia did not provide a value for cost of goods sold, nor did it provide sales information for the 28,391 imported Kia Sephias that, according to Indonesia, had not yet been sold. However, AV/16, p. 3, indicates that all of the imported Kia Sephias will be exempt from the luxury tax when sold. Therefore, the calculation must be based on the estimated sales value of cars that were imported during 1996-97. |
| Step 2  | Determine the US\$ value of importations during the period (1996-97). Based on Attachment U-12 to AV/14, this figure is \$368,453,066.   |
| Step 3  | Using Attachment A-30/1 to AV/14 as a guide, it is assumed that the value of importations equals the CIF price referred to in that attachment.   |
| Step 4  | Attachment A-30/1 shows that the amount of luxury sales tax is equal to 146.6259 per cent of the CIF price. However, this figure is based on the assumption that imported CBU cars are subject to the 200 per cent tariff, an assumption which does not hold for the Kia Sephias imported under Presidential Decree No. 42/1996. Therefore, by eliminating the effect of the 200 per cent tariff, the factor for the luxury tax is reduced to 72.6 per cent.   |
| Step 5  | Multiply the total CIF value by 72.6 per cent to arrive at the US\$ value of the luxury tax exempted. ( $\$368,453,066 \times .726 = \$267,496,925.90$ ).  |
| Step 6  | Determine the total sales value for the same period. Based on Attachment U-12, this figure is Rp. 418,221,435,000.00.  |
| Step 7  | Divide the total sales value by the total number of units sold to arrive at an average sales value in Rp. of cars sold. ( $\text{Rp. } 418,221,435,000 / 11,336 = \text{Rp. } 36,893,210.57$ ).  |
| Step 8  | Multiply the average sales value by the number of units imported to arrive at the total sales value in Rp. of importations. ( $\text{Rp. } 36,893,210.57 \times 39,727 = \text{Rp. } 1,465,656,576,238.97$ ).  |
| Step 9  | Convert the Rp. sales value into dollars by dividing by 2430 (the conversion rate provided in Attachment A-28) ( $\text{Rp. } 1,465,656,576,238.97 / 2430 = \$603,150,854.42$ ).   |
| Step 10 | Divide the total amount of the tax exempted by the total sales value to arrive at the subsidy percentage. ( $\$267,496,925.90 / \$603,150,854.42 = 44.43\%$ ).   |

8.102 For 1998 and 1999, the estimated ad valorem subsidy rate attributable to the luxury tax exemption is 35.20 per cent. This figure is derived as follows:

Table 16

Luxury Tax Exemption (1998-99)

|        |   |
|--------|---|
| Step 1 | According to Attachment U-12, AV/14, the luxury tax is calculated based on the cost of goods sold. Again, Indonesia did not provide this value in its Annex V responses.  |
| Step 2 | Using Attachment A-30/2, AV/14, as a guide, we know that the luxury sales tax amount is 96.8793% of the CIF value. The CIF value can be obtained through information provided in Attachment A-28, AV/14.  |
| Step 3 | Indonesia did not indicate how the values in Attachment A-28 relate to the values in Attachment A-30/2. Therefore, certain assumptions have to be made. Logically, it seems that the "dealer price" in A-28 is the same as the "sole agent sales price" in A-30/2. Attachment A-30/2 shows that the "sole agent sales price" is 426.3768 per cent of the CIF price. Given this assumption, calculate the average dealer's price (without subsidy - since we are trying to determine what part of that price is attributable to the luxury sales tax). [ $(\$22,170 + \$24,085) / 2 = \$23,127.50$ ] |
| Step 4 | Calculate the average CIF price by dividing the average dealer's price by 426.3768 per cent. [ $\$23,127.50 / 426.3768\% = \$5,424.19$ ]  |
| Step 5 | Next, determine the estimated number of units to be sold. [Attachment A-28]. In 1999, there are sales estimated in both the domestic and export markets. Assuming that the luxury sales tax would not be paid on exported cars, use only the number of units sold domestically in the calculation.<br>[1998 - 6,000]                      [1999 - 25,000]   |
| Step 6 | Multiply the number of units sold by the average CIF price to determine the total CIF value of sales.<br>[1998 - $6,000 \times \$5,424.19 = \$32,545,157.24$ ]<br>[1999 - $25,000 \times \$5,424.19 = \$135,604,821.84$ ]   |
| Step 7 | Multiply the total CIF value by 96.8793 per cent to arrive at the total amount of luxury tax exempted.<br>[1998 - $\$32,545,157.24 \times 96.8793\% = \$31,529,520.52$ ]<br>[1999 - $\$135,604,821.84 \times 96.8793\% = \$131,373,002.16$ ]  |
| Step 8 | Determine the total value of sales for the period. [Attachment A-28]<br>[1998 - $\$89,560,000.00$ ] [1999 - $\$373,180,000.00$ (domestic only)]   |
| Step 9 | Divide the total amount of tax exempted by the total sales to arrive at the % of subsidization.<br>[1998 - $\$31,529,520.52 / \$89,560,000.00 = 35.20\%$ ]<br>[1999 - $\$131,373,002.16 / \$373,180,000.00 = 35.20\%$ ]   |



(6) Calculation of subsidization from the exemption from import duties on imported automotive parts

8.103 According to Indonesia, TPN's one-year authorization to import CBU Kia Sephias from Korea duty-free has expired, and Kia Timor is now assembling Timor Kia Sephias in Indonesia. Under the National Motor Vehicle programme, as the producer of a "national motor vehicle", Kia Timor benefits from the tariff exemption on imported automotive parts. For 1998 and 1999, the estimated ad valorem subsidy rate attributable to the exemption from import duties on automotive parts is 14.17 per cent and 9.45 per cent, respectively.<sup>455</sup> This figure is derived as follows:

Table 17

Tariff Exemption on Parts (1998-99)

|        |   |
|--------|---|
| Step 1 | To determine the import duty exemption, we must know the total value of importations. This value was not provided in Indonesia's Annex V responses. Therefore, we must extrapolate the value from what Indonesia did provide.   |
| Step 2 | Determine the amount of local content in the cars sold. [Attachment A-28, AV/14] [1998 - 40%] [1999 - 60%]  |
| Step 3 | From this, assume that the amount of imported content is:<br>[1998 - 60%] [1999 - 40%]  |
| Step 4 | To determine the CIF value of the completed car, follow the steps described above in connection with the luxury tax subsidy for 1998-99, Table 16, to arrive at the average CIF value of \$5,424.19.  |
| Step 5 | Multiply the average CIF value by the percentage of imported parts to obtain the average CIF value of importations. Then multiply that amount by the number of cars sold to arrive at the total CIF value of importations.<br>[1998 - \$5,424.19 x 60% x 6000 = \$19,527,094.34]<br>[1999 - \$5,424.19 x 40% x 25000 = \$54,241,928.74]<br>(Note - For the number of units sold, the number sold solely in the Indonesian market was used because import duty exemption on parts incorporated into an exported product arguably would not be considered an actionable subsidy.) |
| Step 6 | Multiply the value of importations by 65 per cent to arrive at the amount of import duty exemption.<br>[1998 - \$19,527,094.34 x 65% = \$12,692,611.32]<br>[1999 - \$54,241,928.74 x 65% = \$35,527,253.68]   |
| Step 7 | Divide the total value of import duty exemptions by the total sales value to arrive at the % of subsidization.<br>[1998 - \$12,692,611.32 / \$89,560,000.00 = 14.17%]<br>[1999 - \$35,527,253.68 / \$373,180,000.00 = 9.45%]  |

<sup>455</sup> Again, the data provided by Indonesia in its Annex V response do not permit the calculation of a subsidy rate for those Timor Kia Sephias assembled in Indonesia during the latter part of 1997.

(7) Calculation of subsidization from the government-directed \$690 million loan

8.104 With respect to the government-directed \$690 million loan to TPN, the United States estimates the amount of the subsidy to be 7.1 per cent in 1998, 28.95 per cent in 1998, and 5.3 per cent in 2000. The United States calculated these percentages in the following manner.

8.105 As noted above, newspaper reports indicated that the terms of the loan were 3 per cent over the 3-6 month deposit rate, a maturity of 10 years, and a grace period of 3 years. Thus, the first task is to determine the interest rate to be paid by TPN, which is based on the 3-6 month deposit rate. Because Indonesia did not provide this rate in its Annex V responses, the United States was forced to rely on other sources. The most recent information available to the United States is from The Economist Intelligence Unit Limited (April 1997) (EIU)<sup>456</sup>, which indicates that as of the end of February 1997, the average rate on Bank Indonesia certificates was 8.75 per cent.<sup>457</sup> Adding 3 per cent to this figure results in an interest rate on the \$690 million loan of 11.75 per cent.

8.106 The next task is to determine the "benchmark" interest rate against which TPN's interest rate should be judged. Because the Government of Indonesia did not provide the loan to TPN directly, but instead directed banks to provide the loan, it would be inappropriate to use the Government's cost as the benchmark. Instead, one must use the cost of the actual lender; in this case, the banks. The cost to a bank is reflected in the interest rate that it would charge a comparable commercial borrower. Again, because the Government of Indonesia refused to provide relevant information in its Annex V responses, the United States has been forced to estimate the benchmark interest rate based on the best information otherwise available to it.

8.107 The United States began with the rate on a 10-year "Yankee Bond" that the Indonesian Government began to issue in July 1996.<sup>458</sup> According to EIU, the rate on this US\$ denominated bond was set at 7.825 per cent, 1 percentage point above the 10-year Treasury bond rate.<sup>459</sup> The use of a US\$ denominated benchmark is appropriate, because in AV/16, p. 4, Answer 13, Indonesia referred to a US\$ denominated rate.

8.108 The United States added a spread of seven percent to the Yankee Bond rate of 7.825 per cent. According to EIU, p. 28 (Exhibit 16), Indonesian bank spreads range from three to seven percentage points, depending on the reputation of the client. As discussed above, TPN was not a reasonable credit risk for a loan of the magnitude of \$690 million.<sup>460</sup> Therefore, a bank would have charged the maximum spread to a commercial borrower comparable to TPN. Adding 7 per cent to the Yankee Bond rate results in an interest rate of 14.825 per cent.

8.109 Finally, the United States added on a "risk premium" to more accurately reflect the fact that TPN was an unsound credit risk. In other words, a bank lending to a borrower comparable to TPN would have charged more than 14.825 per cent in order to cover its (the bank's) costs. In the absence of any other information, the United States relied on the methodology used by the US Department of Commerce to calculate a risk premium under the US countervailing duty law. Under this

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<sup>456</sup> US Exhibit 16.

<sup>457</sup> According to EIU, these certificates are the primary tools used by Bank Indonesia to control interest rates and money supply.

<sup>458</sup> See EIU, p. 3 (US Exhibit 16).

<sup>459</sup> Because it is highly unlikely that anyone but the US Government is in the business of issuing US\$ denominated Treasury bonds, the United States assumed that the reference in EIU to the 10-year Treasury bond rate is to the 10-year US Treasury bond rate.

<sup>460</sup> In this regard, the United States emphasizes that in the Annex V process, Indonesia refused to answer questions regarding TPN's financial situation. See AV/15, Question 12/29(d) and AV/16, Question 12/29(d).

methodology, in the case of a company considered to be "uncreditworthy," the Department of Commerce adds to the "benchmark" interest rate an amount equal to 12 per cent of the prime rate in the country in question. Here, the United States used 10.825 per cent as the prime rate. This was based on the Yankee bond rate (7.825) plus 3 per cent, 3 per cent being the low spread for bank lending.<sup>461</sup> 12 per cent of 10.825 equals 1.29 per cent. Adding 1.29 per cent to the benchmark rate of 14.825 results in a final benchmark rate of 16.124.

8.110 Having determined the interest rate paid by TPN (11.75 per cent) and the cost to the banks (16.124 per cent), we next must calculate a "grant equivalent" of the benefit received by TPN from the loan. The first step in this process is to calculate the net present value of payments under the loan to TPN and the benchmark loan. The difference in payments between the two loans constitutes the subsidy.

8.111 Assuming that there will be interest-only payments during the 3-year grace period, and assuming an 11.75 per cent interest rate, the payment schedule for the loan to TPN is as follows:

Table 18

Payment Schedule for Loan to TPN

| Year | Beginning Balance | Add: Interest | Less: Payment | Ending Balance |
|------|-------------------|---------------|---------------|----------------|
| 0    | 0                 | 0             | (690,000,000) | 690,000,000    |
| 1    | 690,000,000       | 81,075,000    | 81,075,000    | 690,000,000    |
| 2    | 690,000,000       | 81,075,000    | 81,075,000    | 690,000,000    |
| 3    | 690,000,000       | 81,075,000    | 81,075,000    | 690,000,000    |
| 4    | 690,000,000       | 81,075,000    | 149,994,645   | 621,080,355    |
| 5    | 621,080,355       | 72,976,942    | 149,984,645   | 544,062,652    |
| 6    | 544,062,652       | 63,927,362    | 149,994,645   | 457,995,368    |
| 7    | 457,995,368       | 53,814,456    | 149,994,645   | 361,815,179    |
| 8    | 361,815,179       | 42,513,284    | 149,994,645   | 254,333,817    |
| 9    | 254,333,817       | 29,884,224    | 149,994,645   | 134,223,396    |
| 10   | 134,223,396       | 15,771,249    | 149,994,645   | (0)            |

8.112 Using 16.124 per cent as the interest rate, the payment schedule for the benchmark loan is as follows:

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<sup>461</sup> EIU, p. 28 (US Exhibit 16).

Table 19A

Payment Schedule for Benchmark Loan

| Year | Beginning Balance | Add: Interest | Less: Payment | Ending Balance |
|------|-------------------|---------------|---------------|----------------|
| 0    | 0                 | 0             | (690,000,000) | 690,000,000    |
| 1    | 690,000,000       | 111,255,600   | 111,255,600   | 690,000,000    |
| 2    | 690,000,000       | 111,255,600   | 111,255,600   | 690,000,000    |
| 3    | 690,000,000       | 111,255,600   | 111,255,600   | 690,000,000    |
| 4    | 690,000,000       | 111,255,600   | 171,477,239   | 629,778,361    |
| 5    | 629,778,361       | 101,545,463   | 171,477,239   | 559,846,584    |
| 6    | 559,846,584       | 90,269,663    | 171,477,239   | 478,639,008    |
| 7    | 478,639,008       | 77,175,754    | 171,477,239   | 384,337,523    |
| 8    | 384,337,523       | 61,970,582    | 171,477,239   | 274,830,866    |
| 9    | 274,830,666       | 44,313,729    | 171,477,239   | 147,667,355    |
| 10   | 147,667,355       | 23,809,884    | 171,447,239   | 0              |

8.113 Having calculated payment schedules for both the loan to TPN and the benchmark loan, we now must calculate the net present value of the payment differentials. This results in the following schedule, using a standard net present value calculation and a discount rate of 16.124 per cent:

Table 19B

Payment Differential

| Year  | TPN Loan Payment | Benchmark Loan Payment | Payment Differential | NPV of Pmt. Diff. |
|-------|------------------|------------------------|----------------------|-------------------|
| 0     | 0                | 0                      | 0                    | 0                 |
| 1     | 81,075,000       | 111,255,600            | 30,180,600           | 25,989,976        |
| 2     | 81,075,000       | 111,255,600            | 30,180,600           | 22,381,227        |
| 3     | 81,075,000       | 111,255,600            | 30,180,600           | 19,273,559        |
| 4     | 149,994,645      | 171,477,239            | 21,482,594           | 11,614,049        |
| 5     | 149,994,645      | 171,477,239            | 21,482,594           | 10,173,650        |
| 6     | 149,994,645      | 171,477,239            | 21,482,594           | 8,761,023         |
| 7     | 149,994,645      | 171,477,239            | 21,482,594           | 7,544,541         |
| 8     | 149,994,645      | 171,477,239            | 21,482,594           | 6,496,970         |
| 9     | 149,994,645      | 171,477,239            | 21,482,594           | 5,594,855         |
| 10    | 149,994,645      | 171,477,239            | 21,482,594           | 4,818,001         |
| Total |                  |                        | 240,919,960          | 122,847,850       |

8.114 Having calculated a "grant equivalent" of the loan payment differential of US\$122,847,850, the next step is to translate this lump sum into annual benefits. For this purpose, the United States has prorated the amount of the "grant equivalent" over a 10-year period based on the life of the loan to TPN. An amount is added to each annual allocation to account for the time value of money of the remaining unallocated portion, using a discount rate of 16.124 per cent. Using a "declining balance" formula, these two amounts are added together and divided by one plus the discount rate to obtain the amount of the "grant equivalent" allocable to any one year. This results in the following schedule of annual benefits:

Table 20

Annual Benefit from Loan

| Year | Benefit to Year |
|------|-----------------|
| 0    | 0               |
| 1    | 27,636,640      |
| 2    | 25,930,879      |
| 3    | 24,225,117      |
| 4    | 22,519,355      |
| 5    | 20,813,594      |
| 6    | 19,107,832      |
| 7    | 17,402,070      |
| 8    | 15,696,308      |
| 9    | 13,990,547      |
| 10   | 12,284,785      |

8.115 The final calculation step is to translate the annual subsidy amount into an ad valorem percentage:

Table 21

Annual Subsidy Rate for Loan (1998-2000)

|                  | 1998                        | 1999       | 2000        |
|------------------|-----------------------------|------------|-------------|
| Benefits in US\$ | 27,636,640                  | 25,930,879 | 24,225,117  |
| Sales in US\$    | 387,569,0434 <sup>462</sup> | 89,560,000 | 453,180,000 |
| Subsidy          | 7.1%                        | 28.95%     | 5.3%        |

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<sup>462</sup> The United States has assumed that payment on the TPN loan will not begin until 1998, thus rendering 1998 "Year 1" of the loan. In addition, pursuant to paragraphs 2 and 3 of Annex IV of the SCM Agreement, the denominator in the ad valorem subsidy calculation is based on sales in the preceding year. Accordingly, the denominator for the 1998 subsidy is based on 1997 sales, the subsidy for the 1999 subsidy on 1998 sales, and the subsidy for the 2000 subsidy on 1999 sales.

The figures for 1998 and 1999 sales (Column 1999 and Column 2000) were taken from Attachment A-28, AV/14. The figure for 1997 sales (Column 1998) was estimated based on data in Attachment U-12, AV/14. The United States calculated the total sales value of cars imported during a particular year by calculating an average sales price.

(c) Arguments of Indonesia regarding serious prejudice as a cause of action in this dispute

8.116 The subsidies at issue 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". As Indonesia is a developing country, it is within the ambit of Article 27.3 of the SCM 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.

8.117 Subsidies which are not "prohibited" may be either "actionable" or "non-actionable." The subsidies involved in this dispute do not meet the criteria of Article 8 of the Agreement, and so must fall into the residual category of "actionable" subsidies. This rationale for application of Articles 5 to 7 must be used because the language of Article 27.7 is ambiguous. It states that:

The [remedial] provisions of Article 4 shall not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. The relevant [remedial] provisions in such a case shall be those of Article 7. (Emphasis added.)

8.118 "Export" subsidies and "domestic content" subsidies are not synonymous. The former are covered by Article 3.1(a) and Annex I of the Agreement, while the latter are covered by Article 3.1(b). Given the context of Article 27.7 (including its citation to Article 27.3), the drafters of the Agreement clearly meant Article 27.7 to cover domestic content subsidies, as well as export subsidies. This is confirmed by the analysis above. Under Article 32 of the Vienna Convention on the Law of Treaties, recourse to supplemental means of interpretation is permissible in this instance due to the ambiguity of the text of Article 27.7.

8.119 The European Communities and the United States assert that the actual and alleged subsidies of the National Car programme bestowed by the June 1996 programme, the February 1996 programme and the \$US690 million loan exceed the 5/15 per cent ad valorem thresholds established by Article 6.1(a) of the Subsidies Agreement. They properly recognize, however, that Article 27.8 stipulates that serious prejudice in terms of Article 6.1(a) shall not be presumed where, as here, the subsidy is granted by a developing country Member. Rather, in such a case, a complainant must demonstrate serious prejudice by positive evidence in accordance with the provisions of paragraphs 3 through 8 of Article 6.

8.120 Thus, whether proceeding on the basis of Article 6.1(a) or independently on the bases of Article 6.3, complainants must demonstrate serious prejudice by positive evidence in accordance with the provisions of paragraphs 4 through 8 of Article 6 before the remedial powers of Article 7.8 may be applied.

8.121 In response to a question from the Panel, **Indonesia** indicated that the approximate *ad valorem* amount of subsidization conferred on the Timor by the exemption from the luxury tax was as follows:

|                             |        |
|-----------------------------|--------|
| CBUs imported from Korea    | 29.54% |
| Timors assembled at Tambun  | 26.20% |
| Timors produced at Karawang | 18.68% |

3. Like product

(a) Scope of "like" models

(1) Arguments of the European Communities

8.122 The **European Communities** asserts for purposes of its serious prejudice claims that all passenger cars must be considered as “like” products. The following are the **European Communities'** arguments in this regard:

8.123 In order to assess the effects of the subsidies under consideration it is necessary to define first the scope of the relevant category of “like products”.

8.124 For that purpose, footnote 46 to Article 15.1 of the SCM Agreement provides the following guidance:

Throughout this agreement the term “like product” (“produit similaire”) shall be interpreted to mean a product which is identical i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects has characteristic closely resembling those of the product under consideration

8.125 All motor vehicles falling within the category of “passenger cars”, as defined in Indonesia’s regulations, constitute a single category of “like products” for the purposes of the SCM Agreement given that they all share the same basic physical characteristics and serve an identical end-use. Thus, the passenger cars exported from the European Communities are like the Timor S-515.

8.126 Indonesia takes an unduly restrictive view of what constitutes a “like product”. To paraphrase the Appellate Body, Indonesia has squeezed the “accordion of likeness” to a point where it can no longer sound any note.

8.127 Presently, there are more than 60 different models of passenger cars being sold in the Indonesian market. Yet, Indonesia would have the Panel to believe that the Timor S-515 is so unique that none of them is “like” the Timor S-515. By the same token, it could be claimed that each of the other models of passenger cars sold in Indonesia constitutes also a category of like products on its own. If upheld by the Panel, Indonesia’s approach would render the provisions of Part III and Part V of the SCM Agreement inapplicable except in those cases where subsidies are granted with respect to commodities or similarly homogeneous products.

8.128 The starting point for determining whether the cars exported from the European Communities are “like” the Timor S-515 must be the definition of the term “like product” contained in footnote No 46 of the SCM Agreement. That definition makes it perfectly clear that in order to be “like”, two products need not be identical. In the absence of identical products, two products having “closely resembling characteristics” must be considered as “like” products. It is evident that the Timor S-515 and the passenger cars exported from the European Communities are not identical. Yet, they have sufficiently resembling characteristics to be considered as “like”.

8.129 The European Communities agrees with the proposition that the term “like products” must be construed narrowly in the context of the SCM Agreement. Nevertheless, the European Communities consider that the definition of “like product” contained in footnote No 46 of that SCM Agreement



already embodies such a narrow interpretation. An even narrower interpretation of the definition itself is unwarranted.<sup>463</sup>

8.130 It is true that, within the category of passenger cars, there are virtually limitless variations in respect of factors such as size, weight, engine type, cylinder capacity, engine power, transmission system, equipment, body design, colour, etc.<sup>464</sup> Nevertheless, those variations do not affect the essential similarity of all passenger cars nor prevent them from being “like” products.

8.131 Any attempt to define two or more sub-categories of “like products” within the category of passenger cars on the basis of any of those criteria would unavoidably yield arbitrary results. First of all, it would require to make a necessarily arbitrary choice among all possible criteria, the only alternative being to combine several criteria simultaneously at the risk of multiplying ad infinitum the categories of “like” products. Furthermore, in respect of many of those criteria (e.g. size or cylinder capacity), there is a full continuum of products. Drawing a line within that continuum would be arbitrary, regardless of where the line is drawn. Thus, for instance, a distinction between “large” and “small” passenger cars would be arbitrary because there would always be more “likeness” between the smallest large car and the largest small car than between products at either end of each of the two categories.

8.132 If, despite the above, the Panel took the view that not all passenger cars are “like products”, the European Communities submit that, at the very least, the Opel Optima and the Peugeot 306 must be considered as being “like” the Timor S-515. The table below contains an exhaustive comparison of their physical characteristics. That comparison confirms beyond doubt that the Timor S-515 and the European Communities models concerned, albeit not alike in all respects, have closely resembling characteristics. The European Communities also has submitted sales brochures of the Timor S-515, the Peugeot 306 and the Opel Optima.

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<sup>463</sup> Indonesia’s claim that the notion of “like product” should be construed even more narrowly in the context of an exception granted in favour of developing Members is simply non-sensical. The notion of “like product” is an objective one and cannot have different meanings depending on the GDP level of the subsidising country Member.

<sup>464</sup> Some of the criteria enumerated by Indonesia as being relevant for a like product determination are too subjective (e.g. “reputation”) or vague (e.g. “quality” or “ride and comfort”) for being measurable. Price is not relevant for a like product determination, especially when as in the present case one of the products concerned benefits from a huge subsidy, and the imported products are subject to the payment of very high import duties. As noted by the Panel Report on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, adopted on 10 November 1987, BISD 34/119:

“...like products do not become “unlike”... merely because of .... differences in their prices, which were often influenced by external measures (e.g. customs duties) and market conditions (e.g. supply and demand, sales margins)”

Table 22

Comparison of Certain Models

| Marque<br>Make<br>Modele<br>Basic model | Peugeot<br>306<br>1.8<br>St | Peugeot<br>306<br>1.8<br>St LM | Opel<br>Optima<br>1.8<br>GLS | Opel<br>Optima<br>1.8<br>New CDX | Timor<br>S515<br>1.5 | Timor<br>S515i<br>1.5 |
|---|-----------------------------|--------------------------------|------------------------------|----------------------------------|----------------------|-----------------------|
| I/Mechanical Features                   |                             |                                |                              |                                  |                      |                       |
| Length (mm)                             | 4,240                       | 4,240                          | 4,329                        | 4,329                            | 4,360                | 4,360                 |
| Height (mm)                             | 1,367                       | 1,367                          | 1,410                        | 1,410                            | 1,390                | 1,390                 |
| Width (mm)                              | 1,692                       | 1,692                          | 1,688                        | 1,688                            | 1,692                | 1,692                 |
| Wheel Base (mm)                         | 2,580                       | 2,580                          | 2,517                        | 2,517                            | 2,500                | 2,500                 |
|   |                             |                                |                              |                                  |                      |                       |
| Petrol or Diesel Engine                 | XU7JP                       | XU7JP                          | MPFI                         | MPFI                             | 85C                  | EFI                   |
| Cubic Capacity (cm3)                    | 1,761                       | 1,761                          | 1,796                        | 1,796                            | 1,498                | 1,498                 |
| Number of Cylinders                     | 4                           | 4                              | 4                            | 4                                | 4                    | 4                     |
| Number of Valves/Cylinder               | 8V                          | 8V                             | 8V                           | 8V                               | 8V                   | 16V                   |
| Maximum Power (DIN/ch)                  | 103                         | 103                            | 118                          | 118                              | -                    | -                     |
| Nbr RPM                                 | 6,000                       | 6,000                          | 5,400                        | 5,400                            | -                    | -                     |
| Maximum Power (JIS/ch)                  |                             |                                |                              |                                  | 82                   | 105                   |
| Nbr RPM                                 |                             |                                |                              |                                  | 5,500                | 5,500                 |
| Maxi torque (DIN)                       | 16.0                        | 16.0                           | 16.3                         | 16.3                             | -                    | -                     |
| Maxi torque (JIS)                       |                             |                                |                              |                                  | 12.2                 | 15.0                  |
| Nbr RPM                                 | 3,000                       | 3,000                          | 3,200                        | 3,200                            | 2,500                | 4,000                 |
| Carburetor/Injection                    | I                           | I                              | I                            | I                                | C                    | I                     |
|   |                             |                                |                              |                                  |                      |                       |
| Manual Gear Box (NB. of Speeds)         | 5                           | 5                              | 5                            | 5                                | 5                    | 5                     |
| Automatic Gear Box (NB. of Speeds)      | -                           | -                              | -                            | -                                | -                    | -                     |

| Marque<br>Make<br>Modele<br>Basic model | Peugeot<br>306<br>1.8<br>St | Peugeot<br>306<br>1.8<br>St LM | Opel<br>Optima<br>1.8<br>GLS | Opel<br>Optima<br>1.8<br>New CDX | Timor<br>S515<br>1.5 | Timor<br>S515i<br>1.5 |
|---|-----------------------------|--------------------------------|------------------------------|----------------------------------|----------------------|-----------------------|
| Brakes<br>(Disc/drums/Ventil.)          | VD/DR                       | VD/DR                          | D/DR                         | D/DR                             | VD/DR                | VD/DR                 |
| Anti-lock Brake system                  | -                           | -                              | -                            | X                                | -                    | -                     |
| Power Steering                          | X                           | X                              | X                            | X                                | X                    | X                     |
| II/Outside Features                     |                             |                                |                              |                                  |                      |                       |
| Number of Doors                         | 4                           | 4                              | 4                            | 4                                | 4                    | 4                     |
| Additional Headlamps                    | -                           | -                              | X                            | X                                | -                    | -                     |
| Bodyside Mouldings                      | X                           | X                              | X                            | X                                | X                    | X                     |
| Rear Spoiler                            | -                           | -                              | -                            | -                                | X                    | X                     |
| Light Alloy Wheels                      | -                           | X                              | X                            | X                                | -                    | -                     |
| Tyre Size                               | 185/65/R14                  | 185/65/R14                     | 195/60/R14                   | 195/60/R14                       | 175/70/R13           | 175/70/R13            |
| Metallic Paint                          | X                           | X                              | X                            | X                                | -                    | O                     |
| Tinted Glass                            | X                           | X                              | X                            | X                                | X                    | X                     |
| III/Inside Equipment                    |                             |                                |                              |                                  |                      |                       |
| Air Bag (1/2)                           | -                           | -                              | -                            | 1                                | -                    | -                     |
| Side Impacts Beams                      | X                           | X                              | X                            | X                                | X                    | X                     |
| Central Door Locking                    | X                           | X                              | X                            | X                                | X                    | X                     |
| Adjustable Steering<br>Column           | X                           | X                              | X                            | X                                | -                    | X                     |
| Electric Windows<br>Front/Rear          | F/R                         | F/R                            | F/R                          | F/R                              | X                    | X                     |
| Electric Windows<br>(Front/1 Touch)     | FR/one T                    | FR/one T                       | FR/one T                     | FR/one T                         | -                    | X                     |
| Driver Side Mirror<br>Manu./Electr.     | E                           | E                              | E                            | E                                | M                    | E                     |
| Passenger Side Mirror<br>Manu./Elec.    | E                           | E                              | E                            | E                                | M                    | E                     |

| Marque<br>Make<br>Modele<br>Basic model | Peugeot<br>306<br>1.8<br>St | Peugeot<br>306<br>1.8<br>St LM | Opel<br>Optima<br>1.8<br>GLS | Opel<br>Optima<br>1.8<br>New CDX | Timor<br>S515<br>1.5 | Timor<br>S515i<br>1.5 |
|---|-----------------------------|--------------------------------|------------------------------|----------------------------------|----------------------|-----------------------|
| Alarm System                            | -                           | -                              | X                            | X                                | -                    | -                     |
| Air Conditioning                        | X                           | X                              | X                            | X                                | X                    | X                     |
| Radio Equipment                         | X                           | X                              | X                            | X                                | -                    | X                     |
| Height Adjust. Frt Seats<br>Manu./Elec  | M                           | M                              | M                            | M                                | M                    | M                     |
| Rear Seat Folding                       | 1/3-2/3                     | 1/3-2/3                        | 1/3-2/3                      | 1/3-2/3                          | -                    | -                     |
| Rear Head Restraints                    | X                           | X                              | X                            | X                                | X                    | X                     |
| TRIM                                    | VELOURS                     | LEATHER                        | VELOURS                      | VELOURS                          | CLOTH                | CLOTH                 |
| Number of Rear Seat<br>Belts            | 3                           | 3                              | 3                            | 3                                | 3                    | 3                     |
| 3 <sup>rd</sup> Braking Light           | X                           | X                              | X                            | X                                | X                    | X                     |

8.133 Should the Panel take the view that it is necessary to distinguish two or more “segments” within the category of passenger cars, the European Communities would refer the Panel to the classification made in the DRI Reports. According to the DRI Reports, the models of passenger cars sold in Indonesia between 1994 and 1997 may be classified into four segments, as follows:

Segment B (“Supermini Class”): Daihatsu Charade, Suzuki Baleno, Suzuki Esteem, Toyota Starlet;

Segment C (“Lower Medium Class”): Daewoo Cielo, Ford Laser, Honda City, Honda Civic, Hyundai Accent/Bimantara Cakra, Peugeot 306, Opel Optima, Mitsubishi Lancer, Mazda 323, Mazda MR 90, Toyota Corolla, Toyota Corona, Kia Sephia/Timor S-515;

Segment D (“Upper Medium Class”): Audi A4, Daewoo Cielo, Ford Telstar, Honda Accord, Hyundai Elantra/Bimantara Nenggala, Mazda 626, Mitsubishi Galant, Opel Vectra, Peugeot 405/406;

Segment E (“Executive Class”): Audi A6, BMW 3 Series, BMW 5 series, BMW 7 series, Mercedes Benz C class, Mercedes Benz E class, Mercedes Benz S class, Nissan Cedric, Nissan Zafiro, Toyota Crown, Volvo U.

According to the DRI Reports, no model was sold within Segment A (“Utility Class”).

8.134 Indonesia cannot reasonably deny that the Timor and the EC cars, and in particular the Opel Optima and the Peugeot 306, have closely resembling physical characteristics. For that reason, Indonesia is forced to emphasize the importance of what it terms “non-physical characteristics”. (See Section VIII.B.3). These include a long list of vague and essentially subjective criteria, such as “brand reputation”, “status”, “quality”, “reliability”, etc. which cannot be properly measured and compared. If the Panel upheld Indonesia's view that two vehicles which have closely resembling physical characteristics may nevertheless not be “like” because of differences in factors such as “quality” or “brand reputation”, it would be opening the door to all kinds of arbitrary and abusive distinctions. An examination of prior Panel reports shows that alleged differences regarding

non-physical characteristics have never been regarded as determinant for a like product determination. For instance, in the 1987 case on Japan - Taxes on Alcoholic Beverages<sup>465</sup>, Japan claimed that high quality Scotch whisky was not "like" domestic Japanese whisky of inferior quality. The Panel rightly ignored those arguments and concluded that all whisky was "like". In relative terms, there is no more difference between a Mercedes and a Timor than between a premium brand of malt Scotch whisky and a Japanese brand of second grade whisky made by adding water to a concentrate.

8.135 To be precise, the European Communities' position is that cars which have closely resembling physical characteristics do not become "unlike" simply because of alleged differences in so-called "non-physical characteristics."

8.136 "Riding comfort" is determined by the physical characteristics of a car. The same is true of "quality". "Reputation for quality" is one of the factors which make up the "brand image of a product." It is obvious that "brand image" may influence consumers' choices. In the European Communities' view, however, mere differences in brand image do not suffice to make two products "unlike". Moreover, this criterion is largely subjective, cannot be accurately measured, and may change over time. For instance, by definition new entrants lack an established "brand image". Thus, on Indonesia's construction, a subsidizing Member could always claim that subsidies for the establishment of a new domestic industry cannot cause "serious prejudice" to imports.

(2) Arguments of the United States

8.137 The **United States** argues that the passenger cars which, but for the National Motor Vehicle programme, United States motor vehicle manufacturers would have sold in Indonesia, are "like" the Timor Kia Sephia sedan. The following are the **United States'** arguments in this regard:

8.138 Footnote 46 of the SCM Agreement defines "like product" in the following manner:

Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

8.139 Obviously, this definition provides only general guidance, and a case-by-case analysis is necessary to determine whether a particular product is "like" another. In this regard, the guidance provided by the Appellate Body in connection with the application of the "like product" concept for purposes of the WTO agreements is particularly apt:<sup>466</sup>

No one approach to exercising judgement will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as

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<sup>465</sup> Panel report on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages adopted 10 November 1987, BISD 34S/83, 118.

<sup>466</sup> "Japan - Taxes on Alcoholic Beverages," WT/DS8/R, Report of the Appellate Body, adopted 1 November 1996, p. 22.

well as by the context and the circumstances that prevail in any given case to which that provision may apply.

Factors which should be considered in applying a case-by-case analysis include “a product’s end-uses in a given market, consumers’ tastes and habits, which change from country to country, and the product’s properties, nature and quality.”<sup>467</sup>

- (a) The passenger cars that the United States would have sold in Indonesia are comparable to the Timor.

8.140 With this analytical framework in mind, let us now turn to an analysis of specific passenger cars of US motor vehicle manufacturers. Because of the National Motor Vehicle programme, there currently are virtually no passenger cars of US manufacturers that are imported and sold in Indonesia.<sup>468</sup> However, the passenger cars that were imported and sold in Indonesia prior to the introduction of the National Motor Vehicle programme were “like” the Timor Kia Sephia sedan. In addition, the passenger cars that, but for the National Motor Vehicle programme, would have been imported and sold in Indonesia are “like” the Timor Kia Sephia sedan.

8.141 Prior to the introduction of the National Motor Vehicle programme, General Motors sold two passenger cars under its “Opel” brand that easily can be considered as “like” the Timor Kia Sephia sedan. These are the Opel Optima and the Opel Vectra.

8.142 The Opel Optima and the Timor Kia Sephia both fall within “Segment C” of the motor vehicle market (lower medium class passenger cars).<sup>469</sup> Moreover, as set out in Table 23, below, the specifications for the Optima and the Timor Kia Sephia are quite comparable. The size and weight of the two cars are virtually identical, while the Optima has a slightly bigger engine.

8.143 With respect to the Opel Vectra, while it is positioned slightly higher in the market than the Optima or the Timor Kia Sephia<sup>470</sup>, in terms of specifications, as set out in Table 23, it is not all that dissimilar to the Timor Kia Sephia. The Vectra is slightly larger than the Timor Kia Sephia (e.g., the Vectra is about 100mm longer than the Timor Kia Sephia), and has a more powerful engine. However, both cars share the same end-uses; i.e., to transport passengers.

8.144 Turning to Ford, Ford had well-advanced plans to import and sell Ford Escorts in Indonesia, plans that Ford had to abandon in light of the National Motor Vehicle programme and the introduction of the heavily subsidized Timor Kia Sephia sedan. Like the Timor Kia Sephia, the Escort falls in Segment C of the passenger car market.<sup>471</sup> A comparison of specifications, as set forth in Table 23, confirms the similarities between the Escort and the Timor Kia Sephia and the fact that the Escort is “like” the Timor Kia Sephia. The Timor Kia Sephia is a little bit longer (65mm) and a little bit higher (44mm) than the Escort, while the Escort is a little bit wider (183mm) and has a slightly larger engine (1597cc versus 1498cc for the Timor Kia Sephia).

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<sup>467</sup> Id., p. 21, citing to Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para. 18.

<sup>468</sup> See AV/13, p. 3 (Question 6) and Attachment 8 (Question 6).

<sup>469</sup> See McGraw-Hill World Car Industry Forecast Report, February 1997, pp. 284-85, included as Annex 1 to AV/2. Cars falling within a particular market segment will roughly be of the same size, be in the same price range, and share the same target customers.

<sup>470</sup> The Vectra falls within “Segment D” (upper medium class) of the passenger car market. Id.

<sup>471</sup> See McGraw-Hill World Car Industry Forecast Report, February 1997, pp. 284-85, included as Annex 1 to AV/2.

8.145 The following table demonstrates that the Timor Kia Sephia, the Opel Optima, and the Ford Escort are quite comparable in terms of specifications.<sup>472</sup>

Table 23

Timor, Escort, and Opel Specifications

| Items                  | Timor S515                         | Ford Escort4dr<br>"Ghia"<br>Notchback<br>Manual<br>Transmission | Opel Optima  | Opel Vectra  |
|------------------------|------------------------------------|---|--|--|
| <b>Dimensions</b>      |                                    |   |  |  |
| 1. Overall length (mm) | 4,360                              | 4,295   | 4,329  | 4,477  |
| 2. Overall width (mm)  | 1,692                              | 1,875   | 1,688  | 1,707  |
| 3. Overall height (mm) | 1,390                              | 1,346   | 1,410  | 1,425  |
| 4. Wheel base (mm)     | 2,500                              | 2,523   | 2,517  | 2,637  |
| 5. Turning circle (m)  | 5.1                                | 10  | 4.9  |  |
| 6. Curb weight (kg)    | 1,055                              | 1,145   | 980  |  |
| <b>Engine</b>          |                                    |   |  |  |
| 1. Type                | 4 cyl, inline,<br>SOHC, carburetor | 4 cyl., Zetec<br>inline   | 4 cyl., 8 valves,<br>Multi-Port Fuel<br>injection (MPFI) | 4 cyl., 8 valves Multi-<br>Port Fuel injection<br>(MPFI) |
| 2. Displacement (cc)   | 1,498                              | 1,597   | 1,796  | 1,998  |
| 3. Max. Power          | 85PS/5,500rpm                      | 175@ 5500   | 118 PS/5,400 rpm   | 136 hp   |
| <b>Transmission</b>    |                                    |   |  |  |
| Gear Ratio:            |                                    |   |  |  |
| -1 <sup>st</sup>       | 3.417                              | 3.10  | 3.58   | --   |
| -2 <sup>nd</sup>       | 1.895                              | 1.19  | 2.14   | --   |
| -3 <sup>rd</sup>       | 1.296                              | 1.28  | 1.48   | --   |
| -4 <sup>th</sup>       | 0.906                              | 0.95  | 1.12   | --   |
| -5 <sup>th</sup>       | 0.738                              | 0.76  | 0.89   | --   |
| -Reverse               | 3.736                              | 3.615   | 3.333  | --   |

8.146 Finally, with respect to Chrysler, Chrysler had plans to import and sell its Neon passenger car in Indonesia. The table below presents a comparison of the specifications of the Neon and the Timor Kia Sephia. The data show that the Chrysler Neon closely resembles the Timor Kia Sephia, and, thus, can be considered a "like product" to the Sephia. The Neon is only 4 mm longer, 16 mm wider, and

<sup>472</sup> Source: US companies.

5 mm taller than the Sephia, and is only 54 kilogrammes heavier. Also, although the Neon has a larger engine, both the Neon and the Timor Kia Sephia fall within the C segment, and, thus, in the view of the industry, compete for the same customers.<sup>473</sup> As such, the Neon can safely be considered as “like” the Timor Kia Sephia.

8.147 The specifications for the Chrysler Neon that would have been sold in Indonesia but for the National Car Programme are as follows:

Table 24

Timor and Neon Specifications

| Items                  | Timor S515                      | Chrysler Neon          |
|------------------------|---------------------------------|------------------------|
| Dimensions             |                                 |                        |
| 1. Overall length (mm) | 4,360                           | 4,364                  |
| 2. Overall width (mm)  | 1,692                           | 1,708                  |
| 3. Overall height (mm) | 1,390                           | 1,395                  |
| 4. Wheel base (mm)     | 2,500                           | 2,642                  |
| 5. Turning circle (m)  | 5.1                             | 10.8                   |
| 6. Curb weight (kg)    | 1,055                           | 1,109                  |
| Engine                 |                                 |                        |
| 1. Type                | 4 cyl, inline, SOHC, carburetor | 4 cyl. inline MPI SOHC |
| 2. Displacement (cc)   | 1,498                           | 1,996                  |
| 3. Max. Power          | 85 PS/5,000rpm                  | 98@ 5,850 rpm          |

8.148 To summarize, the passenger cars that US manufacturers did import and sell in Indonesia, as well as the passenger cars that they would have imported and sold in Indonesia, can be considered as “like products” to the Timor Kia Sephia. While none of these US passenger cars is “identical” to the Timor Kia Sephia, identity between motor vehicles is not required under the SCM Agreement. If identify of products were required, it is difficult to fathom how there ever could be a serious prejudice dispute (or a countervailing duty proceeding, for that matter) involving motor vehicles or any other type of consumer good, where slight variations in models or products are made for the very purpose of distinguishing products in competition with one another. Instead, under the SCM Agreement, it is enough that one product has “characteristics closely resembling” those of the subsidized product. The Opel Optima and Vectra, the Ford Escort, and the Chrysler Neon each satisfy this standard.

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<sup>473</sup> Id.



(b) The GM Opel Blazer is comparable to the Kia Sportage

8.149 As noted above, Kia Timor’s plans call for the assembly and sale in Indonesia of the Kia Sportage, to be known as the Timor J520i. When introduced, the Timor Kia Sportage will compete directly with GM’s Opel Blazer, which GM continues to import and assemble in Indonesia.

8.150 A comparison of specifications demonstrates that the Blazer and the Timor Kia Sportage are comparable products:<sup>474</sup>

Table 25

Sportage and Blazer Specifications

| Engine        | Sportage                           | Blazer DOHC                   |
|---------------|------------------------------------|-------------------------------|
| Type          | 2.0L DOHC, 4cyl, 16v               | 2.2L DOHC, 4cyl.              |
| Horsepower    | 130hp 5500 rpm                     | 138hp 5600 rpm                |
| Torque        | 127 lb-ft 4000rpm                  | 195 Nm 3800 rpm               |
| Transmission  | 5 spd man                          | 5 spd man                     |
| Brake         | Front disc/Rear drum with rear ABS | Front disc/Rear drum with ABS |
| Dimension     |                                    |                               |
| Wheel base    | 2650mm                             | 2718mm                        |
| Length        | 4245mm                             | 4602mm                        |
| Width         | 1730mm                             | 1690mm                        |
| Height        | 1650mm                             | 1508mm                        |
| Fuel capacity | 60L                                | 76L                           |
| Head room     | 1005.8mm                           | 1005mm                        |
| Leg room      | 1130.3mm                           | 1078mm                        |

(c) Indonesia’s arguments concerning “like product” are incorrect as a matter of law

8.151 Finally, let us consider the heart of Indonesia’s defense; namely, that none of the passenger cars that would have been sold by US manufacturers can be considered a “like product” to the Timor Kia Sephia sedan for purposes of footnote 46 of the SCM Agreement. Putting aside the fact that Indonesia did not make this argument in connection with the United States claim of serious prejudice, Indonesia nevertheless is, once again, wrong on the facts and the law.

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<sup>474</sup> Source: US companies. The United States also believes that Jeep Cherokees and Wranglers are comparable to the Sportage, but lacks detailed specifications.

8.152 Indonesia begins its like product legal analysis with an accurate quotation of footnote 46, noting that in the absence of an identical product, a like product can consist of a product which “has characteristics closely resembling those of the product under consideration.” (Emphasis added). Because this language obviously undermines Indonesia’s entire case, Indonesia dismisses the quoted phrase as “amorphous and skeletal” and never refers to it again.

8.153 However, as the Appellate Body has so often noted, a treaty interpreter must start with the language of the treaty.<sup>475</sup> The SCM Agreement does not require identity of products, but only a close resemblance. All of Indonesia’s subsequent legal argumentation is designed to do nothing more than divert the Panel’s attention from what the SCM Agreement actually says.

8.154 Next, Indonesia makes the extraordinary argument that the ability to bring a serious prejudice case against a developing country Member constitutes a so-called “exception” to the “right” conferred on Indonesia by the SCM Agreement to subsidize. As such, Indonesia argues, this exception, including the definition of “like product,” must be narrowly construed. This is utter nonsense.

8.155 As a general matter, the United States does not agree with the principle that simply because a particular provision or agreement can be labelled as an “exception” to something else, that provision or agreement must be mechanically and narrowly construed. In the Wool Shirts case, India made a similar argument, and the Appellate Body rejected it.<sup>476</sup> Moreover, it is ludicrous to suggest that like product analyses differ depending upon whether the complainant is challenging the subsidies of a developed or a developing Member.

8.156 However, even assuming that this mechanical rule of treaty interpretation applies, Indonesia’s application of it is 180 degrees backward. If there is an “exception” in Article 27 of the SCM Agreement, it is that developing country Members are excepted from the general prohibition against the use of local content subsidies and the remedies available to combat such subsidies that require no showing of adverse trade effects. Thus, if the principle suggested by Indonesia is to be correctly applied, this Panel must interpret all relevant provisions in such a way as to limit the exceptional treatment afforded by Article 27.3. In the context of this case, this means, among other things, interpreting the term “like product” broadly, not narrowly.<sup>477</sup>

(d) Indonesia’s arguments concerning “like product” are incorrect as a matter of fact

8.157 Having disposed of Indonesia’s legal arguments concerning like product, let us turn to Indonesia’s factual arguments. As discussed above, Table 23 compares the specifications for the Timor Kia Sephia, the Ford Escort, and two types of Opels, the Optima and the Vectra. This comparison establishes the close physical resemblance between these products. However, notwithstanding the fact that physical characteristics are a standard criterion in identifying like products, Indonesia simply dismisses this comparison as “unduly restrictive”.

8.158 With respect to end-use, another standard like product criterion, the United States noted that these cars all have the same end-use; namely, the transport of persons. Here, too, Indonesia dismisses this criterion as irrelevant.

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<sup>475</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>476</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>477</sup> Carried to its logical conclusion, a correct and consistent application of Indonesia’s argument would result in Indonesia bearing the burden of proving that serious prejudice has not occurred. Of course, this is the type of burden shifting that India proposed in Wool Shirts, and that the Appellate Body rejected.

8.159 Instead, Indonesia recycles the same argument it made in connection with Article I of GATT 1994, which is that consumers consider numerous physical and non-physical characteristics in making their purchasing decisions. While this is true in a general sense, it proves nothing, and Indonesia offers no evidence as to how this factor justifies the conclusion that Escorts, Neons, and Opel Optimas and Vectras are not “like” the Sephia. Of course, consumer products, including passenger cars, are different from each other, because product differentiation is one of the means by which products compete. However, the fact that consumer products inevitably will not be identical to one another does not mean that they cannot be considered as “closely resembling” one another for purposes of identifying a “like product” under the SCM Agreement. If products had to be “identical” (or virtually identical) in order to be considered “like,” it would be impossible to bring a serious prejudice case (or a countervailing duty case, for that matter) against a subsidized consumer product.

8.160 There are a few “facts” that Indonesia throws out in order to confuse the issue. First, it notes that the DRI/McGraw-Hill market segmentation categories were developed in the context of the European market. Even if true, Indonesia does not explain how this renders these categories inappropriate for purposes of this case or the Indonesian auto market. Indeed, DRI/McGraw-Hill uses these categories for purposes of its authoritative Asia Automotive Industry Forecast Report.<sup>478</sup>

8.161 Second, Indonesia notes that cars with the same nameplate often differ significantly from market to market. Even if true, Indonesia offers no evidence that the passenger cars in question do differ significantly.

8.162 Third, Indonesia cites the fact that for HTS purposes, passenger cars are distinguished on the basis of total cylinder capacity, with breakpoints at 1000cc, 1500cc, and 3000cc. However, these breakpoints are arbitrary, and provide no basis for concluding that the US passenger cars are not like products to the Sephia simply because the Sephia, at 1,498cc, falls two “cc’s” below the breakpoint. Moreover, Indonesia does not explain why, if 1500cc is such a significant breakpoint, it chose 1600cc as the breakpoint for conferring tax incentives under Government Regulation No. 36/1996.

8.163 Finally, notwithstanding all of the money and resources that Indonesia reportedly has devoted to this case, Indonesia apparently has been able to find only one document, (Indonesia Attachment 12), that groups the Sephia in a different category from the Escort and Neon. However, neither the document itself nor Indonesia explains how these categories were drawn.

8.164 The United States has provided more than sufficient evidence to establish that the US passenger cars in question “closely resemble” the Timor Kia Sephia and, thus, are “like” the Sephia. In response, Indonesia has presented only flawed legal arguments and virtually no evidence.

(e) Market segment

8.165 It is important to put the issue of “market segments” in a proper and legally relevant context. Article 6.4 of the SCM Agreement indicates that displacement or impedance includes a situation where there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product. In analysing changes in relative market shares, the United States generally

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<sup>478</sup> US Exhibit 29 presents two pages of DRI promotional materials that attest to the authoritative nature of the DRI Global Automotive Group. Note in particular that the selected list of clients includes familiar names in this case, such as Chrysler, Ford, GM, Honda, Hyundai, Kia, Mitsubishi, Nissan, and Toyota. The United States does not take the position that the DRI market segmentation is dispositive with respect to the like product issues in this case. Rather, DRI's market segmentation confirms what a traditional like product analysis demonstrates; namely, that the Timor Kia Sephia is “like” the products that US manufacturers would have sold in Indonesia but for the National Car programme.

agrees with the statement by Indonesia that, to be meaningful, market share data must be calculated for the market segment into which the like products fall.

8.166 Having said that, however, it also is important to note that, based on Indonesia's own data, by the end of May, 1997, the Timor Kia Sephia had achieved a market share of 26.53 per cent. *See* AV/14, Attachment U-21/6. Although it is not readily apparent from Attachment U-21/6 itself, when one examines Attachments U-21/4-B and U-21/5-B to AV/14, it is clear that the 26.53 percent figure represents the Timor Kia Sephia's share of the market that includes all passenger cars sold in Indonesia.<sup>479</sup>

8.167 In the view of the United States, the attainment of a 26.53 per cent market share in less than one year more than satisfies the requirements of Article 6.4. Eliminating certain passenger cars from the market segment used by Indonesia in its calculations (i.e., all passenger cars) simply increases the market share attained by the Timor Kia Sephia, thereby making the serious prejudice case against Indonesia all the more damning. Thus, unless the Panel were of the view that the attainment of a 26.53 per cent market share did not demonstrate serious prejudice, attempting to place all of the passenger cars sold in Indonesia into their appropriate market segments would appear to be an exercise that is somewhat tangential to the issues raised in this case.

8.168 Nevertheless, in order to be responsive to the Panel's questions, the United States suggests that instead of "reinventing the wheel", the Panel might want to rely on the market segmentation categories actually used by the automobile industry. Such an approach seems particularly appropriate in light of the fact that "[t]he GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets." Japan - Taxes on Alcoholic Beverages, *supra*, page 26.

8.169 Applying this approach, the Timor Kia Sephia falls into the "C" segment, which includes "lower medium class" cars. (See above for a discussion of automobile market segment categories.) Other C segment passenger cars that are sold (or that, but for the National Car Programme, would have been sold) in Indonesia include: Opel Optima, Ford Escort, Chrysler Neon, Peugeot 306, Toyota Corolla, Honda City, Honda Civic, Nissan Sunny, Mitsubishi Lancer, Daewoo Nexia, Hyundai Accent, and the Mazda 323. It is possible that the Bimantara Cakra or Nenggala models also may fall into the C segment, but the United States lacks sufficient information at this time to make any definitive statements regarding these two models.

8.170 Alternatively, it would be reasonable for the Panel to find that the relevant market segment also includes the "D" segment of "upper medium class" passenger cars. If the market segment were defined as comprising all medium class cars in both the C and D segments, additional cars that are sold (or that, but for the National Car Programme, would have been sold) in Indonesia include: Opel Vectra, Honda Accord, Peugeot 405, 406, and 606, Toyota Corona and (possibly) the Crown, Nissan Sentra, Mitsubishi Galant, and Mazda 626.

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<sup>479</sup> AV/14, Attachment U-21/4-B provides sales figures for passenger cars that benefited from subsidies during the period 1995-1997. The "Total" column for 1997 indicates that as of May, 1997, the total sales volume for these passenger cars was 12,413, of which the Timor Kia Sephia accounted for 7,058. AV/14, Attachment U/21-5-B provides sales figures for passenger cars that did not benefit from subsidies during the period 1995-1997. The "Total" column for 1997 indicates that as of May 1997, 14,038 of these cars were sold. Thus, the total number of passenger cars (both subsidized and non-subsidized) sold in Indonesia during the period January - May, 1997 was 26,451. The 7,058 Timor Kia Sephias sold during this period accounted for 26.68 percent of this total. Presumably, an arithmetic error on the part of the individual preparing AV/14 accounts for the difference between the 26.53 percent figure in Attachment U/21-6 and the 26.68 percent figure derived from Attachments U-21/4-B and U-21/5-B.

8.171 Indonesia makes much of the fact that the passenger car market is segmented and that car manufacturers devote substantial resources to establishing and targeting different market segments. (See Section VIII.B.3.) However, this fact is not new, and it is consistent with the United States position that the Timor Kia Sephia falls within the "C" segment of the passenger car market. Likewise, it is not a new fact that an individual auto manufacturer will try to produce and sell one or more cars within each segment of the passenger car market.

8.172 Consider, for example, Kia Motors, TPN's joint venture partner in the National Car Programme. US Exhibit 30 consists of page 211 of DRI's Asian Automotive Industry Forecast Report, November 1997. Exhibit 30 demonstrates that Kia offers products in passenger car segments A through E, and usually offers more than one car in each segment. Strikingly, however, the Sephia is Kia's sole entry in the "C" segment.

8.173 Indonesia also makes much of the fact that there are numerous differences between passenger cars. However, this, too, is not a new fact, and it is exactly the point the United States has been making throughout this case; namely, that consumer products, including passenger cars, compete on the basis of numerous differences between products. Product characteristics within similar categories will vary among competing models within general bands or market segments. However, this is not enough to render cars within the same market class as "unlike" each other.

8.174 As an example, consider US Exhibit 31. Exhibit 31 is a summary of the various features that Ford has touted as making the Escort preferable to, and distinguishable from, its competition. The United States submits that while these features may distinguish the Escort from its competition, they are not enough to render the Escort "unlike" its competition. By the same token, the fact that the Timor Kia Sephia may have features that distinguish it from its competition is insufficient to render the Timor "unlike" its competition.

8.175 Indonesia argues that so-called "non-physical characteristics" render the Timor "unlike" and non-competitive with the passenger cars of the US manufacturers that are at issue in this case. The United States questions whether, on balance, any such differences exist, and Indonesia has not presented any evidence of such characteristics.

8.176 In this regard, TPN, Ford, and Chrysler each were (or would have been) new entrants to the Indonesian passenger car market (and General Motors was only a relatively new entrant) with little, if any, developed brand image or loyalty. While Indonesian consumers may well have formulated a perception that the cars of US manufacturers are of superior quality as compared to the Timor, such perceptions likely would be balanced by the undoubted patriotic feelings that Indonesian consumers would have with respect to the Timor as the first Indonesian National Car.

8.177 On balance, Indonesia appears to be arguing that if consumer choices were determined solely on the basis of the market, the Timor would have lost out to the Opel Optima, the Ford Escort, and the Chrysler Neon. With this, the United States wholeheartedly agrees, and that is the very crux of this dispute. What this dispute is about is that the choices of Indonesian consumers were not left to the market, but instead were distorted by the massive subsidies provided by the Government of Indonesia. These subsidies enabled the Timor to undercut the prices of competitive products so significantly, that a significant number of consumers appear to have been willing to make a trade-off between quality and price. However, the fact that consumers made this choice is not enough to render the Timor "unlike" the other cars in its class for the purposes of the SCM Agreement.

8.178 Now let us turn to the specifics of Indonesia's model comparisons. At the outset the United States takes issue with Indonesia's assertion that there are four basic physical attributes or specification groupings that differentiate passenger cars and that contribute to segmenting the market. (See Section VIII.B.3, Tables 26 and 27.) Indonesia claims that these attributes are: power plant;

steering and suspension; safety features; and passenger compartment. In the view of the United States, there are three factors that segment the market: power plant, vehicle size, and overall features.

8.179 Having said that, however, let us assume that Indonesia's approach is correct and consider Indonesia's product comparisons. A close look at the comparisons reveals that (1) they fail to rebut the evidence presented by the United States that the GM Opels, the Ford Escort, and the Chrysler Neon are like the Timor Kia Sephia; and (2) Indonesia's comparisons are not even accurate.

8.180 First, however, the United States should note that Indonesia's product comparisons in Table 27 are inaccurate, because Indonesia compares the Timor S515, the base model for the Timor Kia Sephia. Indonesia fails to mention the Timor S515i, the fuel injected model which was imported under the one-year authorization and which, according to Indonesia's own Annex V response is "[t]he only Timor car produced in Indonesia." See AV/14, Attachment 28.

8.181 With respect to the category of "power plant," Indonesia finds the US cars in question to be non-comparable to the Timor. (See Table 26.) The United States does not agree that these differences render the cars in question non-comparable to the S515. However, let us insert the Timor S515i into the comparison. The Timor S515i has a double -overhead cam (DOHC), 16 valve engine. By comparison, the Chrysler Neon has only a single -overhead cam (SOHC) engine, although it also has 16 valves. The Opel Optima has only an SOHC, 8 valve engine. Based on industry estimates, these differences between the Timor S515i and the Opel Optima are worth approximately Rp. 2.5 million.<sup>480</sup>

8.182 Thus, while the Opel Optima and Chrysler Neon have a larger engine displacement than the Timor S515i, the S515i has a DOHC, 16 valve engine, whereas the Neon has only an SOHC, 16 valve engine and the Optima only an SOHC, 8 valve engine. As for the Escort, its engine displacement is only 99 cc's more than that of the S515i. (In this regard, the United States notes that Indonesia incorrectly lists the Neon's engine displacement as 2,000 cc. As clearly set forth in evidence submitted by the United States (Table 23), the Neon's engine displacement is 1,996 cc.)

8.183 In the view of the United States, these differences are insufficient to warrant the conclusion that, in terms of power plant, the US cars do not "closely resemble" the Timor S515i or the S515 within the meaning of the "like product" definition in the Subsidies Agreement.

8.184 Turning to what Indonesia refers to as the category of "steering and suspension", Indonesia finds the US cars to be non-comparable based on the presence of power steering and tire size. (See Table 26 and accompanying notes.) However, according to Timor sales brochures, both the S515 and the S515i have power steering as a standard feature. (See European Communities Exhibit D-4.) Moreover, according to Ford officials, power steering on the Escort is an option, not a standard feature, worth approximately US\$200.

8.185 As for larger tire size, this is a designed option that depends upon anticipated road conditions and generally is defined as a standard feature of minimal value to consumers.

8.186 In short, the US cars cannot be considered "unlike" the S515 or the S515i on the basis of steering and suspension.

8.187 Turning to what Indonesia calls "safety features", with respect to brakes, Indonesia cites the fact that the Neon has antilock brakes. However, this is an optional feature on the Neon, as clearly set forth in Table 27. With respect to the Escort, Indonesia claims that the Escort has rear disc brakes,

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<sup>480</sup> See US Exhibit 32.

but this is incorrect. As set forth in US Exhibit 33, page 3, the Escort has rear drum brakes, just like the Timor. Finally, there are no differences between the Opel Optima and the Timor with respect to brakes.

8.188 With respect to airbags, according to Ford officials, Ford did not include airbags in its Indonesia launch plans for the Escort. The Neon, however, would have had airbags.

8.189 With respect to fuel economy, the United States has some difficulty understanding how this constitutes a "safety feature." Nevertheless, according to the US Department of Energy, the fuel economy of the Sephia is comparable to, and in some cases better than, that of the Escort and the Neon. US Exhibit 34 contains excerpts from the US Department of Energy Fuel Economy Guide: Model Year 1997. US Exhibit 35 summarizes the data from this guide with respect to the Sephia, the Escort, and the Neon. As can be seen, the Sephia actually has superior mileage to the versions of the Escort and Neon that have automatic transmissions. Note also that Indonesia does not provide any source for the fuel economy figures contained in Table 27.

8.190 Turning from fuel economy to vehicle weight, in a note to Table 27, Indonesia cites only the fact that the Opel Vectra is heavier than the Timor, thus conceding that Timors, Neons, Escorts, and Optimas have comparable weights.

8.191 Finally, in the same note to Table 27, Indonesia cites the fact that the Vectra has a larger fuel tank than does the Timor, thereby conceding that Timors, Neons, Escorts, and Optimas have comparably sized fuel tanks. In this regard, the United States would note that it does not believe that fuel tank size plays much of a role, if any role, in consumer purchasing decisions.

8.192 In summary, insofar as "safety features" are concerned, Indonesia's analysis is inaccurate and fails to rebut the US evidence that the cars of US manufacturers are "like" the Timor Kia Sephia.

8.193 Finally, with respect to the category of "passenger compartment," in Table 26, Indonesia concedes that Timors, Neons, Escorts, and Optimas are comparable.

8.194 Thus, Indonesia's own comparisons, when corrected for inaccuracies, demonstrate that the US cars in question are "like" the Timor. However, the United States should note that Indonesia ignores or downplays certain facts that, according to Indonesia, should form a part of any "like product" analysis. We already have mentioned the fact that the engine of the Timor S515i has certain attributes that make it more desirable than the engines in the Optima and the Neon. In addition, Indonesia fails to cite the fact that the Timor S515i has tilt steering, mud flaps, colour key mirrors and bumpers, and a foldable mirror, all of which are attractive features to consumers.

8.195 Moreover, Indonesia ignores the fact that the US manufacturers, as new (or relatively new) entrants into the Indonesian passenger car market, have little, if any, brand loyalty base or a well-developed brand image. Ford, for example, has only one after-sales service outlet in Indonesia.

8.196 Finally, the United States would like to call the Panel's attention to US Exhibit 36, which contains excerpts from the *Catalogue de la Revue Automobile '96*, described by industry officials as an authoritative source. In the entry for the Sephia, the Sephia is described as "techniquement parenté aux Mazda 323/Ford Escort USA/Mercury Tracer." Translated, this means that the Sephia is, among other things, technologically related to the Escort.

8.197 As the United States has explained, the Escort is Ford's entry in the "C" segment of the passenger car market. Given the fact that the Sephia is technologically related to the Escort, it seems fair to say that the Timor Kia Sephia falls within that same segment and is a "like product" to the other cars in that segment.

(f) Indonesia's arguments concerning the burden of proof are incorrect

8.198 Indonesia claims that the United States has failed to satisfy its burden of proof. In the view of the United States, it has more than satisfied its burden as articulated by the Appellate Body in *Wool Shirts*, of presenting a *prima facie* case of serious prejudice. The first and second submissions of the United States establish all of the elements for a serious prejudice case. Instead, it is Indonesia that has failed to rebut the US case. Of course, Indonesia is hard put to rebut the evidence cited by the United States, because much of it is Indonesia's own evidence, submitted in the course of the Annex V process.

8.199 Indonesia presents a new argument that the burden of proof on complainants is higher in this case because Indonesia is a developing country and the ability to bring a serious prejudice case against it allegedly is a derogation of its "right" to provide local content subsidies. (See section VIII.B.3(a)(3).) This is an expansion on Indonesia's earlier argument that "like product" must be interpreted differently in this case because of Indonesia's developing country status.

8.200 The United States addressed Indonesia's earlier argument in section VIII.B.3(a)(2). Indonesia's expansion of its argument brings the argument even more clearly within the scope of the *Wool Shirts* case, where the Appellate Body rejected India's argument that the burden of proof changes simply because a particular provision may be labeled as an exception to something else. Significantly, in its submission, Indonesia does not mention the *Wool Shirts* report when it advances its "derogation" argument.

(3) Indonesia's arguments

(a) The European Communities and the United States have not met their clear burden of demonstrating serious prejudice to a like product on the basis of positive evidence

8.201 The European Communities and the United States implicitly or directly accuse Indonesia of making diversionary arguments on the threshold like product issue. It is they, however, who are engaging in such tactics. Both complainants criticize Indonesia's like product observations, but in doing so they seek to obscure a fundamentally important procedural matter. Namely, that it is they, not Indonesia, that have the burden of demonstrating what are appropriate like products within the meaning of the Subsidies Agreement. Their failure - indeed, their inability - to demonstrate that the Timor is like any European Communities or US car is fatal to their serious prejudice claims.

8.202 Moreover, even if the European Communities and US cars were found to be like the Timor, no serious prejudice would exist or would arise because such cars do not compete with the Timor. The Timor is a no-frills budget car which has tapped a new class of buyers and created a niche at the bottom of the highly segmented passenger car market.

(b) Complainants have not met their substantial burdens of proof with respect to the like product issue

8.203 It is obvious that neither the European Communities nor the United States has met its clear burden of establishing appropriate like products or of demonstrating by positive evidence that any appropriate and relevant like products have suffered or are threatened with serious prejudice. As discussed below, their failure to satisfy the applicable burdens of proof renders their SCM Agreement-based arguments an empty exercise.

8.204 Both complainants have rejected in the most general terms its position that none of the vehicles they sell (or allegedly would have sold) in Indonesia are like the Timor, but, as discussed in detail below, neither has attempted in any meaningful way to address and rehabilitate the fundamental



flaws in its "like product" analysis. This action and inaction reflects an altogether unacceptable disregard for the appropriate and recognized requirement that a complainant has the burden of establishing acceptable "like products" for analytical purposes.<sup>481</sup>

8.205 The failure of the European Communities and the United States to meet their burden of proof on the like product issue eviscerates their entire serious prejudice arguments because they have a correlative obligation to prove serious prejudice to their like products by positive evidence.<sup>482</sup> No amount of creative argumentation or irrelevant data can satisfy the applicable positive evidence standard where, as here, a complainant fails to carry its burden of establishing the proper universe of like products. In order to have any meaning and to support an affirmative determination, the indicia of serious prejudice must flow from apples-to-apples comparisons. As discussed elsewhere in this submission, Complainants have, however, developed and adduced apples-to-oranges "evidence" that is based on faulty like product analyses.

(c) The term "like product" must be very narrowly construed and applied in this proceeding

8.206 Footnote 46 to the Subsidies Agreement provides:

Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

8.207 The somewhat amorphous and skeletal phrase, "characteristics closely resembling," may be fleshed out through reference to prior GATT and WTO cases, but it is well established that the "like product" concept is fluid and its meaning depends on the context in which it is used.<sup>483</sup> As the WTO Appellate Body has stated:<sup>484</sup>

No one approach to exercising judgment will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are

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<sup>481</sup> See Japan-Taxes on Alcoholic Beverages (1 November 1996), WT/DS8/R, 117, para. 6.14 (complainant has burden of proof to show like product in Article III:2 dispute); see generally Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items (25 November 1997), WT/DS 56/R, 90-91, para. 6.35.

<sup>482</sup> The positive evidence standard of the Subsidies Agreement is especially significant in this case because an affirmative finding of serious prejudice would operate to deprive Indonesia, as a developing country, of its right to provide certain subsidies. A derogation of Indonesia's right in this case places an exceedingly high burden of proof on Complainants. See generally Canada-Administration of the Foreign Investment Review Act (FIRA) (7 February 1984), BISD 30S/140, 164, para. 5.20; Japan-Restrictions on Imports of Certain Agricultural Products (22 March 1988), BISD 35S/163, 226-27, para. 5.1.3.7; EEC-Restrictions on Imports of Dessert Apples--Complaint by Chile (22 June 1989), BISD 36S/93, 125, para. 12.3.

<sup>483</sup> See, e.g., Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (10 November 1987), BISD 34S/83 (paras. 5.5 and 5.6 at pp. 113-115); Canada-Import Restrictions on Ice Cream and Yoghurt (5 December 1989), BISD 36S/68 (para. 67 at p. 87); United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (paras. 5.71-5.75 at pp. 293-294).

<sup>484</sup> Japan-Taxes on Alcoholic Beverages, WT/DS8/AB/R (1 November 1996), Report of the Appellate Body, at p. 21.

applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.

8.208 Factors which have been considered in applying a case-by-case analysis include a product's end-uses in a given market; consumer's tastes and habits, which change from country to country; and the product's properties, nature and quality.<sup>485</sup> The tariff treatment of products is another factor that has been considered.<sup>486</sup> Thus, although interpretations of the phrase in one context can promote a better appreciation of the phrase in another context, it is essential to relate the specific interpretation and application to the purpose of the article being construed.<sup>487</sup> Here, the term "like product" must be very narrowly defined.

8.209 At the Havana Conference, it was stated that the words "like product" meant the same product in the context of Article VI of the GATT (antidumping and countervailing duties).<sup>488</sup> The 1959 Report of the Group of Experts on "Anti-dumping and Countervailing Duties" stated that, in the dumping context, the "term should be interpreted as a product which is identical in physical characteristics subject, however, to such variations in presentation which are due to the need to adapt the product to special conditions in the market of the importing country (i.e., to accommodate different tastes or to meet specific legal or statutory requirements)."<sup>489</sup> The exact same definition set forth in footnote 46 of the Subsidies Agreement first appeared in the 1967 and 1979 anti-dumping and countervailing duty agreements.<sup>490</sup> This history amply demonstrates that the "like product" concept is to be very narrowly construed and restrictively applied in anti-dumping and subsidy proceedings.<sup>491</sup> This is because the imposition of discriminatory anti-dumping and countervailing duties are exceptions to the general most-favoured-nation obligation of Article I of the GATT.<sup>492</sup>

8.210 The same logic applies with equal force here. The numerous developing country carve-outs in the Subsidies Agreement (e.g., Article 27) reveal the WTO Members' recognition and acceptance of the necessity of subsidy measures to promote critical development programmes in such countries. In other words, the universe of benefits extended to developing countries under the Subsidies Agreement includes the right (albeit conditional) to provide subsidies. Therefore, because an affirmative finding of the threat of serious prejudice to a "like product" would operate to deprive a developing country Member of this generally available right, "like product" must be narrowly

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<sup>485</sup> See, e.g., Working Party Report on Border Tax Adjustments (2 December 1970), BISD 18S/97 (para. 18 at pp. 101-102); United States-Taxes on Petroleum and Certain Imported Substances (17 June 1987), BISD 34S/136 (para. 5.1.1 at p. 154); United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (para. 5.24 at p. 276); United States-Standards for Reformulated and Conventional Gasoline, WT/DS2/R (20 May 1996), Report of the Panel, at pp. 36-37, para. 6.8.

<sup>486</sup> See, e.g., Working Party Report on the Australian Subsidy on Ammonium Sulphate (3 April 1950), BISD II/188 (para. 8 at p. 191); EEC-Measures on Animal Feed Proteins (14 March 1978), BISD 25S/49 (para. 4.2 at p. 63); Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (10 November 1987), BISD 34S/83 (para. 5.6 at p. 115); United States-Standards for Reformulated and Conventional Gasoline, WT/DS2/R (20 May 1996), Report of the Panel, at p. 37, para. 6.9.

<sup>487</sup> See, e.g., EEC-Imports of Beef from Canada (10 March 1981), BISD 28S/92 (para. 4.2 at p. 98); United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206 (paras. 5.24 and 5.25 at p. 276 and para. 5.71 at pp. 293-294).

<sup>488</sup> E/CONF.2/C.3/SR.30, p. 5.

<sup>489</sup> L/978, adopted on 13 May 1959, BISD 8S/145 (para. 12 at p. 149).

<sup>490</sup> See BISD 15S/24, 25; BISD 26S/171, 172; BISD 26S/56, 65 fn. 1.

<sup>491</sup> See generally Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (10 November 1987), BISD 34S/83 (para. 5.6. at p. 115).

<sup>492</sup> See United States-Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada (11 July 1991), BISD 38S/30 (para. 4.4. at p. 44).

construed.<sup>493</sup> A derogation of Indonesia's right in this case therefore places an exceedingly high burden of proof on Complainants<sup>494</sup>, and Complainants have not met this burden.

- (d) With regard to Timor sales, no like product of the European or the United States has been seriously prejudiced

8.211 Notwithstanding their claims and criticisms of Indonesia's like product approach, neither the European Communities nor the United States sells any car models in Indonesia that are like the Timor. For the purposes of this proceeding, like product determinations must be made with reference to numerous physical and non-physical characteristics and consumer perceptions and preferences. Complainants' like product arguments are woefully inadequate because they fail to address the full range of relevant characteristics and perceptions.

- (e) The European Communities assertions concerning the Opel Optima and the Peugeot 306 are incorrect and misleading

8.212 The European Communities asserts, in effect, that Indonesia's approach to the like product concept is "clearly too restrictive" because at least one of the 60 different models of passenger cars sold in Indonesia must be like the Timor. Putting aside where the burden of proof resides, and the European Communities's failing in that regard, the European Communities's point is very wide of the mark. The issue here is whether any EC passenger cars are like the Timor, not whether any other cars are like the Timor.

8.213 The European Communities's recycled serious prejudice arguments are a hodgepodge of general and specific data. The European Communities has proffered general market share data covering the entire passenger car market, while also making price undercutting, sales and market share arguments limited to the Opel Optima and the Peugeot 306. The European Communities tips its hat to the like product concept by narrowing the focus to two models it claims are within the same segment as the Timor, but, to date, it has furnished no specific information or data to support the "likeness" of these products. Again, and at the risk of being repetitive, this makes European Communities data on market share, sales and price undercutting useless. Moreover, as shown in Tables 26 and 27, the Timor is not like the Opel Optima or the Peugeot 306.

- (f) The United States has sold no like products in Indonesia and its assertions regarding the GM Opels, Ford Escort and Chrysler Neon are misplaced and speculative

8.214 The United States cannot demonstrate serious prejudice because it has not satisfied the essential like product predicate. As demonstrated in Tables 26 and 27, the Ford Escort, Chrysler Neon and Opel Optimas and Vectras are not like the Timor.<sup>495</sup>

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<sup>493</sup> See generally Japan-Restrictions on Imports of Certain Agricultural Products (22 March 1988), BISD 35S/163 (para. 5.2.2.3 at p. 230); Canada-Import Restrictions on Ice Cream and Yoghurt (5 December 1989), BISD 36S/68 (para. 59 at p. 84); EEC-Restrictions on Imports of Apples--Complaint by the United States (22 June 1989), BISD 36S/135 (para. 5.15 at p. 164); Norway-Procurement of Toll Collection Equipment for the City of Trondheim (13 May 1992), BISD 40S/319 (para. 4.5 at p. 336).

<sup>494</sup> See generally Canada—Administration of the Foreign Investment Review Act (7 February 1984), BISD 30S/140 (para. 5.20 at p. 164); Japan-Restrictions on Imports of Certain Agricultural Products (22 March 1988), BISD 35S/163 (para. 5.1.3.7 at pp. 226-227); EEC-Restrictions on Imports of Dessert Apples--Complaint by Chile (22 June 1989), BISD 36S/93 (para. 12.3 at p. 125).

<sup>495</sup> The United States attempts to buttress its position by asserting that "there is plenty of evidence that in the US market the Sephia is considered to be in the same category as the Escort and Neon." This is unavailing for three reasons. First, the Kia Sephia marketed in the United States is a much more advanced car than the

8.215 Further to the like product issue, the United States suggests that the legal analysis should be confined to consideration of the most basic physical characteristics and end uses of passenger cars. Such an analysis would be inappropriate, however, because it is overly simplistic.

8.216 The United States takes Indonesia to task for extending its analysis beyond the definition of "like product" found in footnote 46 to the Subsidies Agreement, but this is unjustified and, at best, disingenuous. The United States states: "Obviously, this definition provides only general guidance, and a case-by-case analysis is necessary to determine whether a particular product is 'like' another. ...Factors which should be considered in applying a case-by-case analysis include 'a product's end use in a given market, consumer's tastes and habits, which change from country to country, and the product's properties, nature and quality.'"<sup>496</sup> The United States also has noted its agreement with Indonesia that "consumers consider numerous physical and non-physical characteristics in making their purchasing decisions." This irrefutable fact is amply borne out by the following statement appearing in Ford Motor Company's 1996 annual report to the US Securities and Exchange Commission:

Ford's share [of industry sales] is influenced by the quality, price, design, driveability, safety, reliability, economy and utility of its products compared with those offered by other manufacturers, as well as by the timing of new model introductions and capacity limitations. Ford's ability to satisfy changing consumer preferences with respect to type or size of vehicle and its design and performance characteristics can affect Ford's sales and earnings significantly.<sup>497</sup>

8.217 The wide range of acknowledged factors that must be considered in identifying which products are like the Timor further points up the failure of the US (and the EC) to satisfy the burden of proof discussed above.

(g) Indonesia's position on the like product issue does not render the Subsidies Agreement inapplicable to consumer products

8.218 The European Communities and the United States separately argue, in essence, that Indonesia's like product analysis is too restrictive because requiring identity between passenger cars would effectively exclude consumer products from the scope of the Subsidies Agreement. Those arguments are fallacious.

8.219 Indonesia has never claimed that products must be identical to be considered like one another. Indeed, Indonesia agrees that some differentiation can exist among like products. It is critical to emphasize, however, that the concept of differentiation must be carefully circumscribed, taking due account of the types of products at issue. For example, while relatively minor and inconsequential differences exist among many consumer products - such as blenders, can openers and toaster ovens - passenger cars are very highly differentiated products. Two cars might even closely resemble one another in terms of their most basic physical characteristics, but yet still be highly differentiated on the basis of numerous other physical and non-physical characteristics, including design, quality, durability, driveability, safety, reliability, brand loyalty, brand image/reputation, status, after-sales

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Timor--the differences are so great that the Sephia is not "like" the Timor. See Indonesia Exhibit 42 at pp. 8-9. Second, analysts' perceptions of the US market have no relevance to the Indonesian market. Finally, even if such perceptions were relevant, not all analysts put the Sephia in the same category as the Escort and Neon. See Indonesia Exhibit 12.

<sup>496</sup> United States citing Japan-Taxes on Alcoholic Beverages (1 November 1996), WT/DS8/R, Report of the Appellate Body, 22.

<sup>497</sup> Ford Motor Company 1996 Annual Report to US Securities and Exchange Commission in Form 10-K at 5 (Indonesia Exhibit 44).

service, fuel consumption and resale value.<sup>498</sup> This multitude of differentiating features among cars, as well as their much higher cost, distinguishes them from nearly all other consumer products. Thus, although it may be difficult to determine appropriate like product categories for the purposes of this proceeding, that difficulty does not support the sweeping assertions of the European Communities and the United States that the adoption of Indonesia's specific approach to the like product issue in this case would make it impossible to bring a serious prejudice case against a subsidized consumer product.<sup>499</sup>

8.220 Product differentiation is significant to the like product issue for another reason. It is recognized that where there is high degree of product differentiation, products are less substitutable, and price is less likely to be a determining factor in purchasing decisions. The exceptionally high degree of product differentiation between the Timor S515 and the European Communities and United States group of purportedly like cars makes them non-substitutable. This is important because, as the panel in Japan-Taxes on Alcoholic Beverages recognized, all like products are "directly competitive or substitutable products."<sup>500</sup> Thus, because the Timor and none of the proposed comparison models are substitutable or "directly competitive," they cannot be considered like products.<sup>501</sup>

(h) Market segment

8.221 Numerous physical and non-physical attributes and consumer perceptions determine the market segment into which any given model falls. These various factors, include, but are not limited to: brand loyalty; quality; brand image/reputation; reliability; design; durability; utility; resale value; ride and comfort; driveability; standard features; safety features; available options; exterior size; interior space; fuel economy; after-sales service; engine size and technology; transmission type; and suspension type.

8.222 The physical attributes and specifications of the Timor set forth by Indonesia in Table 27, as well as the non-physical attributes and perceptions listed above, place the Timor in the market segment composed of budget small passenger cars. The Timor taps new entrants to the car market through this market segment. The same physical and non-physical attributes and perceptions place the Ford Escort, Opel Optima and Vectra, and Chrysler Neon (and Peugeot 306) at the top of the more elevated small car segment.

8.223 The relative positions of the Timor and the United States (and the European Communities) comparison models are amply demonstrated by reference to just their most basic physical differences (These positions are reinforced and made wider by the different non-physical attributes and perceptions of each model.) There are four basic physical attributes or specification groupings that

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<sup>498</sup> For example, as shown in Table 27, the Timor S515 and Mercedes-Benz C180 have many physical similarities, but one cannot reasonably consider them to be like products.

<sup>499</sup> Those assertions also are belied by the many successful countervailing and antidumping duty proceedings in the EC, the US and other countries that have involved consumer products. The local authorities there have used the same or a very similar like product approach as that appearing in the Subsidies Agreement. See generally Certain Electric Fans from the People's Republic of China, USITC Pub. 2461 (December 1991); Certain Personal Word Processors from Japan, USITC Pub. 2411 (August 1991); Top-of-the-Stove Stainless Steel Cooking Ware from Korea and Taiwan, USITC Pub. 1936 (January 1987).

<sup>500</sup> Japan-Taxes on Alcoholic Beverages (1 November 1996), WT/DS8/R, 121, para. 6.22. Although the Panel there was addressing Article III and the Interpretive Notes in Ad Article III, its general statement in this regard applies with equal force here.

<sup>501</sup> The notion of competition and its importance is clearly reflected in the text of the Subsidies Agreement. Competition is the motive force underlying all of the indicia of serious prejudice presented in Article 6.3: the displacement or impeding of imports, significant price undercutting, significant price suppression, price depression, lost sales, or lost market share.

differentiate passenger cars and contribute to segmenting the market: power plant; steering and suspension; safety features; and passenger compartment.

8.224 The power plant grouping includes: engine configuration and engine size; transmission type; horsepower; and torque. The steering and suspension grouping includes: suspension type; drive wheels; steering system; tyre size; and turning cycle. The safety feature grouping includes: braking system; fuel tank capacity and mileage; curb weight; and passive restraint. The passenger compartment grouping includes: interior dimensions and number of passengers.

8.225 The following table highlights the most significant physical differences that make the Timor "unlike" the proposed comparison models:

Table 26

United States and European Communities - Proposed Comparisons

|  | Ford Escort | Peugeot 306 | Chrysler Neon | Opel Vectra | Opel Optima |
|--|-------------|-------------|---------------|-------------|-------------|
| Power Plant <sup>502</sup>             | N           | N           | N             | N           | N           |
| Steering and Suspension <sup>503</sup> | N           | N           | N             | N           | N           |
| Safety Features <sup>504</sup>         | N           | N           | N             | N           | N           |
| Passenger Compartment <sup>505</sup>   | Y           | Y           | Y             | N           | Y           |

Y = Comparable to the Timor S515

N = Not Comparable to Timor S515

8.226 The full data from which the analysis in Table 26 is derived are presented in the table below:

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<sup>502</sup> In comparison to the Timor, these cars have larger engines with greater horsepower and torque. The Neon has an automatic transmission, which is also available for the Peugeot.

<sup>503</sup> In comparison to the Timor, the Escort, Vectra and Optima have power steering and the Peugeot, Neon, Vectra and Optima have larger tires.

<sup>504</sup> In comparison to the Timor, the Neon, Vectra, and Peugeot have ABS; the Escort has rear disc brakes; the Escort, Neon, Vectra and Optima have air bags; Escort and Neon have superior fuel economy; the Opel Vectra is heavier; and fuel tanks of the Vectra and Peugeot are larger.

<sup>505</sup> Interior space (based on exterior measurements) and the number of passengers accommodated are approximately the same, except for the Vectra, which seats an additional passenger.

Table 27

Comparison of Cars

| Item   | Timor S515                             | Ford Escort                       | Chrysler (Dodge Neon)      | Opel Vectra                   | Opel Optima                   | Peugeot 306  | Mercedes-Benz C-180             |
|--|--|-----------------------------------|----------------------------|-------------------------------|-------------------------------|--|---------------------------------|
| 1. Engine Size (cc)  | 1,498                                  | 1,597                             | 2,000                      | 1,998                         | 1,796                         | 1,761  | 1,799                           |
| 2. Engine Configuration and Number of Valves   | SOHC, 4 Cyl. Carburetor, 16 Valves     | DOHC, 4 Cyl. Injection, 16 Valves | OHC, 4 Cyl. Injection      | SOHC, 4 Cyl. Injection        | SOHC, 4 Cyl. Injection        | SOHC, 4 Cyl. Injection   | 4 Cyl. Injection                |
| 3. Suspension<br><u>Front:</u> Independent, MacPherson Strut<br><br><u>Rear:</u> Fully Independent, Multi-linked | Yes<br><br>Yes                         | Yes<br><br>Yes                    | Yes<br><br>Yes             | Yes<br><br>Yes                | Yes<br><br>Yes                | Yes<br><br>Yes   |                                 |
| 4. Brakes<br>1. Front<br>2. Rear<br>3. ABS   | Disc Brake<br>Drums                    | Disc Brake<br>Disc Brake          | Disc Brake<br>Drums<br>Yes | Disc Brake<br>Drums<br>Yes    | Disc Brake<br>Drums           | Disc Brake<br>Drums<br>Yes   | Disc Brake<br>Disc Brake<br>Yes |
| 5. Drive (Front Wheel)   | Yes                                    | Yes                               | Yes                        | Yes                           | Yes                           | Yes  | No                              |
| 6. Steering  | Rack & Pinion, with collapsible column | Rack & Pinion, power-assisted     |                            | Rack & Pinion, power steering | Rack & Pinion, power steering | Adjustable Column (angle) control under steering wheel, power steering |                                 |
| 7. Transmission (Manual 5 or Automatic)  | Manual 5 Speed                         | Manual 5 Speed                    | Automatic 3 Speed          | Manual 5 Speed                | Manual 5 Speed                | Manual 5 Speed   | Manual 5 Speed                  |
| 8. Horsepower (kw/rpm)   | 58/5,500                               | 75/5,500                          | 97/6,000                   | 80.9/5,400                    | 66/5,400                      | 70/6,000   | 122/5,500                       |
| 9. Torque (kgm/rpm)  | 122/2,500                              | 134/3,000                         | 129/5,000                  | 173/2,600                     | 163/3,200                     | 148/3,000  | 199/3,750                       |
| 10. Fuel Tank Capacity (litre)   | 50                                     | 55                                | 57                         | 61                            | 52                            | 80   | 75                              |



Table 27 - Continued

| Item                                 | Timor<br>S515 | Ford<br>Escort | Chrysler<br>(Dodge Neon) | Opel<br>Vectra | Opel<br>Optima | Peugeot<br>306 | Mercedes-Benz<br>C-180 |
|--------------------------------------|---------------|----------------|--------------------------|----------------|----------------|----------------|------------------------|
| 11. Overall Fuel Efficiency (km/ltr) |               |                |                          |                |                |                |                        |
| - Urban                              | 12.3          | 9.5            | 24.2                     |                |                | 5.8            |                        |
| - Suburban                           | 13.9          | 29.7           |                          |                |                |                |                        |
| 12. Curb Weight                      | 1,055         | 1,110          | 1,102                    | 1,245          | 980            | 1,100          | 1,280                  |
| 13. Height                           | 1,390         | 1,346          | 1,320                    | 1,425          | 1,410          | 1,383          | 1,389                  |
| 14. Width                            | 1,692         | 1,875          | 1,687                    | 1,841          | 1,688          | 1,689          | 1,720                  |
| 15. Length                           | 4,360         | 4,295          | 4,295                    | 4,477          | 1,239          | 4,232          | 4,487                  |
| 16. Wheel Base (mm)                  | 2,500         | 2,523          | 2,600                    | 2,637          | 2,517          | 2,580          | 2,690                  |
| 17. Turning Cycle (metres)           | 4.95          | 5              |                          | 5.33           | 4.99           | 5.45           | 5.37                   |
| 18. Tyre Size                        | 175/70R13     | 175/70R13      | 185/65R14                | 195/60R15-87H  | 195/60R15      | 185/60R14      | 195/65R1591H           |
| 19. Number of Passengers             | 4             | 4              | 4                        | 5              | 4              | 4              | 4                      |
| 20. Air Conditioning                 | Yes           | Yes            | Yes                      | Yes            | Yes            | Yes            | Yes                    |
| 21. Air Bags                         | No            | Yes            | Yes                      | Yes            | Yes            | No             | Yes                    |

(i) The Neon is not "like" the Timor

8.227 In addition to the differences already noted, data presented by the United States shows that the Neon is downright luxurious compared to the spartan Timor. According to the United States, the Neon includes the following equipment as standard features:

- compact disc player;
- an electric sunroof; and
- the new, low-force airbags.<sup>506</sup>

8.228 These items are not even offered as options on the Timor. Yet they are standard on the one United States-made car the United States claims is like the Timor. Also, even the limited physical data on the Neon provided by the United States demonstrates that there are other significant physical differences between the Neon and the Timor. (See Table 23.)

8.229 Moreover, the United States effectively concedes that the Timor is perceived in Indonesia just as Indonesia has described it to this Panel - as a lower-quality, budget car.<sup>507</sup> Of course, as Indonesia has discussed and the United States has acknowledged, consumers' perceptions are critical to their purchasing decisions.

8.230 Particularly instructive is the United States' acknowledgement that the Sephia and the Timor are not the same car. In an attempt to sidestep the issue, the United States states that "the only difference ... is the 'Timor' sticker and, perhaps, the country of origin of some of the parts." The United States then notes in passing that "the version of the Sephia sold in the United States has a slightly larger engine than the version sold in Indonesia."

8.231 Furthermore, the United States engages in a far more egregious manipulation of data when it discusses the power of the two cars. We bring to the Panel's attention the fact that the United States has presented misleading data in a side-by-side comparison of the Timor and the Neon. The United States presents a horsepower figure (which the United States labels "HP") in describing the Timor's power output, but a kilowatt-at-rpm figure for the Neon without noting the change in the measurement. The result is an 85 to 98 comparison, instead of the appropriate 85 to 129 horsepower comparison, which, of course, undercuts the United States' position. Moreover, we note that, insofar as the Neon is a US-made car, Chrysler markets it based on horsepower. We trust that the United States did not use this bait and switch intentionally to mislead the Panel, hoping that the improper comparison would go unnoticed.

8.232 Indonesia already has demonstrated conclusively what the United States still seeks to avoid admitting: even the Sephia is not "like" the Timor. The Timor is the Sephia of years gone by. Unlike any producer from the United States, the European Communities or Japan, Kia was willing to license its outdated technology at a fair price, but not even Kia was willing to licence its current technology.

(b) CKDs as "like" finished Timors

8.233 According to the parties, the GM Opel Optima and Vectra, the Ford Escort, the Peugeot 306 and the Chrysler Neon, among other models, are (or would be) imported into Indonesia in Completely-Knocked-Down ("CKD") (rather than CBU) form. Once in Indonesia, they are assembled and sold. The **European Communities** and the **United States** argue that these imports in

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<sup>506</sup> US Exhibit 24, p. 18 lists these items as standard equipment for the Neon.

<sup>507</sup> *Id.*, p. 35 (article notes potential buyers' concerns about the Timor's quality and after-sales service).

CKD form are "like" finished Timors. **Indonesia** disagrees. The following are the parties arguments in this regard:

(1) Arguments of the European Communities

8.234 The proposition that CKD cars must be considered as "like" to assembled complete passengers where the CKD kit already has the "essential character" of the complete car is supported by a generally accepted principle of customs classification, now contained in Rule 2(a) of the General Rules for the Interpretation of the 1996 Harmonised System. According to this principle:

Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled

8.235 Given that Indonesia grants import duty relief for the importation of parts and components for the assembly of passenger cars when the local content of the cars into which they are assembled is more than 20 per cent, imported CKDs may be considered as having the "essential character" of a complete car in those cases where they have not benefited from import duty relief.

8.236 The criteria applied by Indonesia in order to classify the same products when imported into Indonesia still remain unclear. Indeed, the mere fact that those CKD kits benefit from a lower import duty rate does not necessarily mean that they are not classified within the same HS six-digit code as CBU cars. If it was confirmed that the CKD kits exported from the EC are classified by Indonesia as parts and components, rather than as passenger cars, the necessary implication would be that Indonesia does not follow General Interpretative Rule 2(a).

8.237 At any rate, whether or not Indonesia adheres in practice to General Interpretative Rule 2(a) is totally irrelevant to this dispute. The European Communities has invoked General Interpretative Rule 2(a) in support of its contention that CKD kits and CBU cars have "closely resembling characteristics" and, therefore, are "like" products for the purposes of the SCM Agreement. That argument has a general relevance and remains valid, irrespective of whether the importing Member concerned in a particular dispute complies with that rule or not.

8.238 In response to a question from the Panel regarding the condition in which the CKD kits are imported, and the nature and amount of value added in Indonesia, the **European Communities** stated the following:

8.239 Virtually all EC cars (of all models) are exported to Indonesia as CKD kits. The kits already include almost all the parts and components necessary for assembling the cars. The only parts and components which are purchased in Indonesia are low cost universal components, such as batteries and tyres, or accessories such as radios, CD-players and loudspeakers. As a result, the percentage of local added value is very low in all cases. According to the data provided by Indonesia in response to a question raised by the United States during the consultations, (see table below) in 1996, the local content percentage of the EC models assembled in Indonesia ranged from 6.4 per cent to 8.2 per cent.

Table 28

Local Content

| Kind Of Vehicles                | Original country   | Local Content (%) |                 |                 |
|---------------------------------|--------------------|-------------------|-----------------|-----------------|
|                                 |                    | 1994              | 1995            | 1996            |
| <b>I. <u>Commercial Car</u></b> |                    |                   |                 |                 |
| Category I                      | Japan              | 12.201 - 61.016   | 6.398-48.127    | 6.470 - 45.398  |
|                                 | United States      | 29.078            | -               | -               |
|                                 | European Community | -                 | 5.760           | -               |
| Category II                     | Japan              | 31.815 - 37.502   | 23.404 - 33.672 | 24.610 - 33.976 |
|                                 | United States      | -                 | -               | -               |
|                                 | European Community | 21.604            | 25.353 - 28.109 | 22.005 - 22.517 |
| Category III                    | Japan              | 31.164 - 36.621   | 30.431 - 36.060 | 25.295 - 34.819 |
|                                 | United States      | -                 | -               | -               |
|                                 | European Community | 23.061 - 31.634   | 29.273 - 30.964 | 22.529 - 23.280 |
| Category IV                     | Japan              | 1.000 - 31.994    | 2.725 - 30.796  | 3.977 - 30.162  |
|                                 | United States      | 2.200 - 11.800    | 2.200           | -               |
|                                 | European Community | -                 | 4.682           | 4.689           |
| <b>II. <u>Passenger Car</u></b> |                    |                   |                 |                 |
|                                 | Japan              | 5.000 - 42.968    | 6.231 - 42.248  | 6.908 - 42.165  |
|                                 | United States      | 6.000             | 7.536 - 11.200  | 7.663 - 11.066  |
|                                 | European Community | 5.000 - 6.327     | 6.222 - 7.858   | 6.388 - 8.292   |
|                                 | Korea              | -                 | 5.016 - 8.304   | 6.529 - 8.300   |

(2) Arguments of the United States

8.240 The United States agrees with the European Communities that CKD passenger cars must be considered as "like to the assembled complete passenger cars in those cases where the CKD kit has already the 'essential character' of the complete car" for the reasons set forth by the European Communities. The United States would add that, to a large extent, world trade in automobiles is conducted in the form of the export and import of unassembled vehicles, as opposed to completely built-up, finished vehicles. Certainly that is the case in Indonesia, where the only passenger car that has been imported in CBU form and in sizeable quantities was the Kia Sephia during the one-year period in which the tariff and tax exemptions were in effect. Because a CKD passenger car has the essential character of a complete car, it would exalt form over substance to find that a CKD passenger car is not a like product to a finished car.

8.241 In response to a question from the Panel regarding the condition in which the CKD kits are imported, and the nature and amount of value added in Indonesia, the **United States** stated the following:

8.242 In the case of Ford, the Escort CKD kits would have been ordered in groups of 20 vehicles; i.e., an order could be for any multiple of 20 vehicles, such as 20, 40, 60, etc. The kits would have been packaged in waterproof, pre-engineered cases to accept the exact content of the kit, such as the correct number of hoods, fenders, engines, etc. The pre-engineered cases then would have been placed in standardized cargo containers for delivery to the port and subsequent ocean shipment. The CKD kit would have contained all of the individual parts necessary to build a complete Escort, except for locally procured parts and components, such as oil and gasoline.

8.243 With respect to local content, the initial local content of Ford Escorts would have been well below the 20 per cent threshold for obtaining tariff incentives under the 1993 Programme, although Ford planned on increasing the local content over time.

8.244 With respect to the Chrysler Neon, the kits would have been shipped in lots of 72 vehicles. Because under the project, as planned, Neons would have had less than 10 per cent local content, this would have resulted in 85 boxes per lot. The United States does not have a complete list of the components that would have been sourced from Indonesia. According to Chrysler officials, however, due to the low local content, the items that would have been sourced locally would have included such things as paints, oils, gasoline, and other commodities.

8.245 The United States has requested, but not received, information from General Motors concerning the precise composition of its CKD kits.

(3) Arguments of Indonesia

8.246 CKD cars are not "like" finished cars. Although various Customs regimes classify for tariff purposes incomplete, unfinished or unassembled products and finished products under the identical HTS number, this fact in and of itself does not make a completed "ready-to-sell" automobile a like product to an incomplete, unfinished or unassembled car that after importation requires the addition of critical components, labour, capital resources and equipment before it is "ready-to-sell".

8.247 Designation of unassembled and assembled products as like products results in comparisons between articles that are physically dissimilar with different customers and customer expectations. These resultant apples-to-oranges comparisons are economically and legally meaningless.

8.248 The phrase "essential character" is a tariff classification concept. It is not a concept that can be used as the dispositive factor when complainants attempt to cobble together an unworkable comparison analysis.

(c) "Imports" from/"exports" by complainant

8.249 In response to a question from the Panel, the **United States** addressed the question of whether serious prejudice to the interests of the United States could arise in terms of displacement/impedance and price undercutting where the products being displaced/impeded or whose prices were being undercut were not of US origin. The following are the **United States'** arguments in this regard:

(1) Arguments of the United States

8.250 With respect to the Escorts that Ford planned to import into Indonesia, according to Ford's project plan for Indonesia, they would have been sourced from Europe. With respect to the Opel Optimas and Vectras imported into Indonesia, it is the understanding of the United States that imports of Opel Optimas and Vectras have ceased as a result of the National Car programme, although it is possible that cars from inventory may still be available for sale in Indonesia. Prior to the introduction of the National Car programme, Opels were sourced from Europe. With respect to the Chrysler Neons to be imported into Indonesia, they would have been sourced from the United States; specifically, from Chrysler's plant in the state of Illinois.

8.251 It is the understanding of the United States that there are no passenger cars of US origin, in CBU or CKD form, that currently are imported into Indonesia. See AV/13, US Answer to Question #6. While the stray import of a US-origin passenger car cannot be ruled out, as demonstrated below, the US manufacturers cancelled their plans to export passenger cars to Indonesia due to the introduction of the National Car programme. Therefore, at present, vehicle exports (other than trucks) of US origin consist of kits of GM (Opel) Blazers and Jeep Cherokees, both of which fall into the category of "light commercial vehicles."

8.252 It is the view of the United States that serious prejudice to the interests of the United States in terms of displacement/impedance and price undercutting may arise where the products being displaced/impeded or whose prices are being undercut are not of US origin. The reasons for this are as follows:

8.253 Article 6.1 of the SCM Agreement refers to "[s]erious prejudice in the sense of paragraph (c) of Article 5 ... ." Article 5(c), in turn, refers to "serious prejudice to the interests of another Member". In addition, footnote 13 to Article 5(c) states as follows: "The term 'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice." The second sentence of Article XVI:1 states as follows: "In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization." Thus, one has to start with Article XVI:1.

8.254 The second sentence of Article XVI:1, by its terms, does not limit a Member's right to complain about serious prejudice to situations where the products that are being affected by subsidies are of that particular Member's origin. Instead, Article XVI:1 refers to a Member's "interests", the ordinary meaning of which is "the state of being concerned or affected esp. with respect to advantage or well-being". Because General Motors and Ford are undeniably US companies, the United States has a legitimate concern with respect to the well-being of those companies. Thus, actions that affect those companies, or products produced and sold by those companies, affect the interests of the United

States within the meaning of Article XVI:1. In other words, under Article XVI:1, the United States has an "interest" in exports from the EC of the products of US companies, such as General Motors and Ford. The standard of Article XVI:1, through footnote 13, is incorporated into Part III of the SCM Agreement as a basic principle. Had a different result been intended, the drafters could have easily used different language.

8.255 It is true that some of the provisions of Article 6 do and some do not mesh perfectly with this basic principle. Paragraphs (a) through (c) of Article 6.3, for example, simply refer to the effects on like products from "another Member", as opposed to products from the complaining Member, and are consistent with the basic principle of Article XVI:1 and Article 5(c). Paragraph (d) of Article 6.3 does not refer to the effects on like products at all.

8.256 On the other hand, Article 6.7, which describes situations in which serious prejudice shall not arise under Article 6.3, refers to imports or exports from the complaining Member. In the view of the United States, however, the specific rules in Article 6.7 should be interpreted in light of the basic principle in Article XVI:1, as incorporated into Article 5©, and should not be used to override the basic principle.

(2) Arguments of Indonesia

8.257 **Indonesia** argues that the fact that no products of US origin are sold in Indonesia means that the United States has no claim of serious prejudice. The following are **Indonesia's** arguments in this regard:

8.258 The United States admits that:

"there are no passenger cars of United States origin, in CBU or CKD form, that currently are imported into Indonesia";

Opel Optimas and Vectras imported into Indonesia were and would be sourced from the European Communities, not from the United States; and

even if the so-called "plans" of the Big Three were relevant, only one United States company - Chrysler - ever considered exporting a US-made product from the United States to Indonesia (a CKD Neon). Opel sources from the European Communities and the United States admit that Ford would have sourced any Escorts destined for Indonesia from Europe.

Thus, the United States has reduced its serious prejudice claim to one, quite simple, inadequately substantiated allegation: But for the Indonesian measures, Chrysler would have gone forward with its supposed "plans" to try to sell the Neon in Indonesia. Even if this were true, it would not amount to serious prejudice. Therefore, the Panel should reject the United States claims and reject its complaint.

4. Article 6.3(a) of the SCM Agreement - displacement/impedance of imports

(a) Arguments of the European Communities

8.259 The **European Communities** claims that the subsidies at issue cause “serious prejudice” to the interests of the Community in the way described in paragraphs (a) and (c) of Article 6.3 of the SCM Agreement. The following are the **European Communities'** arguments in support of this claim:

8.260 In accordance with Article 6.3 of the SCM Agreement, serious prejudice in the sense of Article 5 © may arise:

.... in any case where one or several of the following apply:

- (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
- (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;
- (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another member in the same market or significant price suppression, price depression or lost sales in the same market”;
- (d) the effect the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidised primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over period when subsidies have been granted.

8.261 The use of the alternative conjunction “or” in the chapeau of Article 6.3 clearly indicates that the presence of one of the factors listed in that provision may be sufficient to establish the existence of serious prejudice.

8.262 The Community claims and will demonstrate here below that the subsidies under consideration cause serious prejudice to the interests of the Community in the manner described in paragraphs (a) and (c) of Article 6.

(1) Subsidized National Cars have displaced and impeded imports of passenger cars from the European Communities

8.263 Although PT TPN entered the Indonesian market only in October 1996, by the end of that year sales of the Timor S-515 already accounted for more than 10 per cent of the total annual sales of passenger cars in that market during 1996. During 1997, sales of the Timor S-515 have continued at a steady pace. As shown in the table included in Annex C-2, by the end of the first semester of 1997, the market share of the Timor S-515 had reached 26.52 per cent. In other words, thanks to the massive subsidisation provided by the Indonesian Government, PT TPN has been able to capture more than a quarter of the Indonesian market for passenger cars in just nine months.

8.264 PT TPN's successful entry into the Indonesian market has taken place, to a significant extent, at the expense of imports from the Community. Indeed, sales of the heavily subsidized Timor S-515 have both “replaced” existing imports of Community passenger cars and “impeded” a further increase in Community imports.



Table 29

Sales of Passenger Cars - Market shares

|          | 1993 | 1994  | 1995  | 1996  | 1997* |
|----------|------|-------|-------|-------|-------|
| Timor    | -    | -     | -     | 10.10 | 26.52 |
| EC**     | 9.9  | 18.28 | 23.72 | 24.09 | 16.15 |
| Japan*** | 89.8 | 81.52 | 69.08 | 59.85 | 50.49 |
| Other    | 0.2  | 0.21  | 7.19  | 5.95  | 6.83  |

\* April-May 1997

\*\* Includes sales of the Opel Optima and the Opel Vectra

\*\*\* Includes sales of the Ford Laser and the Ford Telstar

Source: AV/3 (data derived from attachments A-39/1-A through A-39/5-B).

8.265 Since 1992 and until 1996, exports of passenger cars from the Community grew at a faster pace than demand, resulting in a significant gain in terms of market share. As shown in Table 29, the market share held by passenger cars imported from the Community nearly doubled between 1993 and 1994, from 9.9 per cent to 18.28 per cent, and increased again the following year to 23.72 per cent.

8.266 In 1996, this trend was abruptly interrupted by the entry into the market of the Timor S-515. Thus, the Community's share for 1996 was only marginally higher (24.09 per cent) than its share for 1995 (23.72 per cent). During the first half of 1997, the share held by European Communities imports fell dramatically to only 16.15 per cent, the lowest level since 1993.

Table 30

Sales of the Opel Optima and the Peugeot 306 - Units

|             | 1995   | 1996   | 1997*  | 1997** |
|-------------|--------|--------|--------|--------|
| Opel Optima | 419    | 359    | 165    | 257    |
| Peugeot 306 | -      | 1,017  | 443    | 656    |
| Total       | 38,826 | 42,345 | 26,607 | 49,568 |

\* April-May

\*\* August 1997, based on data from the EC industry

Source: AV/3 (Attachment A-39/1-B).

Table 31

Market shares of the Opel Optima and the Peugeot 306

|             | 1995 | 1996 | 1997* | 1997** |
|-------------|------|------|-------|--------|
| Opel Optima | 1.08 | 0.85 | 0.62  | 0.52   |
| Peugeot 306 | -    | 2.40 | 1.66  | 1.32   |

\* April-May

\*\* August, based on data from the EC industry.

Source: AV/3 (Attachment A-39/1-B).

8.267 Tables 30 and 31 show the impact of the introduction of the Timor S-515 on the sales of the Opel Optima and of the Peugeot 306, the two Community models which are the closest in terms of specifications and price to the Timor S-515.

8.268 The Peugeot 306 was not sold in Indonesia during 1995. In 1996, Peugeot sold 1,017 units of this model, 400 units less than it had originally planned. During the first eight months of 1997 the number of cars sold was only 656 (984 units on an annualized basis, i.e. 33 units less than in 1996). And this despite a substantial increase in overall demand. Indeed, by the end of August 1997, total sales of passenger cars in Indonesia already exceeded by almost 20 per cent the volume sold during the whole of 1996. As a result, the market share of this model shrank from 2.4 per cent in 1996 to just 1.3 per cent during the first eight months of 1997.

8.269 The sales of the Opel Optima fell from 419 units in 1995 to 359 units in 1996. During the first eight months of 1997, Opel sold 257 units of this model. In terms of market share, this represent a decline from 1.08 per cent in 1995 to 0.85 per cent in 1996 and to only 0.52 per cent during the first eight months of 1997. Due to the depressed sales situation, Opel has not ordered any new CKD Optimas from the European Communities since 1996.

8.270 The negative effects of the National Car Programme are not limited to those felt by those Community brands/models that were already present in the Indonesian market. The National Car Programme has also preempted other Community brands/models from entering the Indonesian market.

8.271 Thus, for instance, when the National Car Programme was adopted, Ford was about to start importing CKD Escorts made at its plant in Saarlouis (Germany). With that purpose, Ford had already invested close to US\$1 million worth of tooling in Indonesia. The market upheaval caused by the launching of the National Car Programme forced Ford to suspend indefinitely those plans.<sup>508</sup>

8.272 Similarly, prior to the approval of the National Car Programme, General Motors/Opel had advanced plans to expand and upgrade its assembly facilities in Indonesia. According to those plans, the Opel Optima and the Opel Vectra were to be replaced by new Opel models. In June 1996, General Motors/Opel announced that the planned investments were put on hold because of the situation

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<sup>508</sup> According to a business plan adopted in 1995, Ford would have exported to Indonesia the following quantities of CKD Escorts:

| <u>1996</u> | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> |
|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1,323       | 3,468       | 5,156       | 7,370       | 12,026      | 13,867      | 16,026      | 18,433      |

created by the National Car programme.<sup>509</sup> Since then, General Motors/Opel has discontinued the production in Indonesia of the Opel Vectra. As shown above, although the Opel Optima is still being assembled in Indonesia, sales of that model are dwindling.

8.273 Indonesia makes partial and misleading statements which aim at minimising the importance of the European Communities interests in this case and, thereby, also the seriousness of the prejudice suffered by the European Communities. Thus, Indonesia argues that:

- in 1995 European Communities brands accounted for only 3.3 per cent of total vehicle production in Indonesia;
- exports of motor vehicles and parts to Indonesia were under US\$300 million in 1995;
- European Communities exports consist of Mercedes and BMWs which do not compete with the "small, low technology Timor".

8.274 The percentage mentioned by Indonesia relates to the total market for motor vehicles. The European Communities complaint concerns only the market for passenger cars. In that market the European Communities share reached 24 per cent in 1996.

8.275 Admittedly, in absolute terms the European Communities exports of passenger cars to Indonesia are small. The reason for this, however, is that the Indonesian market itself is still very small (42,346 units in 1996). Indonesia's market for passenger cars nevertheless has considerable growth potential, especially in the middle and small segments. The National Car programme threatens to dislodge the European Communities exporters from the positions they have taken already in that market and prevent them from taking advantage of that growth.

8.276 In any event, it is obvious that the existence of "serious prejudice" in the sense of Articles 5 and 6 of the SCM Agreement is not dependant upon the absolute size or monetary value of the "prejudice". The "seriousness" of the prejudice must always be assessed in relation to the market concerned.

8.277 Sales of models in the high segment of the market still account for a majority of the European Communities exports to Indonesia. To a large extent, this reflects the structure of the Indonesian market, where cars falling within the small and middle segments have accounted traditionally for a smaller share than in more mature markets. Nonetheless, contrary to the impression that Indonesia would like to convey to the Panel, the European Communities does not export to Indonesia only Mercedes and BMWs. In 1996, sales of the Peugeot 306 and the Opel Optima accounted for 15 per cent of the EC exports.

8.278 Indonesia alleges that:

- "... sales of passenger cars carrying EC brand names increased from 8,554 units in 1995 to 9,526 units in 1996"
- "... the market share developments are meaningless ... Market share and demand growth are not necessarily correlated. Many extraneous factors influence this relationship, including changes in customer preferences..."

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<sup>509</sup> See e.g. "GM Halts Indonesia move over national car policy", Financial Times, 13 June 1996 (EC Exhibit C-10).

- "... Timor tapped a new class of buyers and created a new market niche at the bottom"

8.279 Comparison of the sales figures for 1995 and 1996 can be misleading, since the Timor S-515 only entered the market in October 1996. A comparison of the corresponding figures for 1996 (10,075 units) and 1997 (10,714 units on an annualized basis<sup>510</sup>) shows that the increase in sales of European Communities imports was less "substantial" than claimed by Indonesia (ca. 6 per cent). Furthermore, even that modest overall increase masks the fact that during 1997 sales of the Opel Optima have stagnated and sales of the Peugeot 306 have fallen in absolute terms.

8.280 In any event, displacement or impedance of imports in the sense of Article 6.2 of the SCM Agreement may exist not only where imports fall in absolute terms but also in cases where there is a decrease in their market share. This is implicit in the notion of "impedance", which purports to cover the situation where subsidized goods do not displace any pre-existing imports but rather pre-empt imports (including additional imports) from taking place.

8.281 The argument that a loss of market share may constitute serious prejudice is further confirmed by Article 6.4 of the SCM Agreement, which provides that:

For the purposes of paragraph 6.3 (b), the displacement or impeding of exports shall include any case in which .... it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in the normal circumstances shall be at least one year. 'Change in relative shares of the market', shall include any of the following situations: (a) there is an increase in the market share of the subsidized product ...

Although, by its own words, Article 6.4 applies to third-country market situations, there is no reason why the same type of analysis should not be appropriate also in the case of displacement or impedance of imports from the market of the subsidizing country.

8.282 It is worth recalling that, in accordance with Article 15.4 of the SCM Agreement, market shares are one of the relevant factor in establishing whether subsidies imports have caused "injury to the domestic industry" of another Member for the purposes of both Article 5 (a) and Part V of the SCM Agreement.

8.283 Indonesia's contention that "... market share and demand growth are not necessarily correlated" and that "... many extraneous factors influence this relationship, including changes in customer preferences..." is but a mere truism. The European Communities has shown that the fall in market share of European Communities imports has taken place simultaneously with a parallel increase in the market share of subsidized domestic products which have undercut significantly the prices of the European Communities imports. Furthermore, that decrease has interrupted brusquely an upward trend. All this is more than sufficient evidence to conclude that the decline in the market share of European Communities imports has been caused by the subsidies at issue and not by any other "extraneous factor". Especially, since Indonesia has not provided any evidence whatsoever that "other factors" may have caused the sudden decrease in the market share of European Communities imports.

8.284 Indonesia's proposition that the Timor has generated entirely its own demand is purely speculative and cannot be demonstrated. Demand for passenger cars, and in particular for passenger

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<sup>510</sup> Based on Indonesia Exhibit 40.

cars within the same segment as the Timor, had grown steadily over the past few years. It would have continued to increase even without the National Car Programme. That "natural" increase of the market has been captured by the Timor S-515, at the expense of other non-subsidized cars, together with any additional demand allegedly created by the National Car Programme.

8.285 Indonesia's argument that the Timor has "tapped into a new class of consumers" and created its own demand is, in fact, again the same proposition as Indonesia's threshold argument that the Timor is not "like" the European Communities cars. The notion of "competitive" products is broader and encompasses that of "like" products. If the European Community cars are "like" the Timor, it follows necessarily that they compete with the Timor for the same customers. It is conceivable that, due to its very low subsidized price, the Timor may have generated some additional demand for passenger cars. Yet, the Timor has captured not only that additional demand but also sales to customers which, in the absence of the National Car Programme, would have purchased other "like" non-subsidized passenger cars.

(b) Arguments of the United States

(1) Information concerning serious prejudice

(a) The Timor Kia Sephia rapidly acquired a substantial share of the Indonesian market and significantly undercut the prices of other passenger cars in its class

8.286 The introduction of the National Motor Vehicle programme and the announcement that a "national motor vehicle", the Timor Kia Sephia sedan, would soon be on the market at a price of Rp. 35 million had an immediate impact on the market. Soon, there were reports in the press that, as of the beginning of 1996, car sales were falling as Indonesians postponed new vehicle purchases in anticipation of Timor's entry.<sup>511</sup> "Car industry executives predicted that while the Indonesian new car market was growing, the cheap Timor 'national car' would lead people to switch brands rather than promote dramatic industry-wide sales growth".<sup>512</sup>

8.287 These predictions proved accurate. Although the success of the Timor Kia Sephia was not as great as TPN officials predicted, it nonetheless captured a sizeable share of the Indonesian passenger car market. Attachment A-39/6 to AV/3 provides the market share of the Timor Kia Sephia. According to Attachment A-39/6, the Timor Kia Sephia went from a market share of zero in February 1996 (when the National Motor Vehicle programme was announced and Kia Timor was named as the producer of the "national motor vehicle") to a 10.11 per cent market share by the end of 1996. By the end of May 1997, the end of the period covered in Attachment A-39/6, the market share of the Timor Kia Sephia had catapulted to 26.53 per cent in little more than one year.

8.288 The reason why the Timor Kia Sephia could achieve such a significant market penetration in so short a period of time is simple: the Timor Kia Sephia was, and is, the cheapest passenger car in its

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<sup>511</sup> "Early Launching for National Car," Business Times (Singapore), July 9, 1996, p 7 (US Exhibit 14, pp. 96-97); see also "Indonesia's Ghost Car Gives Japan Makers a Shudder," Reuters World Service, 10 May 1996 (Exhibit 14, pp. 33-35).

<sup>512</sup> "Indonesia Car May Not Meet Local Content Clause," The Reuter Asia-Pacific Business Report, 29 July 1996 (US Exhibit 14, pp. 103-104).

class on Indonesian roads.<sup>513</sup> Because of the huge tariff and tax subsidies it enjoys, the Timor Kia Sephia can be sold for 50 per cent of the price of its rivals.<sup>514</sup>

8.289 The data on list prices for passenger cars in Indonesia provided by Indonesia through the Annex V procedure attests to the tremendous price advantage enjoyed by the Timor Kia Sephia. (Attachment A-40/1 to AV/3) As these data demonstrate, the Timor Kia Sephia significantly undercut the prices of every passenger car in its class:<sup>515</sup>

Table 32

List Prices

| Manufacturer & Passenger Car Model | November 1996 price<br>in rupiahs | March 1997 price<br>in rupiahs |
|------------------------------------|-----------------------------------|--------------------------------|
| Timor Kia Sephia S515 metallic     | 33.5 million                      | 33.5 million                   |
| Timor Kia Sephia S515i metallic    |                                   | 36.9 million                   |
| Opel Optima GLS 1800cc             | 69.5 million                      | 70 million                     |
| Toyota Corolla M/T 1600cc          | 71.1 million                      | 68.3 million                   |
| Toyota Corolla A/T 1600cc          | 74.8 million                      | 71.8 million                   |
| Mitsubishi Lancer M/T 1600cc       | 64.0 million                      | 65.0 million                   |
| Mitsubishi Lancer A/T 1600cc       | 67.0 million                      | 68.0 million                   |
| Mitsubishi Lancer DOHC 1800cc      | 72.0 million                      | 72.0 million                   |
| Honda Civic 4dr, GKP 1600cc        | 72.5 million                      | 71.2 million                   |
| Honda Civic 4dr, AKP 1600cc        | 76.2 million                      | 74.9 million                   |
| Peugeot 306 M/T 1761cc             | 62.5 million                      | 63.0 million                   |
| Peugeot 306 A/T 1761cc             | 64.8 million                      | 65.5 million                   |
| Daewoo Nexia DOHC 1500cc           |                                   | 43.0 million                   |

<sup>513</sup> "Indon Domestic Car Sales Race up by 41 per cent in May," Business Times (Singapore), 17 June 1997 (US Exhibit 14, pp. 138-139).

<sup>514</sup> "Bumpy Road Ahead for Motoring Plans," South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-135). In this regard, because of the high tariffs on imported automotive parts and the 35 percent luxury tax on passenger cars, "car prices in Indonesia are among the highest in the world." "Indonesia Draws More Criticism Over Car Plan," The Nikkei Weekly, 17 June 1996, p. 1 (US Exhibit 14, pp. 80-83).

<sup>515</sup> The passenger cars included in the table fall within "Segment C" of the motor vehicle market. See McGraw-Hill World Car Industry Forecast Report, February 1997, pp. 284-85, included in Annex 1 to AV/2. Cars falling within a particular market segment will be of roughly the same size, be in the same price range, and share the same target customers. Segment C includes "lower medium class" passenger cars.

8.290 Significant price undercutting by the Timor Kia Sephia appears when one compares market prices instead of list prices. Annex 3 to AV/2 contains market prices for the last quarter of 1996. Using these data the market prices for passenger cars in Segment C were as follows:

Table 33

Market Prices

| Manufacturer & Passenger Car Model | 4 <sup>th</sup> Quarter 1996 price in rupiahs |
|------------------------------------|---|
| Kia Timor Sephia                   | 35.75 million                                 |
| Opel Optima GLS                    | 59 million                                    |
| Opel Optima CDX                    | 62 million                                    |
| Opel Optima CDX A-BAG              | 64 million                                    |
| Toyota Corolla 1.6XLI              | 66.35 million                                 |
| Toyota Corolla 1.6 SEG MT          | 71.35 million                                 |
| Toyota Corolla 1.6 S-CRUISE MT     | 74.85 million                                 |
| Toyota Corolla 1.6 SEG AT          | 75.25 million                                 |
| Mitsubishi Lancer 1.6 MT           | 65 million                                    |
| Mitsubishi Lancer 1.6 AT           | 70.5 million                                  |
| Mitsubishi Lancer 1.8 MT           | 75.5 million                                  |

- (b) As a result of the National Motor Vehicle programme and the introduction of the heavily subsidized Timor Kia Sephia, US motor vehicle manufacturers abandoned their plans to export passenger cars to the Indonesian market

8.291 The phenomenal market penetration of the Timor Kia Sephia came, in part, at the expense of US motor vehicle manufacturers. Prior to the introduction of the National Motor Vehicle programme and the subsidized Timor Kia Sephia, General Motors, Ford, and Chrysler each had plans to increase their penetration of the Indonesian passenger car market. However, each company had to abandon or suspend its plans as a result of the National Motor Vehicle programme.<sup>516</sup>

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<sup>516</sup> In addition, the United States should note that it has additional information in its possession documenting the plans of Ford, GM, and Chrysler. However, because this information is business proprietary, the United States is reluctant to provide it to the Panel unless the Panel establishes adequate procedures to protect such information.

(i) General Motors

8.292 In the case of GM, it already had invested \$110 million in an assembly plant in Bekasi, West Java, that produced about 7,000 Chevy Blazers (badged as "Opels" in Indonesia), Opel Optimas and Opel Vectras per year.<sup>517</sup> GM had established 34 full service dealerships and, as of November 1996, had 550 employees in Indonesia.<sup>518</sup> It was considering investing in plant expansion, and had approval to bring in new models for the Opel Optima and Opel Vectra.<sup>519</sup> Although the precise figures are confidential, GM's business plan called for sales of Opel Optimas and Vectras in excess of 1,000 cars in 1996 and around 3,000 cars in 1997, with progressive increases in subsequent years.<sup>520</sup>

8.293 However, because of the National Motor Vehicle programme, GM had to put its plans for additional investment in Indonesia on hold.<sup>521</sup> In addition, GM cut back its existing assembly plant from two production shifts to one.<sup>522</sup> According to Indonesia's own information, GM sold only 549 Opels in Indonesia in 1996, and only 176 in the first half of 1997.<sup>523</sup>

8.294 In addition to affecting sales volumes, the introduction of the subsidized Timor Kia Sephia also affected GM's prices. During the period September 1995 - September 1996, the company's transaction prices in Indonesia were reduced by \$7,000 per unit.<sup>524</sup> Moreover, GM's Business Plan/Budget called for price increases on Opel Optimas and Vectras in line with historical price/inflation trends in Indonesia. Historically, the Consumer Price Index (CPI) has increased 8-10 per cent annually in Indonesia, and automotive pricing closely tracks the CPI. However, the introduction of the Timor Kia Sephia resulted in an artificial flattening of motor vehicle prices, while the CPI continued to increase.<sup>525</sup>

(ii) Ford

8.295 In the case of Ford, it had well-advanced plans to import and sell Ford Escorts in Indonesia.<sup>526</sup> Ford had committed to the development of a joint venture, had assigned four full-time employees in Indonesia, and was actively pursuing the acquisition of assembly facilities in Indonesia.<sup>527</sup> Ford had committed assets of \$1 million that included production and assembly equipment, tooling, component parts, and engineering, all of which were in Indonesia prior to the announcement of the National

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<sup>517</sup> See, e.g., "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics--and a Familiar Face at the Helm," Time, 10 June 1996, p. 40 (US Exhibit 14, pp. 69-71); see also "GM Halts Plans for Indonesia Car; Firm Requests Clarification on National Car Policy," The Dallas Morning News, 12 June 1996, p. 6B (US Exhibit 14, pp. 75-76).

<sup>518</sup> Source: US companies.

<sup>519</sup> Source: US companies.

<sup>520</sup> These figures are slightly higher than the projections concerning the Indonesian production/assembly of Opels set forth in East Asian Automotive Growth Markets, Summer 1994, pp. 370-371, which was included as part of Annex 1 to AV/2.

<sup>521</sup> "GM Freezes Indonesian Investment; Policies Create an 'Unlevel Playing Field'," Automotive News, 17 June 1996, p. 38 (Exhibit 14, pp. 84-85); see also "A Furious Flap Over Favouritism," Business Week, July 8, 1996 (US Exhibit 14, pp. 92-95).

<sup>522</sup> Source: US companies.

<sup>523</sup> AV/3, Attachment A-39/5-B.

<sup>524</sup> Source: US companies.

<sup>525</sup> Source: US companies.

<sup>526</sup> "Ford Seeks Inroads in Booming Asian Auto Market," The Reuter European Business Report, 25 April 1996 (US Exhibit 14, pp. 29-30).

<sup>527</sup> Source: US companies; see also "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics -- and a Familiar Face at the Helm," Time, 10 June 1996, p.40 (US Exhibit 14, pp. 69-71).



Motor Vehicle programme.<sup>528</sup> Ford had an approved investment plan of \$56 million, with the feasibility of future investment in assembly to be determined based upon the needs of the market and manufacturing requirements.<sup>529</sup> These plans were part of a broader Asian strategy which already had resulted in investments of \$700 million in India, \$500 million in Thailand, \$350 million in China, and \$100 million in Vietnam, and Ford's total investment in Indonesia easily could have been in line with Ford's investments in these other countries in the region.<sup>530</sup>

8.296 In terms of projected sales volume, the Escort was projected to achieve 5.2 per cent, 10 per cent, 10.5 per cent, and 11 per cent in the first four years after its introduction in 1996, or approximately 15,000 units over the first four years.<sup>531</sup>

8.297 However, like GM, Ford had to scrap its plans in light of the National Motor Vehicle programme.<sup>532</sup> As a result, the projected 15,000 sales of Ford Escorts will not take place. Based on the company's estimates, if Ford had gone ahead with its plans and imported and sold Escorts in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Escort by more than US\$5,000.<sup>533</sup>

(iii) Joint letter from Ford and General Motors

8.298 The **United States** submitted a joint letter from Ford and General Motors, prepared in the context of this dispute, describing "data necessary to establish serious prejudice" and addressing "questions submitted by Indonesia to the United States". (US Exhibit 38.) The following is the text of this letter:

"All of the American automotive manufacturers are global companies with manufacturing, component, and assembly operations around the world. Ford, General Motors and Chrysler were the originators of the modern automotive industry, and today actively participate in more than 130 countries, have more than 1,000,000 employees, in excess of 30,000 dealers worldwide, and annual revenues of more than \$300 billion. Diverse multi-national corporations, whether American or European, develop and commit products to be assembled in various countries but are still the property of the originating corporation in their respective home country. Products that are shared by multi-national American corporations are no less American because they are distributed/assembled/manufactured in the countries when the assets are located.

Ford and General Motors have consensed on this response to the Indonesian question to the USTR and to supply the requested WTO data necessary to establish serious prejudice.

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<sup>528</sup> Source: US companies.

<sup>529</sup> Source: US companies.

<sup>530</sup> Source: US companies; see also "Ford Seeks Inroads in Booming Asian Auto Market," The Reuter European Business Report, 25 April 1996 (US Exhibit 14, pp. 29-30).

<sup>531</sup> Source: US companies.

<sup>532</sup> Source: US companies; see also "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics--and a Familiar Face at the Helm," Time, 10 June 1996, p.40 (US Exhibit 14, pp. 69-71).

<sup>533</sup> Source: US companies.

DATA NECESSARY TO ESTABLISH SERIOUS PREJUDICE

- (1) - Ford proposed to support the Indonesian market with American, European and Japanese sourced products.
  - Ford committed to the development of a joint venture, has assigned four full-time foreign service employees to Indonesia, and was actively pursuing the acquisition of assembly facilities in the market.
  - GM has invested \$110 million for 3 products: Opel Optima, Opel Vectra and Opel Blazer.
  - The Opel Blazer is in production and GM had approval to bring in new models for Opel Optima and Opel Vectra
  - The National Vehicle Programme forced GM and Ford to liquidate inventories under difficult terms:
    - Sales were lost due to depressed market conditions
    - Significant incremental merchandising costs were incurred to relieve inventories
    - Prices/revenues were negatively impacted
  - Timor had significant negative impact on GM and new foreign based suppliers particularly in the suppression of component and sales volumes.
  - Future investment for Ford and GM is on "hold".
    - September 1995 to September 1996 the overall market is down (16.8%) which negatively affected volumes and prices.
      - GM transaction prices were reduced by \$7,000/unit
      - Ford transaction prices were down by \$6,500/unit
    - Perceived instability in the "Regulatory Framework" is negatively impacting ability to attract new investors (suppliers and dealers) and new product investment by manufacturers.
    - GM cut back their current assembly plant from 2 shifts to 1 shift of production.
    - GM anticipates a further (15%) reduction in Blazer retail sales if Kia/Timor Sportage is added to the National Vehicle Programme.
- (2) - Ford cancelled the Escort programme as a direct result of the National Vehicle Programme after having committed assets of \$1.0 million. This included production and assembly equipment, tooling, component parts, and engineering all of which were in Indonesia prior to the National Vehicle Programme.
  - Plans to export to third countries, both vehicles and components, are, or will be negatively affected. Reduced volumes in Indonesia as a result of the National Vehicle Programme has caused higher component costs. At the same time, Korean suppliers will enjoy higher volumes and potentially lower costs due to the monopolistic relationship in Indonesia.
  - Opel Vectra and Optima are regional products. Plans to utilize domestic suppliers in Indonesia to reduce the cost base for other regional assemblies of products have been cancelled due to postponement of the Vectra and Optima production in Indonesia.
- (3) - The impact of the announcement of the National Vehicle Programme in Indonesia was a depression of sales in all potentially impacted retail market segments. The impact on these segments were:

Percentage Point Change 1996 versus 1995

| <u>Segments</u>          | <u>June CYTD (PP Chg)</u> | <u>September CYTD<br/>(PP Chg)</u> |
|--------------------------|---------------------------|------------------------------------|
| B Segment                | (50%)                     | (29.1%)                            |
| C Segment                | +31%                      | +9.2%                              |
| Total Passenger Car      | (1.2%)                    | (5.5%)                             |
| Category I               | (22.6%)                   | (23.6%)                            |
| Category IV              | (24.5%)                   | (25.4%)                            |
| Non-Effectuated Segments | +12.4%                    | +11.7%                             |

- It is clear that when the National Vehicle Programme was announced, which included the sport utility "Sportage" as Timor 520i, the retail sales were depressed because consumers were waiting to evaluate the impact of the National Vehicle Programme.
  - Manufacturers responded to the announcement by increasing incentives in the market to include, but not limited to, free extended warranties, free or low interest rate financing, and free service contracts that included both parts and labour, all of which were especially true in the C Segment where the impact was expected to be the most immediate.
  - These merchandising efforts *artificially* increased the sales volumes in the C Segment, through June versus June a year ago, until inventories were considered by manufacturers to be reasonably aligned, June through September retail sales then plummeted (30.4%) versus the same period last year.
  - In those segments where the National Vehicle Programme was expected to have little or no direct impact on the industry *increased*. Through June CYTD these segments grew +12.4% and through September CYTD they maintained this growth at +11.7%.
  - Ford's Escort and Sport Utility programmes were developed to be the regional basis of Ford's ASEAN and AICO strategy. Indonesia was to be a pivotal manufacturing centre for AICO complementation.
- (4)
- All elements of this question were addressed above in 1 through 3 except for price suppression.
  - The GM Business Plan/Budget called for price increases on Optima, Vectra and Blazer. These were in line with the historical price/inflation trends in Indonesia. These increases have not been possible to offset the CPI increases.
  - Historically the CPI has increased 8-10% annually in Indonesia. This is running consistent for 1996 and the forecast for 1997. Historically, and based on economic principles, automotive pricing closely tracked the CPI as the CPI reflects the cost structure. This is an established,

- normal, cost/price economic structure in the automotive industry for OEM's and component suppliers
- Due to the National Vehicle Programme announcement, prices are artificially flat or decreasing while the CPI continues to increase.
  - The Timor is Korean manufactured today and is operating in a different economic structure than other manufacturers in Indonesia. This is further compounded by the unique exclusion of duties and taxes on Timor.

#### QUESTIONS SUBMITTED BY INDONESIA TO THE UNITED STATES

- A. Indonesia, in mid-1993 took steps to deregulate the automotive industry. US automotive interests viewed this as a very positive and progressive approach to opening the Indonesian market, and when subsequent actions undertaken in 1994 and 1995 reinforced this trend, it revitalized automotive manufacturers' interest in Indonesia.

In February 1996, the Indonesian Government announced a regressive automotive policy that provides preferential tariff and tax treatments for one company. In addition the regulations precluded US or other foreign automotive manufacturers from participating due to restrictive practices relating to foreign equity participation and product naming.

Overall, the US automotive manufacturers believe the National Vehicle Programme damages Indonesia's interests and the Indonesian automotive industry.

We had firm plans to assist the development of the industry in Indonesia, and to make Indonesia a key part of our ASEAN, Asia and global plans. This is now all on hold due to the change in policy direction contained in the National Vehicle Programme. The US automotive manufacturers require renewed confidence in the Indonesian Government if they are to increase, or even maintain, their investments and commitment to Indonesia.

- B.
1.
    - All passenger cars are directly impacted by PT Timor and the Blazer is indirectly impacted because of the passenger car substitution effect and the associated announcement of the "Sportage".
    - All of the passenger cars were impacted by volume depression, price sensitivity, and transaction price reductions in order to be as competitive as was realistically possible given the tariff and tax inequities.
  2.
    - The Ford Escort and Laser, and Opel Optima and Vectra are petrol engines, 4 door sedans that compete in the C Segment of the industry and are immediately impacted by PT Timor
  3.
    - Escort was projected to achieve 5.2%, 10.0%, 10.5% and 11.0% in the first four years after introduction in 1996 or 15,100 units over the first four years. The cancellation of Escort totally eliminated these sales.
    - Laser was projected to sell 1,400 units over the same four year period.
    - Total projected lost unit sales/revenues at retail for Ford is 16,500 units over the four year period.

4. - The local content plan for Escort was just under 20% at launch, progressing to over 20% within 2 years, and over 40% local content within 4 years. This was the committed local content plan that was part of the implementation plan for Escort.
  - GM purchases 45% of Blazer's components locally from 67 suppliers and 55% is imported from 21 locations in 11 countries around the world.
  5. - Both Ford's and GM's vehicles have worldwide component sourcing, and vehicle manufacturing/assembly was to be accomplished in Indonesia.
  6. - Products that are the result of multi-national corporations and their affiliated suppliers worldwide are home country funded and should thus be considered as home country corporate products without regard to the country of sourcing.
- C.
1. - Ford had an approved investment plan of \$56.0 million with the feasibility of future investment in assembly to be determined based upon the needs of the market and manufacturing requirements.
  - GM has invested \$110.0 million in an assembly plant for Optima, Vectra and Blazer, GM's total investment plan was up to \$750 million in Indonesia.
  2. - Ford's total planned investment was committed to the establishment of Escort in the market with both local assembly and increasing local content, ultimately reaching 40% local content by the fourth year.
  - Local content and assembly plans were being implemented for Laser and Telstar as well as future planned product introductions for Indonesia.
  3. - American automotive investment plans have been placed on "hold" pending the determination of the revised regulatory environment, the National Vehicle Programme, the economic stability, and the political future of Indonesia.
  4. - General Motors has invested \$110 million in a plant in Bekasi, and launched the Opel Blazer, Optima and Vectra. They have established 34 full service dealerships and currently have 550 employees in Indonesia.
  - GM had approval to introduce new models for both Optima and Vectra, which is now on "hold".
  - Ford was in the process of launching the Ford Escort, finalizing plans to establish a joint venture in Indonesia and acquiring a manufacturing facility.
  - Ford's plan was part of an Asian strategy which *already has resulted in investments of:*
    - \$700 million in India
    - \$500 million in Thailand
    - \$350 million in China
    - \$100 million in Vietnam
  - Ford was developing plans to launch two major vehicle programmes in Indonesia - one with a product designed and developed primarily for Indonesia.
  - The Ford's total investment in these programmes could have been in line with Ford investments in other countries in the region.

- All future investment by GM and Ford are on "hold".

(iv) Chrysler

8.299 As for Chrysler, prior to the introduction of the National Motor Vehicle programme, it assembled Jeep Cherokees in Cikarang, West Java.<sup>534</sup> It had plans to introduce the Neon, but like GM and Ford, it had to abandon these plans once the National Motor Vehicle programme was introduced.

8.300 The **United States** submitted two newspaper articles in connection with its arguments regarding Chrysler's plans. The texts of these articles follow:

"A FURIOUS FLAP OVER FAVOURITISM":<sup>535</sup>

"A major Asian country has rigged its auto market. General Motors, Ford and Chrysler, which had high hopes of cracking the market, are up in arms. The stakes are so high that US Commerce Secretary Mickey Kantor was scheduled to visit in late June for a showdown with his trade counterparts.

The country isn't Japan or China. It's Indonesia, the largest market in booming Southeast Asia. Just how the Government of President Suharto drew the wrath of Detroit's Big Three is a fascinating case study of how things work in Indonesia. The Japanese are also irritated with Suharto and are attacking his "national car" programme, which gives a prominent role to South Korea's embattled Kia Motors Corp.

Indonesia has an annual per capita income of only \$1,000, but the Big Three expect the market to grow rapidly as Indonesians get richer and a young population matures. Even though the Japanese control 95 per cent of the market, Ford Motor Co. sent in a management team early this year to expand a small operation that sells Ford Lasers as taxis into a manufacturer of European-engineered Escorts. General Motors Corp. and Chrysler Corp. were moving ahead with similar plans. KEEPING MUM. But the Indonesian Government spoiled the party in February. By decree, a new company run by President Suharto's youngest son, 33-year-old Hutomo Mandala Putra, will be allowed to sell imported sedans from Kia for less than half the price of competing models - that is, about \$15,000 compared with \$30,500 for a Toyota Corolla. The deal is typical in a country known for the pervasive business interests of the President's family.

Under the arrangement, Kia will ship its four-door Sephia sedan to Indonesia without paying import duty or luxury tax. The car will come in under the Timor brand name of the new national carmaker, Kia-Timor Motor, which is 70 per cent owned by Hutomo. Kia owns the remaining 30 per cent and is contributing 30 per cent of the new company's \$100 million capital. The plan is for the venture to start assembling the cars in Indonesia next year and eventually export some.

Few Indonesians dare to criticize the programme, since the presidential palace deals harshly with opponents. But the new company's impact on the Indonesian market has been impossible to hide: consumers are waiting for the

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<sup>534</sup> "Like Father, Like Son; Indonesia's Proposed 'National Car' Has Plenty of International Critics-- and a Familiar Face at the Helm," Time, 10 June 1996, p. 40 (US Exhibit 14, pp. 69-71).

<sup>535</sup> "A Furious Flap Over Favouritism", Business Week, 8 July 1996, p.14 (US Exhibit 14, pp.99-95).

bargain-basement sedan to roll off the pier later this year. With monthly sales down at least 10 per cent, the Association of Indonesian Automotive Industries says this year's sales could fall far short of the 383,000 cars sold in 1995. That helps explain why the Japanese are threatening to take Indonesia to the World Trade Organization for a ruling on its car programme. "This is against WTO rules", complains an official of Japan's Ministry of International Trade & Industry.

In addition to the WTO threat, the Americans are trying to use the prospect of withheld investment to force Suharto to budge. With about \$110 million invested, GM is still assembling Opel Vectras, Opel Astras, and Chevrolet Blazers but has delayed expansion plans. Chrysler is making Jeep Cherokees and had planned to introduce the Neon and a minivan, but now those plans are on hold. Members of Ford's recently arrived management team have been left idle, with their children enrolled in the local international school. TIT FOR TAT. Indonesian officials see poetic justice for Japan: Toyota Motor Corp. has resisted demands from its Indonesian partner, Astra International, to rev up exports of the \$19,000 Toyota Kijang utility vehicle, because that would mean it would be competing with other Toyota assemblers in Asia. For its part, the Government defends the Kia deal, saying Indonesia has no time to lose if it is to get ready for lowering its trade barriers to fellow members of the Association of Southeast Asian Nations in 2003.

Getting the Timor project up and running will be difficult. It is already behind schedule, and supply will probably not meet demand, says F. Soeseno, Secretary-General of the Association of Indonesian Automotive Industries. Kia-Timor Motor will be allowed to import 40,000 of the 1.5-litre sedans until June 1997, by which time the company is supposed to have started assembly at a new plant that has yet to be built. The percentage of Indonesian-made parts is to increase steadily to 60 per cent by September 1999 - a schedule Toyota officials say will be impossible to keep. Critics also say the Timor will be hamstrung without strong distribution and service networks.

But Kia vows to make the deal work and is staking \$400 million to build the assembly plant. To meet local content requirements, it plans to help 30 Korean parts suppliers form joint ventures with Indonesian companies. One reason Kia is so determined is that it is getting squeezed in the home market by Hyundai Motor and Daewoo Motor - and now the mighty Samsung group is charging into the auto industry. Some analysts believe Kia's very survival as an independent manufacturer may hinge on making the Indonesian deal work. Small wonder that Kia Executive Vice-President Kim Seung-Ahn says: "Kia is fully committed to helping Indonesia develop a national car".

Some of Kia's backers, however, say they are against the Timor deal. Ford owns 33.4 per cent of Mazda and 9.4 per cent of Kia. Mazda in turn owns 7.5 per cent of Kia. Indonesian officials hint that Ford and Mazda are quietly pleased with their backdoor entrance into Indonesia, through Kia. But both Ford and Mazda deny that. "What we would get is peanuts", says Terry Emrick, Ford's top executive in Indonesia. "It has absolutely no effect". Ford executives add that most Indonesian consumers still won't be seeing their company's branded products. STEPPING BACK. Ultimately, industry analysts expect the Government to yield to the international uproar, possibly by keeping the national car programme in place but at the same time reducing tariffs on competing models. The Americans might not be big beneficiaries if they are too heavy-handed and anger the Indonesians. Although Japan protested forcefully at first, Tokyo seems to be stepping back and letting

Washington confront Suharto, says Andrew H. Card Jr., Chief Executive of the American Automobile Manufacturers Assn. "Japan doesn't have a long history of standing at the front of the line", says Card.

Moreover, unlike the Americans, Toyota has not put its plans on hold for a new plant near Jakarta. So while the Big Three sulk, Toyota could quietly increase the local content of its Kijang beyond the 60 per cent level, allowing it to be sold free of duty and luxury taxes. "The Indonesians will in one way or another have to accommodate the Japanese", concludes John Bonnell, Director of Southeast Asia for Automotive Resources Asia Ltd. in Bangkok. So, too, are the Koreans likely to persevere. The key question is whether the Americans will prove as adept at playing the game Indonesian-style.

#### Anatomy of an Indonesian Controversy

**A DEAL IS CUT** The son of Indonesian President Suharto makes a pact with Kia Motor of South Korea to make a "national car" for the country. At first, the Sephia sedan will be assembled in Korea but brought into Indonesia duty-free.

**JAPANESE OUTRAGE** This undermines Toyota, which is assembling vehicles in a joint venture with Astra International. Toyota and other Japanese makers persuade the Government of Prime Minister Ryutaro Hashimoto to protest Kia's sweetheart agreement.

**AMERICAN ANGER** General Motors, Ford, and Chrysler, which had been contemplating making big investments in Indonesia, delay those plans. US Commerce Secretary Mickey Kantor was scheduled to arrive in Jakarta to protest the Kia deal.

**BACKDOOR WINNERS?** Ford owns a controlling stake in Mazda, and both companies own minority shares in Kia. The Sephia, meanwhile, is largely based on Mazda designs and parts. But Ford says this channel into Indonesia is not adequate."

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"GM FREEZES INDONESIA INVESTMENT; POLICIES CREATE AN 'UNLEVEL PLAYING FIELD'"<sup>536</sup>

"General Motors has put plans for additional investment in Indonesia on hold because of that country's "national car" project.

Donald Sullivan, GM's Asian and Pacific Operations President, said here that the automaker has no intention of pulling out of Indonesia, however.

"We currently have \$110 million invested in a relatively new plant in Indonesia. We're there to stay", he said at a press conference announcing details of GM's new Thai plant.

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<sup>536</sup> "GM Freezes Indonesian Investment: Policies Create an 'Unlevel Playing Field'", Automotive News, 17 June 1996, p.38 (US Exhibit 14, pp.84-85).



But he added, "We've been very disappointed" by Jakarta's new national car policies. Those policies, he said, create an "unlevel playing field" for auto companies in Indonesia.

Sullivan said GM had been considering investing in a plant expansion, as well as unspecified infrastructure-related areas. He did not respond to a request to say how much GM had been planning to invest.

Both Ford Motor Co. and Chrysler Corp. shelved proposed Indonesian projects earlier this year in the wake of the new policy. Chrysler was close to a decision to begin assembling Neons from knockdown kits, while Ford was considering a small assembly plant.

As previously reported, Indonesian President Suharto issued a decree in late February that granted import-duty and luxury-sales tax exemptions for a "national car", the Timor, to be produced by a joint venture between Korea's Kia Motors Ltd., and Suharto's youngest son, Hutomo (Tommy) Mandala Putra.

The tax breaks will allow the car to be priced at about half the sticker of competing models.

Under blistering criticism from Japan, the United States and the European Union, Indonesia recently revised the policy so as to allow other companies to qualify for the tax breaks if their Indonesian-assembled cars have local content of at least 60 per cent.

A second revision, though, would allow the Timor to be built in Korea for up to a year while a plant in Indonesia is constructed, if Indonesian workers do the actual assembly work in Korea.

The former revision appeared aimed at placating the Japanese, but the latter one greatly fanned Japanese resentment of the policy. Infuriated by the prospect of a car assembled in Korea being given preferential tax treatment over Japanese vehicles assembled in Indonesia, Japan last week moved closer to filing a complaint over the policy with the World Trade Organization."

8.301 Prior to the introduction of the National Car Programme, Chrysler already was assembling Jeep Cherokee and Wrangler vehicles in Cikarang, West Java. Chrysler, together with Lippo Group and Ningz Pacific, was studying an assembly joint venture in Lippo City to assemble Neon passenger cars and other passenger vehicles.<sup>537</sup> The planned investment in this joint venture would have been more than US\$150 million. Chrysler's business plan called for initial sales of more than 15,000 vehicles per year, including 1,000 to 2,000 Neons per year, with volumes progressively rising thereafter. The Neons would have been sourced from the United States; specifically from Chrysler's plant in the state of Illinois.

8.302 Chrysler's plan for investment in Indonesia was part of a broader Asian strategy under which Chrysler already was manufacturing or selling vehicles in Thailand, Malaysia, China, Taiwan and

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<sup>537</sup> See also Indonesia Exhibit 11.

Japan. Indeed, Chrysler recently decided to expand its Singapore operations and intensify its sales campaign in Asia, concentrating particularly on the Neon and its Jeep vehicles.<sup>538</sup>

8.303 However, because of the National Car Programme, Chrysler was forced to put its plans for additional investment in Indonesia on hold, and did not proceed to the final approval stage. In addition, Chrysler was forced to significantly reduce production of Jeep vehicles at its existing assembly plant. Based on Chrysler estimates, if Chrysler had gone ahead with its plans to sell the Neon in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Neon by more than US\$5,000.<sup>539</sup>

8.304 The **United States** submitted a letter from Chrysler, prepared in the context of this dispute, summarizing Chrysler's "activities in Indonesia around the time the National Motor Vehicle Programme was announced". (US Exhibit 39.) The following is the text of the information provided in that letter:

**"Chrysler Corporation - Indonesia**

- Prior to introduction of the National Motor Vehicle Programme, Chrysler was already assembling Jeep Cherokee and Wrangler vehicles in Cikarang, West Java. Chrysler, together with Lippo Group and Ningz Pacific, was studying an assembly joint venture located in Lippo City to assemble Neon passenger cars and other passenger vehicles. Planned investment in this joint venture would have been more than \$150 million. Although the precise figures are confidential, Chrysler's business plan called for initial sales of more than 15,000 vehicles per year, including 1,000 to 2,000 Neons per year, with volumes progressively rising thereafter.

- Chrysler's plan for investment in Indonesia was part of a broader Asian strategy under which Chrysler was already manufacturing or selling vehicles in Thailand, Malaysia, China, Taiwan and Japan.

- However, because of the National Motor Vehicle Programme, Chrysler had to put its plans for additional investment in Indonesia on hold, and did not proceed to the final approval stage. In addition, Chrysler was forced to significantly reduce production of Jeep vehicles at its existing assembly plant. Based on Chrysler's internal estimates, if Chrysler had gone ahead with its plans to produce and sell the Neon in Indonesia, the Timor Kia Sephia would have undercut the price of the least expensive version of the Neon by more than \$5,000."

(c) Under the SCM Agreement, the one-year tariff and tax exemptions continue to provide actionable subsidies that cause serious prejudice

8.305 With respect to Indonesia's "dead measures" argument, it is premised on carving up the National Car programme into a series of individual programmes. However, there is no basis for this type of legal surgery, because all of the individual components of the National Car programme refer back to Presidential Instruction No. 2/1996, the document which gave birth to the single National Car programme. Indeed, in its first submission, Indonesia is inconsistent in this regard, sometimes referring to certain measures as "programmes" in their own right, and at other times referring to them as "aspects" of a single programme, the National Car programme.

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<sup>538</sup> "Still on the Right Road," *Asian Business*, November, 1997 (US Exhibit 24, pp. 16-23).

<sup>539</sup> A comparison of the specifications of the Timor S515 and the Chrysler Neon is provided in Table 23.

8.306 In addition, as a legal matter, there is no basis in the SCM Agreement for carving up the National Car programme in this manner. Article 6.1(a), the provision on which the US claim of serious prejudice is based, refers to the "total ad valorem subsidization of a product", not the "total ad valorem subsidization of a product under a particular programme". Likewise, paragraphs 2 and 4 of Annex IV refer to the "overall rate of subsidization."

8.307 In addition to being based on a faulty legal premise, Indonesia is wrong on the facts. The United States has explained above how Indonesia's "dead measures" argument is wrong with respect to the US claim regarding Article I of GATT 1994. However, even assuming for purposes of argument that Indonesia's argument is correct with respect to Article I, it is not correct for purposes of the SCM Agreement. This is because the subsidies provided under the one-year authorization are, by Indonesia's own admission, "non-recurring" subsidies. As demonstrated in the first US submission, these subsidies must be allocated to future time periods, something that Indonesia has not disputed and cannot dispute.

8.308 Because these subsidies must be allocated to future periods, they continue to benefit sales of the Timor Kia Sephia and continue to cause serious prejudice, regardless of whether the Sephias sold were imported from Korea or assembled in Indonesia. In addition, because these subsidies are allocated to future periods, they remain subsidies that can be withdrawn within the meaning of Article 7.8 of the SCM Agreement, possibly by means of TPN repaying the subsidies to Indonesia.

(d) The other components of the National Car programme cause serious prejudice

8.309 Indonesia's next argument is that the components of the National Car programme other than the one-year tariff and tax exemption could not have caused serious prejudice. This argument is equally flawed.

8.310 First, as noted above in connection with Indonesia's "dead measures" argument, there is no basis in the SCM Agreement for carving up the National Car programme into individual programmes.

8.311 Second, Indonesia argues that the Tambun plant is producing only 1,000 vehicles per year. Even if true, this does not dispel the fact that these vehicles are subsidized, nor does it reflect the anticipated annual production of the Timor Kia Sephia, which Indonesia estimated at 6,000 units per year in 1998, and 35,000 units per year in 1999. See AV/14, Attachment A-28. Nor does it reflect the fact that the passenger car market in Indonesia is relatively small. In addition, Indonesia's reference to the Cikampek plant, where the Sportage will be built, is misleading, because it is designed to make the Panel believe that the additional capacity afforded by that plant will not benefit the Sephia. However, the Sephia also will be built at Cikampek, the Tambun facility being only a temporary facility pending the completion of the Cikampek plant.

8.312 In short, through the subsidies that it currently is receiving, the Kia Timor joint venture will have the wherewithal to maintain, and expand upon, the 26 per cent market share that it already has achieved. Moreover, by means of the subsidies that it currently is receiving, the Kia Timor Sephia can continue to be sold at prices that significantly undercut the prices of like products.

8.313 Finally, Indonesia's arguments simply mischaracterize what has happened in this case. As a result of the introduction of the National Car programme and the sale at cut-rate, subsidized prices of the Timor Kia Sephia, like passenger cars of US manufacturers were driven out of the Indonesian passenger car market or precluded from entering it. The subsidies currently in effect, including the subsidies under the one-year authorization, merely ensure that US passenger cars will continue to be excluded from the Indonesian market.

8.314 Thus, this is not a “threat” case as Indonesia would have this Panel believe. To the contrary, it is a case of current and continuing serious prejudice.

8.315 The tariff and tax subsidies provided under the National Motor Vehicle programme have displaced or impeded like products of US motor vehicle manufacturers from the Indonesian market, within the meaning of Article 6.3(a). In addition, these subsidies resulted in significant price undercutting by the subsidized Timor Kia Sephia sedan as compared with the price of like products of US motor vehicle manufacturers, within the meaning of Article 6.3(c).

- (e) The tariff and tax subsidies under the National Motor Vehicle programme displaced or impeded imports of passenger cars of US motor vehicle manufacturers into the Indonesian market

8.316 Under Article 6.3(a) of the SCM Agreement, serious prejudice exists where “the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member.” With respect to imports of GM, Ford, and Chrysler passenger cars, this situation is precisely what occurred in Indonesia as a result of the National Motor Vehicle programme and the introduction of the subsidized Timor Kia Sephia sedan.

8.317 Attachment A/39/6 to AV/3 provides the market share of the Timor Kia Sephia. According to Attachment A/39/6, the Timor Kia Sephia went from a market share of zero in February 1996 (when the National Motor Vehicle programme was announced and Kia Timor was named as the producer of the “national motor vehicle”) to a 10.11 per cent share of the market by the end of 1996. By the end of May 1997, the last period covered in Attachment A/39/6, the market share of the Timor Kia Sephia had catapulted to 26.53 per cent.

8.318 This phenomenal market penetration came, in part, at the expense of the passenger cars of GM, Ford, and Chrysler. As set forth in AV/15, in response to Indonesia’s Question 6, each of these companies had plans to increase its penetration of the Indonesian passenger car market, but each company had to abandon or suspend its plans as a result of the National Motor Vehicle programme.<sup>540</sup> Numerous news reports substantiate the existence of these plans, as well as the deathblow dealt to them by the announcement of the National Motor Vehicle programme and the fact that the three firms would be forced to compete against the massively subsidized Timor Kia Sephia.<sup>541</sup>

8.319 Although the precise figures are confidential, in the case of GM, which already was selling its Opel passenger cars in Indonesia when the National Motor Vehicle programme was introduced, GM’s business plan called for sales of Optimas and Vectras in excess of 1,000 cars in 1996 and around

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<sup>540</sup> Like other automotive manufacturers in Indonesia, the passenger cars exported to Indonesia by Ford, Chrysler, and GM (like the Timor Kia Sephia itself) would have been in the form of kits that would have undergone final assembly in Indonesia. “Because of high duties on imports, the bulk of vehicles sold in Indonesia are locally assembled by joint ventures set up with local companies.” “Jakarta Policy Stalls Expansion Plans; Japanese Firms Rethink Strategy After Suharto’s ‘National Car’ Decree,” The Nikkei Weekly, 25 March 1996, p.1 (US Exhibit 14, pp. 19-23).

<sup>541</sup> See, e.g., “Like Father, Like Son; Indonesia’s Proposed ‘National Car’ Has Plenty of International Critics--and a Familiar Face at the Helm,” Time, 10 June 1996, p. 40 (US Exhibit 14, pp. 69-71); “GM Halts Plans for Indonesia Car; Firm Requests Clarification on National Car Policy,” The Dallas Morning News, 12 June 1996, p. 6B (US Exhibit 14, pp. 75-76); “GM Freezes Indonesian Investment; Policies Create an ‘Unlevel Playing Field’,” Automotive News, 17 June 1996, p. 38 (US Exhibit 14, pp. 84-85); see also “A Furious Flap Over Favouritism,” Business Week, 8 July 1996 (US Exhibit 14, pp. 92-95); “Ford Seeks Inroads in Booming Asian Auto Market,” The Reuter European Business Report, 25 April 1996 (US Exhibit 14, pp. 29-30).

3,000 cars in 1997, with progressive increases in subsequent years.<sup>542</sup> According to Indonesia's own information, however, GM sold only 549 Opels in 1996, and only 176 in the first half of 1997.<sup>543</sup>

8.320 In the case of Ford, the company projected sales volumes in Indonesia for the Escort of over 1,000 units in 1996, over 3,000 units in 1997, with steady annual increases thereafter.<sup>544</sup>

8.321 Regarding Chrysler, according to Chrysler officials the launch date for the Neon project would have been mid-1997, had the project not been cancelled due to the National Car Programme.

8.322 The United States notes, however, that the precise timing of such sales is not critical to a serious prejudice analysis in this case. Chrysler was shut out of the market, and it will continue to be shut out of the market as long as TPN continues to benefit from massive subsidies. In the meantime, the market share of the Timor shot to over 26 per cent of the total Indonesian passenger car market and significantly undercut the prices at which the Neon would have been sold. TPN is well-positioned to increase its market share while new entrants, such as Chrysler remain shut out of the Indonesian market. In the view of the United States, this satisfies the criteria for serious prejudice under Article 6.3 of the SCM Agreement.

8.323 In this regard, the United States would like to memorialize an exchange that took place at the second meeting of the Panel. The United States made the point that Indonesia appeared to be arguing that the US claim of serious prejudice could succeed only if the US manufacturers had first gone forward with their plans, notwithstanding the introduction of the National Car Programme. The United States observed that such a requirement would force companies facing massively subsidized competition to engage in commercially irrational behaviour, and that it could not have been the intent of the drafters of the SCM Agreement to make irrational behaviour by private firms a prerequisite to relief under the SCM Agreement. This is particularly true in light of the fact that one of the purposes of the SCM Agreement was to establish a more effective multilateral remedy against subsidies that cause adverse effects. Certainly, in this case it would have been foolhardy for the US companies to proceed with their plans in light of the artificial 50 per cent price advantage that the Timor Kia Sephia enjoyed due to the subsidies provided by the Government of Indonesia.

8.324 In response, Indonesia stated that it was not arguing that the US companies actually had to have made sales, but that the companies had to have had "credible" plans to enter, or expand their presence in, the Indonesian passenger car market.

8.325 In the view of the United States, the evidence provided by the United States concerning the plans of General Motors, Ford, and Chrysler more than establishes the credibility of those plans. Indonesia has not argued that the evidence presented by the United States is inaccurate, and Indonesia has not offered evidence of its own to rebut the evidence put forward by the United States.

8.326 Finally, the plans of the US companies must be put in context. In terms of population, Indonesia is the fourth largest country in the world. Indonesia is in Asia, a region in which each of the US companies has been seeking to expand its presence. General Motors already was selling passenger cars in Indonesia, and continues to sell sports utility vehicles. Chrysler also continues to sell sports utility vehicles. Ford sells taxis. In light of all of these factors, it seems implausible that

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<sup>542</sup> These figures are slightly higher than the projections concerning the Indonesian production/assembly of Opels set forth in East Asian Automotive Growth Markets, Summer 1994, pp. 370-371, which was included as part of Annex 1 to AV/2.

<sup>543</sup> AV/3, Attachment A/39/5-B.

<sup>544</sup> The precise figures constitute business proprietary information that the United States is reluctant to provide to the Panel absent adequate procedures to protect such information.

the companies would not have gone forward with their plans had the National Car Programme not been introduced.

8.327 In the view of the United States, the Panel's task should be to answer the following question: "Is it more likely than not, based on the evidence, that the US companies would have gone forward with their plans had the National Car Programme not been introduced?" In the view of the United States, the evidence in this case clearly warrants the answer "Yes".

8.328 Overall, prior to the announcement of the National Motor Vehicle programme, the three US companies had plans to spend more than US\$750 million to increase their presence in the Indonesian motor vehicle market.<sup>545</sup> However, the US companies had to abandon their plans for importing and selling passenger cars in Indonesia. While each of the three companies is a highly competitive automobile manufacturer, their business decisions - unlike TPN's - are necessarily governed by commercial considerations. With the onset of the National Motor Vehicle programme, the introduction of the Timor Kia Sephia, and the prospect of competing against the Indonesian Treasury, the three US companies were forced to abandon their plans, and could only watch as the Timor Kia Sephia quickly acquired 26 per cent of the Indonesian market.

(1) The evidence on sales trends shows that the subsidies provided under the National Car programme have caused displacement or impedance

8.329 Indonesia claims that the sales numbers show no discernible impact of the Timor Kia Sephia on the sales trends of US-brand passenger cars.<sup>546</sup> Because this is one of the few instances in which Indonesia actually discusses facts, these "facts" warrant close scrutiny.

8.330 With respect to General Motors, the data cited by Indonesia shows that sales of GM Opels began to decline in 1996, the year in which the National Car programme was introduced. However, Indonesia does not refer to its own data, which demonstrates that during the first half of 1997, Opel sales declined even further. In addition, Indonesia totally ignores the fact that General Motors had plans to increase its sales of Opels to over 1,000 cars in 1996 and around 3,000 cars in 1997, with progressive increases thereafter. Indonesia also ignores the well-documented fact that General Motors had to cancel its expansion plans following the introduction of the National Car programme.

8.331 In the case of Ford, Indonesia simply provides sales figures for Ford Lasers, a car sold exclusively to the taxi market. Given Indonesia's insistence elsewhere that a "like product" comparison calls for passenger cars to be virtually identical, the relevance of taxi sales to a serious prejudice case involving passenger cars is puzzling, and Indonesia offers no explanation. Moreover, Indonesia provides no response concerning Ford's well-publicized plans to introduce the Ford Escort to the Indonesian passenger car market.

8.332 Finally, in the case of Chrysler, Indonesia correctly notes that Chrysler did not market Chrysler-brand passenger cars in Indonesia during 1994-96. However, Indonesia simply ignores the fact that Chrysler was planning to introduce the Neon to the Indonesian passenger car market, but that Chrysler, too, had to cancel its plans following the introduction of the National Car programme.

8.333 In addition to ignoring the evidence, Indonesia ignores the law. Article 6.4 of the SCM Agreement, which provides guidance concerning the analysis of market displacement or impedance, states as follows:

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<sup>545</sup> Source: US companies.

<sup>546</sup> The United States must emphasize that this argument was not made in connection with the US claim of serious prejudice. However, it is addressed here in anticipation of Indonesia "rethinking" its defence.

For the purposes of paragraph 3(b), the displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in the relative shares of the market to the disadvantage of the non-subsidized like product over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances shall be at least one year). "Change in relative shares of the market" shall include any of the following situations: (a) there is an increase in the market share of the subsidized product ... .

8.334 What happened in the Indonesian passenger car market over the last year fits perfectly within Article 6.4. The subsidized Timor Kia Sephia and the non-subsidized GM Opels, Ford Escort, and Chrysler Neon effectively started with a market share of zero. Each of the companies in question had plans to increase the market share of its cars. However, through subsidies, the Timor Kia Sephia captured 26 per cent of the Indonesian passenger car market, while the other cars remained at zero. This is a classic situation of displacement or impedance.<sup>547</sup> Moreover, while Article 6.4, by its terms, applies to third-country market situations, there is no reason why this type of analysis is not suitable with respect to the displacement or impedance of imports from the market of the subsidizing Member.<sup>548</sup>

(2) The Timor does not occupy a special niche

8.335 In addition to claiming that the Timor is not "like" other cars, Indonesia argues that the Timor does not compete with Opels, Escorts, or Neons because allegedly "the Timor has tapped into a new class of consumers and created a niche at the bottom of the market". Indonesia also claims that "a consumer who purchases ... a Toyota, Opel or Peugeot is extremely unlikely to purchase a Timor, and vice versa". All of this constitutes an effort on the part of Indonesia to talk around the undeniable fact that, in one year, the Timor Kia Sephia acquired over 26 per cent of the total Indonesian passenger car market.

8.336 Significantly, Indonesia provides no evidence to support its assertions regarding a new market niche. The market data discussed on page 21 of Indonesia's second submission, which relates to all passenger cars, simply shows that the overall Indonesian passenger car market has grown slightly. It does not disprove that the Timor has, through subsidization, stolen sales from US manufacturers in the lower-medium passenger car class.

8.337 If the Timor does occupy a special niche, it is the niche of "heavily subsidized lower-medium class car". However, for serious prejudice purposes, the fact that a product is heavily subsidized, and thus can significantly undercut the prices of its competition, cannot be used as a basis for concluding that there is no competition or that the products in question are not "like" each other.

8.338 Moreover, Indonesia is simply incorrect that market share data is not an indicia of serious prejudice. Nothing in Article 6.3(a) precludes a consideration of market share data, and its use is consistent with Article 6.3(b), which also deals with displacement or impeding of imports. In this regard "displace" means "to crowd out: take the place of". Webster's Third New International Dictionary. Market share data provides a measure of the extent to which the Timor has "crowded out"

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<sup>547</sup> Moreover, as previously noted, if certain passenger cars are excluded from the market share calculation, the market share of the Timor Kia Sephia is increased.

<sup>548</sup> Indeed, Indonesia would be hard-pressed to contest the application of Article 6.4, having already argued that the Panel should analyze threat of serious prejudice under Article 6 based upon the countervailing duty standards for threat of injury contained in Article 15.7 of the SCM Agreement.

or "taken the place of" like products from US manufacturers, and thereby cause serious prejudice to the interests of the United States.

(3) The prejudice caused to like products of US manufacturers was serious

8.339 Indonesia attempts to argue that whatever harm US interests may have suffered, it is not enough to be considered "serious" within the meaning of the Subsidies Agreement. Again, however, in advancing this argument, Indonesia discusses total sales figures rather than sales of passenger cars that are "like" the Timor.

8.340 Moreover, Indonesia totally ignores the sales that the US manufacturers would have made but for the introduction of the National Car programme. GM's plan called for around 3,000 sales of Opels in 1997, Ford's plan called for roughly 2,000 Escorts in 1997, and Chrysler's plan called for between 1,000 to 2,000 Neons in 1997. Even if the US manufacturers only achieved one-half of the lower end of their projections, this still would have amounted to roughly 3,000 cars, which, in the Indonesian passenger car market, is a considerable amount. The fact that these sales have not occurred is not "trifling," as Indonesia would have this Panel believe.

(4) Indonesia has not provided any evidence to rebut the fact that US Manufacturers had well-developed plans to enter, or increase their presence in, the Indonesian passenger car market

8.341 Finally, let us discuss the US manufacturers' plans for the Indonesian market. Significantly, Indonesia does not challenge the existence of these plans or offer evidence aimed at disproving the existence of these plans. Indeed, the only evidence offered by Indonesia on this particular issue supports the position of the United States. Submitted as US Exhibit 37 is a document entitled "Indonesia's Automotive Market," which was submitted by Indonesia as Indonesia Exhibit 11 (first submission). Pages 3-4 of US Exhibit 37 discuss the plans of each of the three US manufacturers and describe how these plans were cancelled or suspended as a result of the National Car Programme.

8.342 Rather than attempting to rebut the evidence presented by the United States (which Indonesia knows it cannot do), Indonesia instead relies on the procedural defense that the United States allegedly has not presented enough evidence to trigger Indonesia's obligation to present rebutting evidence. However, as stated by the Appellate Body in the Wool Shirts case, at page 14, the burden on the United States, as the complainant, merely is to adduce "evidence sufficient to raise a presumption that what is claimed is true." In the view of the United States, it has more than satisfied this burden by providing information obtained from the US companies and information contained in newspaper articles and trade journals.

8.343 In addition, to satisfy Indonesia's insistence that the United States provide documents straight from the companies themselves, the United States has submitted documents containing information jointly submitted by Ford and General Motors to the Office of the US Trade Representative (USTR)<sup>549</sup>, and information submitted by Chrysler to USTR<sup>550</sup>. The United States emphasizes that there is little new information contained in these documents, because most of the information contained in these documents was also contained in the US first and second submissions. The United States trusts that the submission of these documents will put an end to Indonesia's accusations that the United States has relied on hearsay evidence.

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<sup>549</sup> US Exhibit 38.

<sup>550</sup> US Exhibit 39.



- (5) As a factual matter, it is simply not established that the tariff and tax benefits conferred on TPN under Decree No. 42/96 will ever be reimbursed

8.344 The **United States** argues, in connection with its arguments regarding whether the June 1996 programme is an expired measure, that it is not established that the tariff and tax benefits conferred on TPN under Decree No. 42/96 will ever be reimbursed. These arguments are set forth in Section X.B.

(c) Response by Indonesia

8.345 The following are **Indonesia's** responses to the complainants' arguments regarding displacement or impedance of imports:

- (1) The complainants' presentation with respect to actual serious prejudice to their interests is irrelevant because it relates solely to the alleged effects of the terminated June 1996 Programme

8.346 The complainants' collective serious prejudice allegations encompass only the National Car programme, which they allege has three components: (i) the June 1996 programme, which provided conditional exemptions from import duties and the luxury tax for imported national cars; (ii) the February 1996 programme, which provides conditional exemptions from the luxury tax and from import duties on parts and components used for the assembly of national cars in Indonesia; and (iii) the August 1997 US\$690 million loan to TPN.<sup>551</sup>

- (2) To establish serious prejudice, complainants must prove that a subsidy exists and that it is causing or threatens to cause serious prejudice

8.347 In order to maintain a claim of serious prejudice, the complainants must establish both:

1. the existence of a measure conferring an actionable or prohibited subsidy<sup>552</sup>; and
2. adverse effects in the form of serious prejudice to their interests resulting from the measure conferring the subsidy.<sup>553</sup>

Thus, in short, the complainants must show that a subsidy exists and that it causes or threatens adverse effects resulting in serious prejudice. The complainants have not made and cannot make this showing.

- (3) Complainants' allegations of serious prejudice fail because they have not demonstrated that an existing subsidy measure has resulted in actual serious prejudice

8.348 The complainants allege that their interests have suffered serious prejudice through the displacement or impedance of imports (Article 6.3(a)) and price undercutting (Article 6.3(c)) by the national car during 1996 and the first half of 1997. They rely heavily on contemporaneous sales and price data provided by the Government in the Annex V process, but fail to acknowledge that the sales and price data relating to the national car during 1996 and 1997 (to date) relate exclusively to national

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<sup>551</sup> As demonstrated, complainants' arguments concerning the loan are irrelevant because the loan and related issues are not within the scope of this Panel proceeding. Also, in any case, the loan was delivered on commercial terms.

<sup>552</sup> See Subsidies Agreement, Article 1.1. See also Subsidies Agreement, Articles 3.1.(b), 5, 6 and 7, each of which refers to extant subsidies.

<sup>553</sup> See Subsidies Agreement, Articles 5(c) and 6. The phrase, "serious prejudice to the interests of another Member," includes the threat of serious prejudice. See Subsidies Agreement, fn. 13.

cars that benefitted solely from the June 1996 programme. As discussed above, the June 1996 programme terminated in its entirety in June 1997. Thus, even if Complainants' assertions regarding actual serious prejudice in 1996 and 1997 were correct (which they are not), this harm would not be cognizable in this proceeding because the underlying measure complained of has already been withdrawn. Complainants' claims, therefore, are moot.<sup>554</sup>

8.349 At the same time, the two<sup>555</sup> remaining components of the National Car Programme could not have caused actual serious prejudice to either Complainants' interests. TPN did not begin assembling the national car in Indonesia under the February 1996 programme until June 1997. Moreover, the Tambun Plant at which the national car is being assembled will produce vehicles at the rate of only 1,000 units per year.

8.350 The August 1997 loan to TPN will be used to fund the construction of the Cikampek Plant, where the Sportage will be built. As discussed above, however, the Sportage will not be designated as a "national motor vehicle" and will not benefit from the tariff and tax subsidies extended under the February 1996 programme. Additionally, even if the August 1997 loan were deemed to confer a subsidy on the Sportage, actual serious prejudice could not arise because no vehicles have yet been built.

8.351 In sum, the June 1996 programme has been withdrawn and neither the February 1996 programme nor the August 1997 loan has caused actual serious prejudice to the complainants' interests. The practical effect of the foregoing analysis is to leave intact and relevant only the complainants' threat of serious prejudice allegations. As demonstrated below, like the complainants' claims of actual serious prejudice, these allegations lack merit and do not require or warrant any remedial action.

(4) The complainants' allegations regarding the cancellation of their companies' plans for the Indonesian market have not been adequately substantiated

8.352 A similar evidentiary failure plagues the European Communities and United States assertions regarding the plans and/or projections of GM, Ford and Chrysler for the Indonesian market. Complainants have attempted to provide a thin veneer of authenticity to their various claims regarding the companies' plans and/or sales projections by citing to newspaper and trade articles, but this is wholly inadequate. The positive evidence standard of the Subsidies Agreement, along with the many uncertainties of business and the inherently speculative and fluid nature of plans and projections, requires much more than this. The European Communities and US claims should be summarily dismissed because they have not been substantiated with even a single source document.<sup>556</sup>

8.353 A closer look at the United States' allegations concerning the plans of the Big Three is also in order. First, as a preliminary matter, Indonesia notes that it has contested and does contest the existence of "well-developed" Big Three plans to enter or expand in Indonesia's market for passenger

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<sup>554</sup> Indeed, the Subsidies Agreement, in its entirety, is designed to provide a remedy for existing subsidy measures. This is demonstrated most clearly in Article 7.8, which directs Members maintaining a subsidy measure found to cause serious prejudice either to withdraw the measure or to remedy the adverse effects.

<sup>555</sup> Actually, only one measure, the February 1996 policy, remains because the August 1997 loan to TPN is outside the scope of this proceeding and, in any case, was delivered on commercial terms. In order to be thorough, however, the loan is discussed as well.

<sup>556</sup> See Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items (11 November 1997), WT/DS 56/R, 91, para. 6.40 ("adversary is obligated to provide the international tribunal with relevant documents which are in its sole possession"). Indonesia reserves the right to comment on any such documents or materials which might be supplied by the EC or the US.

cars. Where are these claimed "business plans"? The United States has failed to introduce any source documentation concerning them. At most, the United States has established that company personnel have informed reporters, or reporters have speculated, that the Big Three had "plans" to invest in Indonesia and such "plans" allegedly were frustrated by the National Car Programme. This is not positive evidence; in fact, it does not even rise from the level of hear-say.

8.354 Second, the so-called "plans" appear not to be "plans" at all, but, at most, plans to develop plans. According to the United States, the "plans" break down as follows for each manufacturer. For both Ford and GM, the United States' rebuttal mentions no "plan" to export US-made autos to Indonesia. Moreover, Chrysler, the only remaining manufacturer, had no firm plan to enter Indonesia's passenger car market. Rather, according to the United States, Chrysler "was studying" a joint venture in Indonesia to assemble Neon passenger cars and other passenger vehicles.<sup>557</sup> Studying or considering a joint venture is not the same as having a concrete plan. And, on top of this, the United States again has failed to provide positive evidence, as it must, to support any of these claims.

8.355 The United States claim regarding Chrysler is based not on positive evidence, but on hear-say. This also is true of the European Communities allegations concerning the plans of Ford and GM. For their claims to have any merit at all, the European Communities and the United States would have to prove by positive evidence that:

- first, they had documented plans to import cars like the Timor;
- second, the National Car Programme in fact caused the companies to cancel their claimed plans;
- third, had they continued with their plans, a substantial number of their cars would have been sold in Indonesia had the National Car Programme not been instituted; and
- fourth, the National Car Programme would negatively have impacted their sales such that serious prejudice would have resulted.

8.356 However, neither the European Communities nor the United States has satisfactorily addressed these interrelated factors, much less provided even minimal support for these points. Rather, they have claimed, without adducing a single substantiating source document, that the companies had plans to enter Indonesia's market that were foiled by the Timor.

8.357 In this regard, Indonesia notes that Ford and Chrysler did not submit a single application for approval of the development of passenger car production or assembly facilities in Indonesia during the period of 1993 to the present. In sum, Ford and Chrysler have never had any real plans to produce or assemble a like product in Indonesia. Moreover, in 1993, GM submitted to Indonesia a passenger car production and assembly plan, which Indonesia approved. Not only is there no evidence to support the termination of any plans, since 1993, GM has continued to expand its operations. In fact, in November of 1997, GM submitted to Indonesia an application to significantly expand its production and assembly operations in Indonesia. Indonesia approved this application in December 1997. These facts belie the claims of the European Communities and United States regarding serious prejudice. They also demonstrate that, if any abandoned plans existed, the United States and the European Communities could introduce evidence of the plans that the Indonesian government already would have copies of - the request for approval of new or expanded operations in Indonesia. Thus,

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<sup>557</sup> Id. at para. 12, p. 3.

the Panel should not allow Complainants to hide their lack of evidence behind the cloak of confidentiality.

8.358 Indonesia accordingly submits that the Panel's consideration of this issue should focus on the complete lack of positive evidence to support the United States and European Communities claims, and the fact that, even accepting the United States and European Communities stories, the Big Three do not have and never had any concrete, confirmed plans to sell a car like the Timor in Indonesia.

8.359 We also urge the Panel to note the inconsistencies and the narrowing trend in the United States presentations. First, the United States argued that all of the Big Three sold or would have sold like products in Indonesia; now it argues that none of them sell like products in Indonesia and that only Chrysler was considering doing so. One wonders what tomorrow's admission will be.

8.360 In sum, Indonesia should not be penalized for what the United States claims, but has not properly established, were business plans, projections or decisions by United States-based companies. Indonesia asks the Panel to find the United States arguments baseless and to reject the United States complaint.

(5) Sales of the Timor have not affected sales in Indonesia of US-based passenger car manufacturers for three basic reasons

8.361 Sales of the Timor have not affected sales in Indonesia of US-based passenger car manufacturers for three basic reasons. First, US-based manufacturers compete in a market segment dominated by Japanese-based manufacturers.<sup>558</sup> To date, their marketing efforts have stumbled badly.

8.362 Second, US-based manufacturers' claimed "efforts" to sell passenger cars that compete with the Timor are either non-existent, nebulous, or purely speculative. For example, Ford makes much of the fact that it has assigned four foreign service employees to Indonesia and invested US\$1 million in Indonesia.<sup>559</sup> Ford has 370,000 employees worldwide and its automobile segment alone registers sales of US\$118 billion.<sup>560</sup> Obviously, Ford's commitment to Indonesia (other than to Indonesia's tax-free taxi market) is virtually non-existent. Chrysler's commitment to the Indonesian market is greater than Ford's, but it is directed not at the passenger car segment but to sales of Jeep-type vehicles. Chrysler Cherokees and Wranglers do not compete with Timor sedans. Chrysler's attempt to show serious prejudice in the Timor passenger car segment by introducing its "plans" to assemble Neons in Indonesia is unpersuasive. Chrysler statements that it "... was studying an assembly joint venture ... [p]lanned investment "... and "the precise figures are confidential ..." <sup>561</sup> are vague and unsupported. There is not one piece of evidence on the record of this proceeding that supports these statements.

8.363 Indonesia has bared its soul in presenting its case to this Panel and responding to the complainants' questions. Complainants should not be able to succeed before this Panel by relying on wisps of intra-corporate marketing brainstorming while failing to provide substantive real-world data to the Panel for scrutiny by all parties.

8.364 General Motors' presentation, although superficially more compelling than Ford's or Chrysler's, misses the point entirely. GM goes to great lengths to detail its investment in the Opel

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<sup>558</sup> As Japan has previously acknowledged in this proceeding, Japan does not market a car that competes with the Timor.

<sup>559</sup> US Exhibit 38, pp. 1-2.

<sup>560</sup> Ford 10-Q (1996) and "Ford Motor Company - The History of Ford Motor Company - An American Legend".

<sup>561</sup> US Exhibit 39, Page 2.

Optima, Opel Vectra and Opel Blazer, however, GM has never sold more than a few hundred of these vehicles in Indonesia. GM's claim of lost potential sales thus is purely speculative.

8.365 The history of GM's marketing efforts in Indonesia is a much better barometer of the real situation. GM's history of sales efforts in Indonesia is one of sporadic, unfocused marketing efforts that have each failed to penetrate the target market - the Japanese-dominated passenger car segment. GM has no-one to blame but itself for failure to successfully compete with the Japanese in Indonesia for a share of that value-added market. As Indonesia continually has stressed through an analysis of physical characteristics, the Optima, Vectra and Blazer do not compete with the Timor.

8.366 Third, Timor sales do not affect sales by US-based passenger car manufacturers because other issues, rightly or wrongly, have dissuaded the "Big Three" from investing the capital necessary to successfully sell passenger cars in Indonesia. The US finally has acknowledged that the Big Three's decisions to place a "hold" on their "plans" for Indonesia was based on factors other than the National Car Programme. The Indonesian market is dominated by the Japanese. The Japanese are firmly entrenched, and Japanese vehicles hold approximately 90 per cent of the market.<sup>562</sup> This fact alone makes it difficult for the Big Three to justify millions of dollars of capital investments. Furthermore, Indonesia's road transportation infrastructure is in the early stages of development and its personal use market represents a small percentage of a relatively small market.<sup>563</sup>

8.367 Simply put, the reasons the Big Three "withdrew from" or "failed to enter" the Indonesian market have nothing to do with the National Car Programme. They withdrew because (1) the market for small cars is too small to justify and sustain the necessary capital investments and, in any case, is dominated by Japan; (2) the low annual per capita income in Indonesia results in a minute high-profit market niche that is dominated by Mercedes-Benz and BMW that precludes penetration by the Big Three; (3) low-income, entry-level automobiles such as the Timor do not provide the per-unit profit necessary to generate investment returns that the Big Three enjoy in their important markets - North America and Europe; and (4) the investment incentives provided in countries such as Thailand are better than those provided in Indonesia.<sup>564</sup>

8.368 In conclusion, US-based manufacturers did not suffer serious prejudice due to Indonesia's National Car Programme. The Timor, because of its low-income, entry-level appeal, does not compete with US-based automobiles. US-based manufacturers' automobiles are positioned to compete in other market segments, against Japanese models in Indonesia and in the rest of the world. The Indonesian market is dominated by the Japanese, per-unit profit margins would become very thin if the US were to compete, and the higher profit per-unit market niche is dominated by BMW and Mercedes-Benz. Thus, for the Big Three to make the investments necessary to compete in Indonesia would be incompatible with the short-horizon, quarterly profit maximization principles that drive US-based manufacturers.

- (6) Even if the European Communities and US cars were found to be like the Timor, no serious prejudice exists or will arise because they do not compete with the Timor

8.369 Assuming, *arguendo*, that the European Communities and US cars were found to be like the Timor, this would not be tantamount to determining that the National Car programme has caused or will cause serious prejudice to European Communities and US interests. The like product determination merely establishes the proper analytical framework in which to consider, in turn,

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<sup>562</sup> US Exhibit 37, Page 1.

<sup>563</sup> *Id.*

<sup>564</sup> *Id.*

whether the separate components of the programme have caused serious prejudice to complainants' interests.<sup>565</sup> In other words, it is not enough for complainants to show that the Timor is subsidized and that, at the same time, their commercial welfare has declined or not improved as expected. Rather, they must demonstrate the existence of a causal link between the two events. As discussed below, the European Communities and the United States have not shown and cannot show this requisite linkage because the Timor is a low-end, no-frills budget car that is not in the same market segment as the more-advanced, state-of-the-art Escort, Neon, Optima, Vectra or Peugeot 306.<sup>566</sup>

8.370 Available sales data for 1996 and 1997 reveal that the Timor has tapped into a new class of consumers and created a niche segment at the bottom of the market.<sup>567</sup> These data also show that sales in the non-Timor segments have increased, despite the introduction of the Timor. Total sales by all manufacturers increased from 38,826 cars in 1995 to 42,346 cars in 1996, for a total increase of 3,520 cars. The Timor was introduced in 1996 and 4,278 units were sold. Total sales by all manufacturers increased from 28,265 units in the first three quarters of 1996 to 53,033 cars during the first three quarters of 1997, for a nearly two-fold increase of 24,768 cars. Timor sales of 11,853 cars in the first three quarters of 1997 accounted for less than one-half of this phenomenal growth.

8.371 The sales data set forth in the following table also demonstrate that the European Communities and the US positions (and Japan's position) in the marketplace have improved since the Timor was introduced.<sup>568</sup>

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<sup>565</sup> This causation requirement is apparent from the text of the Subsidies Agreement. Article 5 provides: "No Member should cause, through the use of any [specific] subsidy ..., (c) serious prejudice to the interests of another Member." (footnote omitted) Articles 6.2 and 7.1 speak of subsidies "resulting" in serious prejudice. Articles 6.3(a) and (c) respectively state that serious prejudice may arise where "the effect of the subsidy is to displace or impede the imports of a like product" and "the effect of the subsidy is a significant price undercutting ... of a like product." "Effect" is defined as: "Something accomplished, caused, or produced; a result, consequence. Correlative with CAUSE." The Compact Oxford English Dictionary at p.496 (2d ed. 1987).

<sup>566</sup> The US also claims that the Timor J520i is like the GM Opel Blazer and will pose a threat to US light commercial vehicles. Indonesia need not, however, address this claim because the Timor J520i is not and will not be covered by the National Car Program. Certificate of Registration of Mark/Type/Variant of Motor Vehicle, No. 1039/DJ-IIMK/X/1997, Department of Industry and Trade of the Republic of Indonesia, the Directorate General for Metals, Machinery and Chemical Industry (Indonesia Exhibit 42, Attachment E).

<sup>567</sup> The Indonesian passenger car market can be properly examined only on a segmented basis. That market (like all other car markets) is characterized by a very high degree of market differentiation and specialization. Thus, a consumer who purchases a Mercedes-Benz or BMW or, for that matter, a Toyota, Opel or Peugeot, is extremely unlikely to purchase a Timor, and vice versa. See generally United States-Measures Affecting Alcoholic and Malt Beverages (19 June 1992), BISD 39S/206, 294, para. 5.73.

Car manufacturers devote very substantial resources to establishing and targeting different market segments and smaller niches in their production, advertising and marketing. For example, GM follows a strategy of selling dozens of different models where competitors sell just a few. This "needs segmentation" approach is designed to aim vehicles more precisely at buyers based on buyers' specific demographics, attitudes and desired car features. See Daniel McGinn, *Divide and Conquer: Meet the Researcher Behind GM's Controversial Marketing Strategy*, Newsweek, 1 December 1997, at pp.50 and 52 (Indonesia Exhibit 42, Attachment B).

<sup>568</sup> Opel Optima and Vectra sales are attributed to the EC.

Table 34

|                    | 1995   | 1996   | 1997 <sup>569</sup> | 1Q/3Q 1997 | 1Q/3Q 1996 |
|--------------------|--------|--------|---------------------|------------|------------|
| EC                 | 9,213  | 10,075 | 11,093              | 8,320      | 7,653      |
| US                 | 2,880  | 3,652  | 4,456               | 3,342      | 2,594      |
| Japan              | 23,941 | 21,693 | 34,304              | 25,728     | 16,718     |
| Others/CBU Imports | 2,792  | 2,648  | 5,053               | 3,790      | 1,300      |
| Timor              | 0      | 4,278  | 15,804              | 11,853     | 0          |
| TOTAL              | 38,826 | 42,346 | 70,710              | 53,033     | 28,265     |

Source: Gaikindo; Government of the Republic of Indonesia

8.372 In sum, the foregoing data run contrary to the European Communities and US assertions that sales of the Timor have displaced or impeded imports of the claimed like products.<sup>570</sup>

8.373 Finally, Indonesia notes that the operative standard for remediation is "serious prejudice." This concept does not lend itself to ready measurement and, accordingly, its meaning has not crystallized despite its relevance to many GATT proceedings. This does not, however, mean that it is without content.

8.374 Article 31.1 of the Vienna Convention on the Law of Treaties provides: "A Treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose." "Serious" is defined as: "Weighty, important, grave; (of quantity or degree) considerable, not trifling".<sup>571</sup>

8.375 The European Communities and the United States point to specific, concrete sales data for only the Opel Optima and Vectra and the Peugeot 306. GM sold 549 Opels in Indonesia in 1996 and 284 Opels from January through September 1997 (379 units on an annualized basis); 1,086 Peugeot 306's were sold in 1996 and 762 (1,016 annualized) were sold through September 1997. Thus, even when taken together, the net decline in sales for the three models from 1996 (1,635 cars) to 1997

<sup>569</sup> Annualized on the basis of January through September 1997 sales.

<sup>570</sup> Of course, this standard is not even applicable if the Panel determines that cars assembled by EC or US manufacturers in Indonesia from imported kits are not like the Timor. Indonesia notes that the EC and the US rely heavily on market share trends and the US refers to Article 6.4 of the Subsidies Agreement for guidance in analyzing market displacement or impedance. First, only Articles 6.3(a) and (c) pertain to this case and they do not refer to market share as an indicia of serious prejudice. Second, historical and current market share data are meaningless, because the Timor's establishment of a new market segment has fundamentally transformed the Indonesian passenger car market. Thus, in order to have even limited meaning, market share data must be compiled on a segment-specific basis. As for the EC's suggestion that sales of the Opel Optima and Peugeot 306 should not have declined in 1997 because of a substantial increase in general demand, sales, demand growth and market share are not necessarily correlated. The EC itself has observed: "Since 1992 and until 1996, exports of passenger cars from the Community [to Indonesia] grew at a faster pace than demand, resulting in a significant gain in terms of market share."

<sup>571</sup> The Compact Oxford English Dictionary at p.1716 (2d ed. 1987).

(1,395 cars) will be only approximately 240 cars. These cars represent only approximately 1.5 per cent of projected total European Communities and US sales in 1997 (15,549 cars). Thus, even if the drop in sales could be attributed to the Timor (and it cannot), such a minuscule decline could hardly be considered anything other than trifling and certainly cannot serve as the basis for a finding of serious prejudice.

(7) The EC has failed to prove serious prejudice

8.376 The European Communities focuses on sales of EC-produced cars in Indonesia with passing reference to the plans of Ford and GM. (Indonesia acknowledges that the EC does not attempt to claim any United States-produced cars as its own.) The European Communities originally had argued that the Opel Vectra also is like the Timor, but now apparently concedes this was an error.

8.377 Thus, apart from the European Communities' allegations concerning Ford and GM plans, the success of the European Communities' complaint hinges on the European Communities demonstrating by positive evidence, first, that the Opel Optima or the Peugeot 306 is like the Timor and, second, that Indonesia's measures have caused serious prejudice by impacting sales of these cars.

8.378 The European Communities has not met either of these burdens. Even putting aside the many important, non-physical characteristics that must be considered in establishing like products here, Indonesia already has demonstrated, and the European Communities' like product matrix<sup>572</sup> confirms, that the Timor is not like the Optima or the 306 when only physical characteristics are considered. Also, the European Communities has presented no positive evidence demonstrating that the Timor has had any impact on European Communities sales. Although Indonesia has not commissioned or performed any econometric or market research on this point, the data we have seen suggest that the Japanese models, many of which are like the Optima and the 306, are continuing to dominate the market segments above the Timor. If the European Communities is losing sales, then it is losing them to the Japanese like products, not to the "unlike" Timor. Therefore, Indonesia asks that the Panel reject the European Communities' arguments and dismiss the European Communities' Complaint.

8.379 Further to the last point, Indonesia notes that, notwithstanding the positive evidence standard, none of the complainants has undertaken econometric or market studies to support their positions. A study would allow the Panel to evaluate the various other criteria the European Communities deems "too subjective" or "too vague". Yet they have not done so. Had Indonesia the burden of proof or persuasion, the Panel and Parties already would have the data in front of them. Complainants have avoided any thorough investigation or analysis of the Indonesian market because they know such analysis would confirm Indonesia's position.

8.380 Rather than engaging these important issues, the European Communities continues to advance its idea that all passenger cars are like products, i.e., Mercedes-Benzes, Bentleys, Yugos and Timors compete for the same customers. It has no choice but to do so because only by avoiding causality can it succeed.

8.381 Later, the European Communities plays fast and loose with market share data, asserting that the European Communities accounts for 24 per cent of Indonesia's market, but failing to mention that the vast majority of this share is from sales of "models in the high segment of the market" (i.e., BMWs, Mercedes-Benzes and Volvos). Moreover, the European Communities ignores the fact that Japan's sales have increased by over 50 per cent.

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<sup>572</sup> EC Exhibit D-3.



8.382 The truth, or "truism", as the European Communities says, is that the Timor taps a different market segment. The European Communities states that "[t]he proposition that the Timor has generated entirely its own demand is purely speculative and cannot be demonstrated". But, first, Indonesia's presentation is not speculative; it is based on a reasoned view of the market and TPN's marketing intention for the Timor. Indonesia's view, unlike that of the European Communities, accounts for the phenomenal growth in Japan's sales. Second, Indonesia's view can be demonstrated. More importantly, however, Indonesia does not bear the burden of proof here. The European Communities does. It has failed to prove its allegations, and so the Panel should reject the European Communities' assertions and dismiss the European Communities' complaint.

5. Article 6.3(c) of the SCM Agreement—Price Undercutting

(a) Arguments of the European Communities

8.383 The following are the **European Communities'** arguments regarding price undercutting by subsidized national cars:

- (1) The prices of the subsidized National Cars undercut significantly the prices of like passenger cars imported from the Community

8.384 In accordance with Article 6.3 of the SCM Agreement, serious prejudice may arise, *inter alia*, where the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of the like product of another member.

8.385 The massive subsidies granted to PT TPN have allowed this company to price the Timor S-515 well below the passenger cars imported from the Communities.

8.386 Table 35 ranks all the passenger cars of up to 1,800 cc offered in the Indonesian market according to their listed sale price. They show that the Timor S-515 was the least expensive model on sale in Indonesia in November 1996 and again in March 1997, with the only exception of the Mazda MR-90, a relatively old model which was sold in very small quantities<sup>573</sup>.

Table 35

Listed prices in Indonesia for passenger cars of up to 1800 cc

**November 1996**

| Model                     | Price (thousand Rp) |
|---------------------------|---------------------|
| Mazda MR-90               | 30,200              |
| <b>Timor S515 Solit</b>   | <b>33,000</b>       |
| <b>Timor S515 Metalic</b> | <b>33,500</b>       |
| Suzuki Baleno SY 416      | 43,500              |
| Bimantara Cakra MT        | 45,000              |
| Bimantara Cakra AT        | 48,650              |
| Toyota Starlet            | 47,800              |
| Honda City GM             | 50,975              |
| Ford Laser GHIA saloon    | 58,800              |
| <b>Peugeot 306 M/T</b>    | <b>59,000</b>       |
| Bimantara Nenggala M/T    | 53,100              |
| <b>Peugeot 306 M/T</b>    | <b>62,500</b>       |
| Bimantara Nenggala A/T    | 63,500              |
| Mitsubishi Lancer M/T     | 64,000              |
| <b>Peugeot 306 A/T</b>    | <b>65,500</b>       |
| Mitsubishi Lancer A/T     | 67,000              |
| <b>Opel Optima GLS</b>    | 70,000              |
| Toyota Corolla M/T        | 71,100              |
| Lancer DOHC               | 72,000              |
| Honda Civic 4 Door NB GKP | 72,490              |
| Toyota Corolla A/T        | 74,800              |
| Honda Civic 4 Door NB AKP | 76,190              |
| Toyota Corona             | 80,700              |

Source: AV/3, Attachment A-40/1. **March 1997**

<sup>573</sup> 102 units in 1996 and 16 during the first half of 1997. See AV/3, Attachment A-39/1- B.

| Model                       | Price (thousand Rp) |
|-----------------------------|---------------------|
| Mazda MR-90                 | 30,000              |
| <b>Timor S515 Solit</b>     | <b>33,000</b>       |
| <b>Timor S515 Metalic</b>   | <b>33,500</b>       |
| <b>Timor S515 I Solit</b>   | <b>36,400</b>       |
| <b>Timor S515 I Metalic</b> | <b>36,900</b>       |
| Bimantara Cakra MT          | 39,900              |
| Daewoo Nexia DOHC           | 43,000              |
| Bimantara Cakra AT          | 43,450              |
| Suzuki Baleno SY 416        | 44,750              |
| Toyota Starlet              | 48,100              |
| Honda City GM               | 51,300              |
| Bimantara Nenggala M/T      | 53,100              |
| Bimantara Nenggala A/T      | 57,000              |
| Ford Laser GHIA Saloon      | 59,000              |
| <b>Peugeot 306 M/T</b>      | <b>59,500</b>       |
| <b>Peugeot 306 M/T</b>      | <b>63,000</b>       |
| Ford Laser GHIA Saloon      | 63,200              |
| Mitsubishi Lancer M/T       | 65,000              |
| <b>Peugeot 306 A/T</b>      | <b>65,500</b>       |
| Mitsubishi Lancer A/T       | 68,000              |
| Mazda Astina                | 68,300              |
| Toyota Corolla M/T          | 68,300              |
| <b>Opel Optima GLS</b>      | <b>70,000</b>       |
| Honda Civic 4 Door NB GKP   | 71,160              |
| Toyota Corolla A/T          | 71,800              |
| Lancer DOHC                 | 72,000              |
| Honda Civic 4 Doors         | 74,860              |
| Toyota Corona               | 81,200              |

8.387 More particularly, the data evidence that the Timor S-515 undercut significantly the prices of the closest Community models in terms of specifications. In November 1996, the price of the Timor S-515's most expensive version was 43 per cent lower than the price of the least expensive version of the Peugeot 306 and 52 per cent lower than the price of the Opel Optima. As of March 1997, the margins of price undercutting were almost identical.

(b) Arguments of the United States

8.388 The **United States** submits that the tariff and tax subsidies provided under the National Motor Vehicle programme have resulted in significant price undercutting by the Timor Kia Sephia. The following are the **United States'** arguments in this regard.

8.389 Under Article 6.3(c) of the SCM Agreement, serious prejudice exists where "the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market ... ." Article 6.5 elaborates on the analysis of price undercutting:

For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

(1) Tariff and tax subsidies

8.390 Put simply, the Timor Kia Sephia is the cheapest car on Indonesian roads.<sup>574</sup> Because of the huge tariff and tax breaks it enjoys, the Timor Kia Sephia can be sold for 50 percent of the price of its rivals.<sup>575</sup>

8.391 The newspaper accounts are consistent with the hard data. As set forth in Table 31, above, the Timor Kia Sephia S515 sold for Rp. 33.5 million, while the Opel Optima GLS (the least expensive Opel) sold for Rp. 69.5 million. In other words, the Timor Kia Sephia sold for less than one-half the price of the Opel Optima. In March, 1997, this price gap increased slightly, as the Timor Kia Sephia sedan continued to sell for Rp. 33.5 million, while the price of the Opel Optima GLS increased slightly to Rp. 70 million. Even the fuel-injected version of the Timor Kia Sephia, the S515i, sold for only Rp. 36.9 million in March 1997.

8.392 With respect to the Ford Escort, Ford, of course, abandoned its plans to sell the Escort in Indonesia due to the National Motor Vehicle programme. However, based on company figures, the Timor Kia Sephia S515 would have undercut the price of the least expensive version of the Escort by more than US\$5,000.<sup>576</sup>

8.393 Moreover, the Timor Kia Sephia did not significantly undercut the prices of only US passenger cars. It significantly undercut the prices of every passenger car in its class sold in Indonesia, as demonstrated in Tables 32 and 33, above.

8.394 The reasons why the Timor Kia Sephia could so significantly undercut the prices of its competition are obvious. First, the Timor Kia Sephia was not subject to import duties, whether

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<sup>574</sup> "Indon Domestic Car Sales Race up by 41 per cent in May," Business Times (Singapore), June 17, 1997 (US Exhibit 14, pp. 138-139).

<sup>575</sup> "Bumpy Road Ahead for Motoring Plans," South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-135).

<sup>576</sup> The United States has precise figures regarding the planned prices for Ford Escorts in Indonesia. However, these figures constitute business proprietary information that the United States is reluctant to provide to the Panel absent adequate procedures to protect such information.

imported from Korea in CBU form during 1996-1997 or as kits from July 1997 onward. Second, the Timor Kia Sephia is not subject to the 35 per cent luxury tax.

8.395 Information provided by Indonesia (Attachment A-28 to AV/3) effectively concedes that the tariff and tax subsidies under the National Motor Vehicle programme are responsible for the significant level of price undercutting. This table contains data for 1998 and 1999 regarding the Timor Kia Sephia S515i that will be assembled at the Karawang facility. Row 4 of the table (Unit Dealer Price) indicates that the effect of the tariff and tax subsidies of the National Motor Vehicle programme is to lower the price of the Timor Kia Sephia sedan by US\$7,243-9,158.

8.396 The United States does not necessarily accept the accuracy of the data in this table. For one thing, it does not deal with the 1996-97 period during which the tariff subsidy was even greater due to the exemption of imports of CBU Kia Sephias from the 200 per cent tariff. Therefore, it does not reflect the price impact of this particular subsidy. In addition, during the Annex V process, Indonesia refused to explain the basis on which "unit cost" was estimated in the table, the figure from which "unit dealer cost" apparently was derived.<sup>577</sup> Nevertheless, the table constitutes an admission as to the tremendous impact of the tariff and tax subsidies on the price of the Timor Kia Sephia.

(c) Responses by Indonesia

8.397 The following are **Indonesia's** responses to the complainants' arguments regarding price undercutting.

(1) Price comparisons made

8.398 The European Communities and the United States claim price undercutting by the Timor, but their position is fallacious because it is based on a misleadingly simplistic comparison of list prices. The Subsidies Agreement and commercial reality require that other factors affecting price comparability be considered.

8.399 Article 6.5 of the Subsidies Agreement requires that price comparisons must take "due account ... of any other factor affecting price comparability". This requirement, in conjunction with the positive evidence standard, means that Complainants have the burden of quantifying and making appropriate price adjustments for the physical characteristics and consumer preferences and perceptions that distinguish the Timor from their manufacturers' products. This task may be difficult, but it is absolutely indispensable. In the same vein, Article 6.3(c) requires that there be "significant price undercutting". As reflected in Article 6.5, the existence of any price undercutting and a determination as to its significance necessitates an apples-to-apples comparison.<sup>578</sup>

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<sup>577</sup> In AV/15, in Question 12/28(a), the United States renewed its earlier request for an explanation of the estimated unit cost for cars to be produced at the Karawang facility. (Karawang is the district in which Cikampek is located). In AV/16, p. 3, instead of answering the question, Indonesia referred the United States to Table A-30/2 of Attachment U-12. However, Table A-30/2 merely provides a list of costs in relative terms, and, as such, cannot be used as a basis for estimating unit costs in absolute terms. In other words, under Table A-30/2, if one starts with a cost of  $X$ , the final price will be  $616.9X$ . However, Table A-30/2 does not allow one to determine what  $X$  is.

<sup>578</sup> Although not directly applicable, it is instructive to note that local authorities which administer WTO-consistent antidumping and countervailing duty regimes routinely split a like product category into numerous specific products when making price comparisons among products for injury assessment purposes. For example, in the 1992 antidumping duty investigation of Minivans from Japan, the US International Trade Commission and the parties acknowledged and wrestled with the difficult task of determining the comparability of various minivan models. The Commission, with the parties' input, eventually subdivided the unitary minivan

(2) Factors affecting price comparability

8.400 Numerous physical and non-physical factors and consumer perceptions affect the price comparability of passenger cars. These include, but are not limited to: brand loyalty; quality; after-sales service, brand image/reputation; reliability; design; durability; utility; resale value; ride and comfort; driveability; standard features; safety features; available options; exterior size; interior space; fuel economy; engine size and technology; transmission type; and suspension type. As demonstrated in Tables 26 and 27 above, there are numerous physical differences between the proposed comparison models that must be taken into account when comparing their prices. The above-identified non-physical attributes and consumer perceptions also require such an accounting.

8.401 One possible approach to quantifying the price effects of certain physical differences would be to consider the surcharges commonly assessed by dealers for enhanced features, such as a larger engine and advanced engine technology; special safety features (e.g., anti-lock brakes and air bags); trim packages; interior appointments (e.g., power windows and locks and sound system); and an automatic transmission. Of course, the usefulness of such surcharges as bases for adjustments would be constrained by their limited cross-model transferability.

8.402 Quantifying the price effects of other physical and non-physical factors and perceptions is much more difficult because specific surcharges do not exist. One way to gauge the price premium consumers willingly pay for the unique packages of features offered by the Peugeot 306 and Opel Optima would be to design and conduct targeted consumer surveys. Such surveys are commonplace in the automotive industry.<sup>579</sup>

6. Adjustments for factors affecting price comparability

(a) Arguments of Indonesia

8.403 As shown, numerous "other factors" affect the price comparability of the Timor, the Peugeot 306 and the Opel Optima and these factors must be taken into account when assessing the European Communities (and the United States) price undercutting claims. Indonesia respectfully notes the burden of establishing like products properly rests with complainants.

(b) Arguments of the European Communities

8.404 The European Communities has shown that:

- the Timor S-515 was the least expensive passenger car on sale in Indonesia in November 1996 and again in March 1997;
- specifically, in November 1996, the price of the Timor S-515's most expensive version was 43 per cent lower than the price of the least expensive version of the Peugeot 306 and 52 per cent lower than the price of the Opel Optima. As of March 1997, the margins of price undercutting were almost identical.

8.405 Indonesia has not provided any evidence in order to rebut the above claims. Instead, Indonesia's only arguments with respect to the existence of price undercutting are the following:

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like product category into fifteen specific products for price-comparison purposes. See Minivans from Japan, USITC Pub. 2529 (July 1992) at pp.5 and A-100 (Indonesia Exhibit 45).

<sup>579</sup> See generally Daniel McGinn, Divide and Conquer: Meet the Researcher Behind GM's Controversial Marketing Strategy, Newsweek, 1 December 1997 at pp. 50-52 (Indonesia Exhibit 42, Attachment B).

- Article 6.5 of the SCM Agreement requires that any price comparisons shall be made at the same level of trade, at comparable times and due account must be taken of any other factor affecting price comparability. The European Communities has not attempted to account for "any other factors" in its analysis.
- The Mazda MR-90 and the Ford Laser are sold at prices below those charged for the Timor.

8.406 All the price comparisons made by the European Communities are based on the listed retail prices provided by Indonesia itself (in Attachment A-40/1 to its Annex V Response). The European Communities understands that all the prices mentioned in that information are at the same level of trade (namely, at retail level) and correspond to the same period of time (November 1996 and March 1997). The European Communities believes that there are no relevant "other factors" (including differences in physical characteristics) which may affect significantly price comparability between, on the one hand, the Timor S-515 and, on the other hand, the Opel Optima and the Peugeot 306. Indonesia itself has not been able to identify any such "other factor", let alone any factor which may account for a level of price undercutting of 50 per cent.

8.407 Further, the European Communities is not aware of any "other factor" (including differences in physical characteristics) which may explain the massive price undercutting by the Timor. Indonesia cannot place upon the European Communities the burden of proving the negative, i.e. that no "other factor" is responsible for the price undercutting. The evidence adduced by the European Communities is more than sufficient to raise a presumption that the subsidies in dispute have caused significant price undercutting. If Indonesia considers that the price differences are due to any "other factor", it is for Indonesia to prove it.

8.408 In any event, the data contained in Indonesia's Annex V response confirm that the price undercutting is essentially attributable to the subsidies received by PT TPN. According to the following table (provided by Indonesia AV/3, Attachment A-28), the estimated dealer prices for the Timor during 1998 will be between US\$22,170 and US\$24,085 "without subsidy" and USD 14,927 "with subsidy". The estimated price "with subsidy" is almost the same as PT TPN's listed price for the Timor as of March 1997, which price undercut the listed price for the least expensive version of the Peugeot 306 (US\$24,405) by 39 per cent. In contrast, the estimated price "without subsidy" for the Timor would have undercut the listed price of the Peugeot 306 by only between 1 and 9 per cent. In other words, according to Indonesia's own estimates, the subsidies received by PT TPN would account for between 77 and 97 per cent of the price difference between the Timor and the Peugeot 306.

Table 36  
Timor Cars Manufactured In Karawang Plant

US\$1 = Rp. 2430

| No. | Item                            | 1997 | 1998 (estimated) | 1999 (estimated) | Remarks  |
|-----|---------------------------------|------|------------------|------------------|--|
| 1   | Capacity (unit)                 | NA   | 63,000           | 63,000           |  |
| 2   | Output                          | NA   | 6,000            | 35,000           | The only Timor car produced in Indonesia is the S-515i DOHC - 1500 cc. |
| 3   | Unit cost (US\$)                |      |                  |                  |  |
|     | a. with subsidy                 | NA   | 7,000 - 9,000    | 7,000 - 9,000    |  |
|     | b. without subsidy              | NA   | 9,664 - 12,852   | 9,664 - 12,852   |  |
| 4   | Unit dealer price (US\$)        |      |                  |                  |  |
|     | a. with subsidy <sup>1</sup>    | NA   | 14,927           | 14,927           |  |
|     | b. without subsidy <sup>2</sup> | NA   | 22,170 - 24,085  | 22,170 - 24,085  |  |
| 5   | Sales in Indonesia              |      |                  |                  |  |
|     | a. Unit                         | NA   | 6,000            | 25,000           |  |
|     | b. US\$ (million)               | NA   | 89.56            | 373.18           |  |
| 6   | Export                          |      |                  |                  |  |
|     | a. Unit                         | NA   | 0                | 10,000           |  |
|     | b. US\$ (million)               | NA   | 0                | 70 - 90          |  |
| 7   | Local content (%)               | NA   | 40               | 60               |  |
| 8   | Subsidy (US\$ million)          |      |                  |                  |  |
|     | a. import duty                  | NA   | 15.99 - 23.12    | 51.80 - 74.89    |  |
|     | b. luxury sales tax             | NA   | 27.47 - 31.84    | 96.81 - 110.97   |  |

Note: <sup>1</sup>Dealer price is calculated without Luxury Sales Tax, Import Duty and Registration Fee.

<sup>2</sup>Dealer price is calculated without Registration Fee.



8.409 As noted, the Mazda MR-90 is an old model. The European Communities believes that there have been no sales of this model since May 1997 and that between January and April of 1997 only 19 units were sold. The Ford Laser is sold exclusively for use as a taxi, free of customs duties and of sales taxes. Therefore, any comparison with the prices of models which are subject to import duties and sales taxes is meaningless.

(c) Arguments of the United States

8.410 Indonesia takes a perfunctory stab at arguing that the price analyses conducted by the United States and the European Communities are flawed. Indonesia does not assert that these price comparisons were not made at the same level of trade or at comparable times, but instead asserts that the Complainants failed to account for "any other factors" within the meaning of Article 6.5. Aside from the fact that Article 6.5 does not impose a burden on the complaining party to adjust for "any other factors," but instead identifies such factors as something for a panel to consider, the United States does not know of any such factors, and Indonesia has not identified any. Essentially, Indonesia is seeking to have the Panel impose on the United States and the European Communities the burden of proving the negative; i.e., that "other factors" do not exist.

8.411 Moreover, as stated by numerous commentators, the only factor responsible for the significant price undercutting by the Timor Kia Sephia is subsidies, and the 50-60 per cent price advantage that these subsidies confer.<sup>580</sup>

8.412 The United States is unaware of any other factor that would account for the massive price undercutting of like products by the Timor Kia Sephia. As numerous analysts have recognized, this price undercutting is attributable to the huge subsidies provided by Indonesia.<sup>581</sup>

8.413 In the view of the United States, the party that would benefit from having an "other factor" being taken into account under Article 6.5 should bear the burden of proving the existence of such a factor and its effect on price comparability. Otherwise, as the United States has already noted, the opposing party would bear the burden of proving the negative, an unreasonable burden which is typically impossible to satisfy and which the drafters of the SCM Agreement could not have intended, given that one of the purposes of the SCM Agreement was to create an operational multilateral remedy against subsidies.

8.414 In that regard, the relevant provisions of the Anti-dumping Agreement, which deals extensively with issues of price comparability, provide useful guidance on this point. Indeed, Indonesia has previously acknowledged that concepts developed in the anti-dumping context can be relevant to an analysis of serious prejudice.

8.415 Article 2.4 of the Anti-dumping Agreement deals with the topic of making a fair comparison between normal value and export price, and provides that due allowance shall be made for a variety of factors, including "any other differences which are also demonstrated to affect price comparability".

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<sup>580</sup> See, e.g., "Jakarta's Car Wars," Business Times (Singapore), 28 May 1996 (US Exhibit 14, pp. 46, 48); "Indonesia Draws More Criticism Over Car Plan," The Nikkei Weekly, 17 June 1996 (US Exhibit 14, pp. 80-81); "Bumpy Road Ahead for Motoring Plan," South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-133); and "Indonesia Company: Suharto Clan's Business Activities," EIU Viewswire, 28 July 1997 (US Exhibit 14, pp. 154, 156).

<sup>581</sup> See, e.g., "Jakarta's Car Wars", Business Times (Singapore), 28 May 1996 (US Exhibit 14, pp. 46, 48); "Indonesia Draws More Criticism Over Car Plan, The Nikkei Weekly, 17 June 1996 (US Exhibit 14, pp. 80-81); "Bumpy Road Ahead for Motoring Plan", South China Morning Post, 8 June 1997 (US Exhibit 14, pp. 132-133); and "Indonesia Company: Suharto Clan's Business Activities", EIU Viewswire, 28 July 1997 (US Exhibit 14, pp. 154, 156).

In other words, the party seeking an allowance must demonstrate the effect of a factor on price comparability. The last sentence of Article 2.4 states: "The authorities shall indicate to the parties in question what information is necessary to ensure a fair comparison and shall not impose an unreasonable burden of proof on those parties." Thus Article 2.4 appears to impose the burden of proof on the party seeking an allowance or an adjustment to normal value or export price, although the burden imposed cannot be an unreasonable one.

8.416 The United States cannot speak for the practice of all Members, but certainly the practice of the US authorities responsible for administering the US anti-dumping law is to impose the burden of proof on the party seeking an adjustment, whether the party be an exporter seeking an adjustment that will lower a dumping margin or a domestic party seeking an adjustment that will increase a dumping margin.

8.417 By the same token, an evenhanded application of Article 6.5 would be to impose the burden of proof on the party claiming the existence of any "other factor affecting price comparability". This avoids the imposition of the unreasonable burden of proving the negative.

8.418 The United States would also note that Article 6.5 refers to "due account being taken of "other factors". The ordinary meaning of "due" is "fitting or appropriate". As the United States has previously stated, it is unaware of any factors other than the subsidies provided by Indonesia that would account for the massive price undercutting reflected in sales of the Timor Kia Sephia. Also, as previously stated, even Indonesia's own data show that subsidies cause the price of the Timor Kia Sephia to be between US\$7,200-9,100 lower than would otherwise be the case. AV/14, Attachment A-28, note 4.

8.419 It is submitted that even if it is assumed for purposes of argument that the United States bears the burden of taking "due" account of other factors, the United States has met its burden of establishing that no account for such factors is "due" in this case.

## 7. Additional EC rebuttals to Indonesia's responses to serious prejudice claims

### (a) The subsidies received by PT TPN pursuant to Presidential Decree 42/96 have not been withdrawn

8.420 Indonesia's first argument is based on the wrong premise that there are two different "programmes", each providing different subsidies. In reality, however, there is but a single National Car Programme based on Presidential Instruction 2/96. Presidential Decree 42/1996 does not introduce a new "programme". The sole purpose of Presidential Decree 42/1996 was, by its own words, to extend on a temporary basis to National Cars imported from Korea the "same treatment"<sup>582</sup> already granted in February 1996 to National Cars assembled in Indonesia.

8.421 Moreover, Indonesia's first argument makes the fundamental error of confusing the measure granting a subsidy with the subsidy itself. A subsidy continues to exist - and, therefore, may be "withdrawn" or its adverse effects "removed" in the sense of Article 7.8 of the SCM Agreement - for as long as it continues to benefit the sale of goods by the recipient firm, even if the measure granting that subsidy has already expired.

8.422 In the present case, the permit given to PT TPN for importing 45,000 units of the Timor S-515 duty and tax free from Korea expired as of 30 June 1997. Yet, the subsidies received by PT

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<sup>582</sup> See Article 1 of Presidential Decree 42/1996 in EC Exhibit A-13. The translation provided by Indonesia (Attachment 6) states that imported National Cars "will be treated equally ...".

TPN pursuant to that authorization have not been "withdrawn". Sales of passenger cars by PT TPN after 30 June 1997 have continued to benefit from those subsidies and, as a result, to cause serious prejudice to the interests of the European Communities.

8.423 In this regard, the European Communities notes and agrees with the argument made by the United States to the effect that the subsidies granted under the one-year authorization to import cars from Korea duty and tax free are non-recurring subsidies and therefore should be allocated to future time periods.

8.424 Furthermore, even if the total amount of the subsidies had to be attributed to the passenger cars imported from Korea before 30 June 1997, it remains that more than 70 per cent of those cars had not been sold yet as of that date. In fact, it can be estimated that if sales of the Timor S-515 continue at the same pace as until now, the last Timor S-515 imported from Korea under Presidential Decree 42/1996 will not be sold until March 1999. This cannot be explained away simply as an "inventory overhang".

8.425 Indonesia does not address directly the evidence of serious prejudice submitted by the European Communities. Allegedly, because it need not do so given that the Timor S-515 is unlike any other passenger car and that, in addition, the so-called "June 1996 Programme" has already expired. In reality, because Indonesia cannot provide any evidence to rebut the EC claim, which is based on evidence supplied by Indonesia itself as part of its Annex V response.

- (b) Indonesia's suggestion that the fact that the import duty and luxury tax benefits with respect to CBUs imported from Korea under the June 1996 programme will be reimbursed or not provided precludes a finding of serious prejudice is incorrect

8.426 According to Indonesia, all the benefits granted under the so-called June 1996 programme were already "provided" before 30 June 1996. The relevant question, therefore, is whether those benefits continue to have effects. As long as those benefits are not effectively and definitively reimbursed by PT TPN (increased with an appropriate amount of interest), it cannot be considered that the subsidies have ceased to produce effects.

8.427 The letter that Indonesia has submitted indicating that the Timors imported as CBUs from Korea do not meet legal requirements to receive National Car benefits is a letter from SUCOFINDO to the Indonesian Government, which contains the results of an audit conducted by SUCOFINDO. The European Communities understands that the Indonesian Government has not yet taken any formal decision ordering the reimbursement based on SUCOFINDO's audit. Moreover, assuming that such decision was taken, it is likely to be appealed by PT TPN. Even if that appeal was unsuccessful, it would still be possible for the Indonesian Government to "forgive" PT TPN's debt.

8.428 In sum, PT TPN has not yet reimbursed any of the unpaid taxes and duties and it is still uncertain whether it will be required to do so in the future. Thus, there is no reason to assume that the subsidies have ceased or will cease to cause serious prejudice. In those circumstances, the Panel is required to rule on this claim, like on all other claims included in its terms of reference.

- (c) The subsidies granted under the National Car Programme for the assembly of passenger cars will continue to cause serious prejudice to the Community industry

8.429 The permit issued to PT TPN for importing Timor S-515 cars duty free and tax free from Korea expired on 30 June 1997. Nonetheless, the sales of those cars, together with the sales of subsidized cars assembled by PT TPN in Indonesia, will continue to cause serious prejudice to the Community interests in the foreseeable future.

8.430 As of 30 June 1997, the number of Timors S-515 imported duty free and tax free from Korea and not yet sold was 28,391. In comparison, the total demand for passenger cars during 1996 was 42,345 units. Thus, the number of Timors S-515 imported from Korea and not yet sold as of 30 June 1997 would have been sufficient to cover almost 70 per cent of the total Indonesian demand for passenger cars during the whole of 1996. As already noted, those cars will not be subject to the Sales Tax on Luxury Goods when they are sold.

8.431 From June 1997 and until May 1998, PT TPN will assemble the Timor S-515 at the Tambun Plant. According to Indonesia, this Plant has a production capacity of 3,000 cars per year and is currently producing at the rate of 1,000 cars per year.

8.432 As from May 1998, PT TPN will start producing the Timor S-515 at its own plant in Karawang. According to the investment permit approved by the BKPM, the Karawang Plant is designed to produce 120,000 cars per year, of which 80,000 sedans. In comparison, the forecast demand for passenger cars during 1998 and 1999 is 64,000 and 72,000, respectively.<sup>583</sup> Thus, Karawang Plant will have more than sufficient production capacity to supply 100 per cent of the Indonesian demand during the next two years.

8.433 According to the more conservative estimates now produced by the Indonesian authorities for the purposes of this dispute, the production capacity of Karawang Plant will be 63,000 units.<sup>584</sup> Though less than originally planned, this capacity will still be sufficient to cover almost 100 per cent of the expected demand for 1998.<sup>585</sup>

8.434 According to the same estimates, the actual output of Timors S-515 will be 6,000 units in 1998 and 35,000 units in 1999, of which 25,000 for sale on the Indonesian market.<sup>586</sup> This means that the Indonesian Government expects that, despite an unexplained very low rate of capacity utilization, in 1999 Karawang Plant will supply over 35 per cent of the forecast total sales in the Indonesian passenger car market. In other words, the Indonesian authorities are counting on a further 10 per cent increase in PT TPN's market share between now and 1999.

8.435 As shown above, the estimated subsidization rate (on sales value) of the cars assembled by PT TPN in Indonesia is lower than the corresponding rate for cars imported from Korea but still very substantial. This will enable PT TPN to continue to undercut significantly the prices of the Community cars. In fact, according to PT TPN's own estimates, the retail price for the cars assembled at Karawang Plant, will be virtually the same as the 1997 prices for the cars imported from Korea.<sup>587</sup>

8.436 The European Communities has established not only that the National Car Programme has caused serious prejudice but in addition that it will continue to do so in the foreseeable future. This claim is not to be confused with a claim of threat of serious prejudice. Since the National Car Programme has already caused serious prejudice, there is no need for the EC to show that it threatens to cause serious prejudice. The EC has submitted also a claim of threat of serious prejudice, but only in the alternative, i.e. in the eventuality that the Panel was to find that the National Car Programme has not caused actual serious prejudice. (See Section VIII.B.7.)

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<sup>583</sup> Data from DRI's report on "East Asian Automotive Growth Markets" included in AV/2, Annex 2.

<sup>584</sup> AV/3, Attachment A-28.

<sup>585</sup> Data from DRI's report on "East Asian Automotive Growth Markets" included in AV/2, Annex 2.

<sup>586</sup> AV/3, Attachment A-28.

<sup>587</sup> In AV/3, Attachment A-28, Indonesia has indicated that the estimated unit dealer price "with subsidy" for the Timors S-515 assembled at Karawang Plant during 1998 and 1999 will be US\$14,927. This price is almost identical to PT TPN current prices. Thus, according to AV/3, Attachment A - 40/1, in March 1997 PT TPN's listed retail prices for the Timor S-515 ranged from US\$13,535 to US\$14,861.

8.437 The European Communities has shown that:

- As of 30 June 1997, the number of Timors S-515 imported duty and tax free from Korea and not yet sold was 28,391. As mentioned above, if sales of the Timor S-515 continue at the same pace as until now, it may be estimated that the last Timor S-515 imported from Korea will not be sold until March 1999.
- From May 1998, the Timor S-515 will be assembled at Karawang Plant. According to the investment permit issued by the Indonesian Government to PT TPN, this Plant has been designed to produce 80,000 sedans per year.
- According to Indonesia's Annex V response, the actual output of Timor S-515 at Karawang Plant will be 6,000 units in 1998 and 35,000 units in 1999, of which 25,000 for sale on the Indonesian market. In comparison, until September of this year, PT TPN sold 13,476 units. This means that PT TPN expects to increase its sales by almost 40 per cent between now and 1999.
- In its Annex V Response, Indonesia has admitted that the current prices for the Timor S-515, and consequently the level of price undercutting, will remain unchanged during 1998 and 1999.

8.438 Indonesia has not advanced any evidence whatsoever to rebut the above allegations. It could hardly do so, since they are all based on data provided by Indonesia itself in its Annex V Response.

8.439 The European Communities presents a rebuttal to the argument that the measure has expired and therefore is not relevant to the Panel's work in the context of its claims under Article I:1 of GATT 1994. (See Section VII.E.2) In addition, with respect to the implications, if any, of an eventual repayment by TPN of the benefits under the programme, the European Communities makes the following arguments:

8.440 According to Indonesia, all the benefits granted under the so-called June 1996 programme were already "provided" before 30 June 1996. The relevant questions, therefore, is whether those benefits continue to have effects. As long as those benefits are not effectively and definitively reimbursed by PT TPN (increased with an appropriate amount of interest), it cannot be considered that the subsidies have ceased to produce effects.

8.441 The letter submitted by Indonesia is a letter from SUCOFINDO to the Indonesian Government which contains the results of an audit conducted by SUCOFINDO. The European Communities understands that the Indonesian Government has not taken yet any formal decision ordering the reimbursement based on SUCOFINDO's audit. Moreover, assuming that such decision was taken, it is likely to be appealed by PT TPN. Even if that appeal was unsuccessful, it would still be possible for the Indonesian Government to "forgive" PT TPN's debt.

8.442 In sum, PT TPN has not reimbursed yet any of the unpaid taxes and duties and it is still uncertain whether it will be required to do so in the future. Thus, there is no reason to assume that the subsidies have ceased or will cease to cause serious prejudice. In those circumstances, the Panel is required to rule on the serious prejudice claim, like on all other claims included in its terms of reference.

8. Additional United States arguments concerning serious prejudice the government-directed \$690 million loan

8.443 As demonstrated above, the tariff and tax subsidies provided under the National Motor Vehicle programme have caused serious prejudice to the interests of the United States. The government-directed \$690 million loan to TPN exacerbated the serious prejudice that already existed at the time when the Government of Indonesia ordered the banks to provide the loan.

8.444 As a result of the concessional financing provided to TPN through the intervention of the Indonesian Government, TPN's costs of doing business will be reduced even further. This continued Government backing will ensure that TPN and its joint venture, Kia Timor, continue to enjoy a competitive advantage vis-a-vis their competitors in the Indonesian passenger car market, and that imports of passenger cars from US motor vehicle manufacturers will (a) continue to be displaced or impeded from the Indonesian market; and (b) will continue to experience significant price undercutting from the subsidized Timor Kia Sephia sedan.

9. Claims of threat of serious prejudice under the SCM Agreement

(a) Claim of the European Communities

8.445 The **European Communities** claims that, in the alternative, the subsidies granted under the National Car Programme to passenger cars pose a threat of serious prejudice to the Community interests. The following are the **European Communities'** arguments in support of this claim.

8.446 As demonstrated above, the subsidies granted under the National Car Programme have caused actual serious prejudice to the Community interests and will continue to do so in the foreseeable future.

8.447 Nonetheless, assuming *arguendo* that the Panel considered that the available evidence does not warrant a finding of actual serious prejudice, the facts discussed above in order to demonstrate that the subsidies in question will continue to cause serious prejudice to the Community industry are more than sufficient to conclude that the National Car Programme poses a threat of serious prejudice to the Community interests.

(b) Claim of the United States

8.448 The **United States** claims that the 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 Article 6 and 27 of the SCM Agreement. The following are the **United States** arguments in support of this claim:

(1) Claim as raised

8.449 The United States has demonstrated that the National Motor Vehicle programme already has resulted in serious prejudice insofar as passenger cars are concerned. However, these subsidies also threaten serious prejudice with respect to US exports of light commercial vehicles to the Indonesian market. As indicated above, Kia Timor plans to assemble its own version of the Kia Sportage, a light commercial vehicle, to be sold in Indonesia as the Timor J520i. As discussed below, the Timor Kia Sportage also will benefit from subsidies, and likely will have the same adverse effects on US light commercial vehicles as the Timor Kia Sephia had on US passenger cars.

8.450 By way of background, note 13 to Article 5© of the SCM Agreement provides that the term "serious prejudice" includes "threat of serious prejudice". Although the SCM Agreement does not

address in detail the elements of a threat of serious prejudice case, logically, the elements for such a case should be the same as for a serious prejudice case. The principal difference between the two types of cases is that in a serious prejudice case, all of the elements already exist, whereas in a threat of serious prejudice case, all of the elements need not have come to pass.

8.451 In this case, the United States has previously demonstrated that three of the four necessary elements already exist. The government-directed \$690 million loan (1) constitutes a subsidy, (2) is specific, and (3) exceeds 5 per cent ad valorem. Because the ostensible purpose of this subsidy is to fund the construction of the Cikampek facility where the Timor Kia Sportage will be assembled, the loan confers a subsidy on the Sportage.<sup>588</sup>

8.452 In addition, the United States has shown that US light commercial vehicles imported and sold in Indonesia are "like" the Timor Kia Sportage. As set forth in Table 25, based on a comparison of specifications, the GM Opel Blazer is sufficiently similar to the Sportage to be considered a "like product".<sup>589</sup>

8.453 The only remaining question is what the effects will be of the Timor Kia Sportage once it is introduced into the Indonesian market some time next year. Based on the pricing strategy employed by TPN in connection with the Timor Kia Sephia, it is reasonable to assume that TPN will take advantage of the subsidies it receives from the Government to significantly undercut the prices of its competition within the meaning of Article 6.3©. As such, a threat of serious prejudice exists.

(2) Claim not pursued due to Panel's ruling on the admissibility of the \$690 million government-directed loan

8.454 The United States claim of threat of serious prejudice was limited to the impact of the subsidized Sportage on light commercial vehicles of US manufacturers. The threat of serious prejudice claim was based on the related claim that the US\$690 million government-directed loan to TPN (the purpose of which was to finance the construction of the Cikampek plant at which the Sportage will be assembled) constitutes an actionable subsidy. Because the Panel has dismissed the US claim regarding the loan, the United States is not currently pursuing its claim of threat of serious prejudice.

8.455 However, while the Panel has ruled that the US claims concerning the loan are inadmissible, the loan remains relevant to this case. *Cf., Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel, and Other Items*, WT/DS56/R, Report of the Panel issued 25 November 1997, para. 6.15. Indonesia asserted at the first meeting of the Panel that after TPN's start-up phase, the market will determine the winners and the losers, as it should." Indonesia's Statement to the Panel, page 2. This statement is simply contradicted by the fact that the Government of Indonesia ordered a consortium of banks to provide a \$690 million loan to TPN on preferential terms. The loan is a subsidy, and, with a 10-year term, has a 10-year allocation period. In other words, TPN will be deemed to be receiving subsidies from the loan for the next ten years. The existence of the loan belies Indonesia's claim that, as of 1999, the "market" will determine the winners and the losers. Moreover, Indonesia's claim that the Government of Indonesia played no role in the provision of the loan is so at odds with the reported facts that it calls into question the credibility of other factual assertions made by the Government of Indonesia in this case.

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<sup>588</sup> To date, the Government of Indonesia has insisted that the Timor Kia Sportage will not be designated as a "national motor vehicle" and will not benefit from the tariff and tax subsidies under the National Motor Vehicle programme. Be that as it may, an issue remains as to whether the tariff and tax subsidies provided to the Sephia also provide benefits to the Sportage.

<sup>589</sup> The United States also believes that the Jeep Cherokee and Jeep Wrangler are "like" the Sportage.

(c) Response by Indonesia

8.456 **Indonesia** responds to the threat of serious prejudice claims raised by the European Communities and the United States by arguing that these complainants must demonstrate a threat of serious prejudice by positive evidence in accordance with the provisions of paragraphs 3 through 8 of Article 6. The following are **Indonesia's** arguments in this regard:

8.457 The specific threat allegations of the EC relate solely to the putative effects of the February 1996 component of the National Car Programme and the specific threat allegations of the United States relate solely to the putative effects of the August 1997 loan.<sup>590</sup> As discussed above, these allegations implicate the 5 per cent ad valorem standard of Article 6.1(a), as well as the generally available serious prejudice standards of Article 6.3. This does not, however, result in the application of different types of threat analyses to these different bases for actionability.

8.458 In this case, Article 27.8 operates to apply the general standards of Article 6.3 to any Article 6.1(a) allegations. As demonstrated below, complainants have failed to show by positive evidence, as they must under either Article 6.1(a) or 6.3, that their interests are threatened with serious prejudice.<sup>591</sup>

(1) The actual and alleged subsidies provided pursuant to the February 1996 National Car Programme or the August 1997 loan to TPN, respectively, do not threaten serious prejudice to European Communities or US interests

8.459 Paragraphs (a) and (c) of Article 6.3 apply to the European Communities and United States threat of serious prejudice allegations. Both paragraphs expressly focus on the effect of the subsidy at issue on a "like product" of another Member. This threshold concept significantly limits the scope of the effects analysis that is to be undertaken here. As discussed above, Indonesia disagrees with the complainants' like product arguments.

(a) Complainants' threat allegations are based on inappropriate like product analyses

8.460 The complainants' threat allegations are based on inappropriate like product analyses. The EC takes an unduly expansive approach, boldly asserting that all motor vehicles falling within the category of passenger cars, as defined in Indonesia's regulations, constitute a single category of like products. The United States, in contrast, takes an unduly restrictive approach, looking only at limited engine, transmission, brake and dimension data for the Sportage and the Opel Blazer.<sup>592</sup> As discussed

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<sup>590</sup> The EC speaks generally of the continued effects of the terminated June 1996 programme and of the "estimated subsidisation rate (on sales value) of the cars assembled by PT TPN in Indonesia" and the United States asserts generally that National Car Programme subsidies threaten serious prejudice to US exports of light commercial vehicles, but such generalized pleading fails to satisfy even the most rudimentary positive evidence or due process standards.

<sup>591</sup> Thus, although the US Annex IV calculations regarding the August 1997 loan are flawed in several critical respects, the Government needs not here address their validity and accuracy. Also, although not within the scope of their specific threat allegations, and thus not germane, the same holds true for the application by the US and the EC of the 5%/15% tests to the February and June 1996 aspects of the National Car Programme. The calculations relating to the June 1996 programme are moot because the programme has been terminated. Similarly, the calculations relating to the February 1996 programme are moot because the only evidence of actual serious prejudice that is adduced relates exclusively to the now-terminated June 1996 programme. Article 6.1(a) is not implicated by the February 1996 programme because, as demonstrated below, Complainants have failed to satisfy the evidentiary standard imposed by Article 27.8 with respect to threat of serious prejudice.

<sup>592</sup> Although not relevant, this errant approach also contaminates the like product analysis relied upon by the US with respect to passenger cars. The reliance of the US and, to a lesser extent, the EC on the



above, the Sportage is not (and will not be) a national car. Moreover, the application of customary like product criteria demonstrates the specious nature of each complainant's approach.

8.461 The end-use criterion offers no guidance here because widely dissimilar vehicles, such as buses, motorcycles, vans and cars, serve to transport people and carry cargo. Indeed, animals and human-drawn means of conveyance also serve these purposes.

8.462 With respect to cars, consumer's tastes and habits and the product's properties, nature and quality are inseparable. Contrary to the positions taken by the European Communities and the United States, the markets for passenger cars and light commercial vehicles are very highly differentiated. It is widely recognized that consumers consider numerous physical and non-physical characteristics in making their purchasing decisions: quality; reputation; price; resale value; ride and comfort; standard features; safety features; available options; exterior size; interior space; engine size and technology (e.g., horsepower, in-line/V configuration, valve design); fuel efficiency; etc.<sup>593</sup>

8.463 Finally, that with respect to tariff treatment, passenger cars are distinguished on the basis of total cylinder capacity and fuel type (gasoline versus diesel), with Harmonized Tariff System breakpoints occurring at 1000cc, 1500cc and 3000cc.<sup>594</sup> In this respect, it is especially important to note that the Timor is one of the few passenger cars sold in Indonesia with a cylinder capacity of less than 1500cc.<sup>595</sup>

8.464 In sum, although it may be difficult to determine appropriate like product categories for the purposes of this proceeding, it should be abundantly clear that the categories urged by the European Communities and the United States are not appropriate. This is especially so considering that a restrictive interpretation of that phrase is required here. The European Communities and the United States have not met their burden of proving that products are like and of establishing acceptable like product categories.<sup>596</sup> As further discussed below, their failure to adduce appropriate evidence on those bases results in their failure to affirmatively demonstrate, as they must, that their interests are threatened with serious prejudice through the effects of the February 1996 programme or the 1997 loan to TPN.

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DRI/McGraw-Hill market segmentation categories is also misplaced. First, the DRI/McGraw-Hill categories pertain to the European, not the Indonesian, car market. See AV/2, at Annex 1, p. 284. Second, cars with the same nameplate often differ significantly from market to market. Finally, there is disagreement among industry authorities as to how to segment the market. For example, a US industry authority places the more-advanced US version of the Kia Sephia in a "Budget" category, wholly apart from the Escort, Neon, and any Opel Optima-equivalent GM model. See Indonesia Exhibit 12.

<sup>593</sup> Indeed, if all that mattered was a car's general market segment, we would not observe the very significant price spreads that exist between cars in the same segment. For example, as set forth by the United States in Table 31, the March 1997 list price for a Daewoo Nexia DOHC 1500cc was 43 million rupiah, while the list price for a Honda Civic 4-door, AKP 1600cc was nearly 75 million rupiah.

<sup>594</sup> See HTS Category 87.03. A number of countries also consider other factors (e.g., interior space; body type; number of cylinders; height) in further subdividing this category for statistical and other purposes.

<sup>595</sup> It is also noteworthy that two other vehicles fitting in the HTS 1000cc to 1500cc category (the Mazda MR-90 (1400cc) and the Ford Taxi (1300cc)), are sold at prices below those charged for the Timor. See AV/14, at Attachment U-22/1 at 3; AV/13, at Attachment 7.

<sup>596</sup> See generally Japan-Taxes on Alcoholic Beverages, WT/DS8/R (1 November 1996), Panel Report, at p. 117, para. 6.14 (complainants have burden of proof to show like product in Article III:2 dispute).

(b) Complainants have failed to demonstrate that the effects of the February 1996 Programme or the August 1997 loan to TPN threaten serious prejudice

(1) The threat of serious prejudice standard

8.465 As a threshold matter, it is important to emphasize that the threat of serious prejudice standard must be very exacting.<sup>597</sup> For example, unsubstantiated conjecture, speculation and assumptions certainly could not constitute the "positive evidence" called for by Article 27.8. Moreover, the temporal dimension is also critical, given the fluidity of the economic and business environments (on both macro and micro levels). Projections and forecasts may be carefully developed, but they are all too susceptible to revision. Thus, the more remote an item is in time, the less reliable it is as a current indicator of future developments. In sum, the threat alleged must be real and imminent, and the threat standard must be applied cautiously and judiciously, especially when the rights of a developing country Member are at stake.

(2) The EC assertions

8.466 The European Communities: (i) asserts that future sales of the national cars imported under the June 1996 programme will cause (unspecified) serious prejudice; (ii) implies that national cars assembled in Indonesia under the February 1996 programme will displace or impede European Communities imports; and (iii) argues that TPN will be able and currently plans to set retail prices that will undercut significantly the prices of EC cars in 1998 and 1999. None of these points, however, supports an affirmative threat finding.

8.467 As for the European Communities' specific assertions, any overhang in the inventory of imported national cars is irrelevant to this proceeding. These cars benefitted only from the June 1996 programme, which has terminated.

8.468 The EC's future displacement/impedance<sup>598</sup> and price undercutting<sup>599</sup> arguments are also without merit. As discussed above, the European Communities' failure to develop and adduce like produce-specific evidence strips their already sketchy threat argument of any validity.

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<sup>597</sup> Article 15.7 of the Subsidies Agreement, which pertains to the imposition of countervailing measures, is especially instructive in this respect. It provides, in pertinent part: "A determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent." Article 15.8, in turn, extends an additional cautionary note, even where the imposition of countervailing measures is warranted: "With respect to cases where injury is threatened by subsidized imports, the application of countervailing measures shall be considered and decided with special care."

Further guidance can be found in the pronouncements of various GATT bodies that have addressed the same threat concept in the anti-dumping context. The Report of the Group of Experts on "Anti-dumping and Countervailing Duties" states: "With respect to cases where material injury is *threatened* by dumped imports, the Group stressed that the application of anti-dumping measures had to be studied and decided with particular care." (13 May 1959) BISD 8S/145 (para. 16 at p. 150)(emphasis in original). The Committee on Anti-dumping Practices stated: "[A]nti-dumping relief based on the threat of injury must be confined to those cases where the conditions of trade clearly indicate that material injury will occur imminently if demonstrable trends in trade adverse to domestic industry continue, or if clearly foreseeable adverse events occur." Recommendation Concerning Determination of Threat of Material Injury (21 October 1985), BISD 32S/182 (para. 5 at p. 183). See also Korea-Anti-dumping Duties on Imports of Polyacetyl Resins from the United States (27 April 1993), BISD 40S/205 (para. 271 at p. 293).

<sup>598</sup> Although not applicable here, GATT panels addressing displacement/impedance claims have imposed a high burden of proof on the complainants, requiring them to provide clear and substantial evidence to

8.469 Nevertheless, the fact that the national car does not and will not compete significantly with EC cars is borne out by historical data. For example, notwithstanding the June 1996 programme, total Indonesian sales of passenger cars carrying European Communities brand names increased from 8,554 units in 1995 to 9,526 units in 1996.<sup>600</sup> Moreover, taking 1996 as the reference year, the breakdown of passenger car sales by brand was as follows: Mercedes-Benz, 3,829 units (40.2 per cent of total European Communities sales); BMW, 3,608 units (37.9 per cent); Peugeot, 1,401 units (14.7 per cent); and Volvo, 688 units (7.2 per cent).<sup>601</sup> It simply strains credulity to suggest that the small Timor is or will be a rival of Mercedes-Benz, BMW, Peugeot or Volvo. Thus, the historical data are yet another factor refuting the European Communities' assertions that the national car threatens to cause (or, in fact, has caused) serious prejudice to the European Communities' interests.

(3) The US claim

8.470 The United States threat allegation is one-dimensional, focusing solely on the putative effects the yet-to-be-built Sportage will have on sales of the GM Opel Blazer. The United States first asserts that the August 1997 loan to TPN constitutes a specific subsidy that exceeds 5 per cent ad valorem, and claims all that is in question is what the effects will be of the Sportage when it is introduced into the market.<sup>602</sup> The United States then simply asserts that "[b]ased on the pricing strategy employed by TPN in connection with the Timor Kia Sephia, it is reasonable to assume that TPN will take advantage of the subsidies it receives from the Government to significantly undercut the prices of its [the Sportage's] competition within the meaning of Article 6.3(c)." This is no more than unsubstantiated, unvarnished speculation that does not even remotely approach the type of positive evidence required by the SCM Agreement. This fact, coupled with the inadequate US like product analysis discussed above, is fatal to the threat allegation of the United States.

8.471 Further, Indonesia has informed the complainants and the Panel that it will not grant National Car status to a Sportage-type vehicle.<sup>603</sup>

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support their claims. See French Assistance to Exports of Wheat and Wheat Flour (21 November 1958), BISD 7S/46 (para. (c) at p. 55); EC—Refunds on Exports of Sugar (6 November 1979), BISD 26S/290 (para. 4.28 at pp. 314-315 and para. (f) at p. 319).

<sup>599</sup> Of course, Article 6.5 requires that any price comparisons shall be made at the same level of trade and at comparable times and that due account must be taken of any other factor affecting price comparability. Neither the EC nor the US has even attempted to account for "any other factors" in its analysis.

<sup>600</sup> See AV/14, at Attachment U-21/1-B (does not include Opel brand). Both the US and the EC include sales of Opel in their statistics and serious prejudice calculations. The Government asks that the Panel issue a ruling regarding which of the Complainants should be allowed to claim Opel sales as its own.

The EC understandably ignores its substantial increase in sales and instead focuses on market share, claiming that its market share increased "only marginally" from 1995 to 1996 and "fell dramatically" during the first half of 1997. Such market share developments are meaningless, however. As the EC itself states: "Since 1992 and until 1996, exports of passenger cars from the Community grew at a faster pace than demand, resulting in significant gains in terms of market share." This demonstrates that market share and demand growth are not necessarily correlated. Many extraneous factors influence this relationship, including changes in customer preferences.

<sup>601</sup> See AV/14, at Attachment U-21/1-B.

<sup>602</sup> Notwithstanding the US allegation, the loan is not a subsidy because its terms are fully consistent with commercial considerations and, in any case, the loan is outside the scope of this proceeding. The Government, however, needs not debate the point here because the alleged effects do not threaten serious prejudice to US interests.

<sup>603</sup> In this regard, Indonesia has submitted to the complainants and to the Panel a letter to TPN from the Ministry of Industry and Trade denying National Car benefits for a Sportage-type vehicle (No. 1039/DJ-ILMK/X/1997 of 21 October 1997, Indonesia Exhibit 42, Attachment E).

C. Claim under Article 28 of the SCM Agreement<sup>604</sup>

1. Claim raised by the United States

8.472 The **United States** claims that Indonesia has extended the scope of its tariff and tax subsidies in a manner inconsistent with Article 28.2 of the SCM Agreement. The following are the **United States'** arguments in support of this claim:

8.473 Indonesia first introduced its system of local content-based tariff and tax incentives in 1993, well before the date on which Indonesia signed the WTO Agreement and the date on which the WTO Agreement entered into force for Indonesia. However, after the WTO Agreement entered into force with respect to Indonesia, Indonesia extended the scope of those subsidies. In so doing, Indonesia violated Article 28.2 of the SCM Agreement.

8.474 To begin with, the tariff and tax incentives provided under the 1993 programme constitute so-called "import substitution" or "local content" subsidies within the meaning of Article 3.1(b) of the SCM Agreement. First, they satisfy the definition of a "subsidy" under Article 1.1 of the SCM Agreement, because they (a) result in government revenue that is foregone; and (b) they confer a benefit by lowering a firm's tariff and/or tax bill. Indeed, Indonesia has conceded that these measures constitute subsidies. Second, these subsidies fall within the purview of Article 3.1(b) because they are "contingent ... upon the use of domestic over imported goods". Thus, these subsidies are prohibited under Article 3 of the SCM Agreement.

8.475 Although Indonesia's tariff and tax incentives satisfy the definition of a prohibited subsidy, Indonesia is not currently subject to the prohibition of Article 3.1(b), because it is a developing country. Under Article 27.3 of the SCM Agreement, "[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 Agreement."

8.476 However, while Indonesia is not currently subject to the provisions of Article 3.1(b) prohibiting the use of local content subsidies, Indonesia is subject to the provisions of Article 28.2 of the SCM Agreement that prohibit the extension of the scope of subsidy programmes that are inconsistent with the provisions of the SCM Agreement. Article 28, which is entitled "*Existing Programmes*," applies to "[s]ubsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement ... ." <sup>605</sup> Article 28.2 provides the following: "No Member shall extend the scope of any such programme, nor shall such a programme be renewed upon its expiry."

8.477 Indonesia has extended the scope of its pre-WTO tariff and tax subsidies in several ways. First, Decree No. 223/1995 revised the tariff subsidies previously available under Decree No. 645/1993 with respect to passenger car parts. The revision was as follows:

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<sup>604</sup> **Japan**, in its first submission alleged that Indonesia had violated Article 28 of the SCM Agreement. Japan did not, however, make a claim with respect to this alleged violation.

<sup>605</sup> Article 28.1, SCM Agreement.

Table 37

Passenger Car Parts

| Local Content Rates                        | Import Duty Rates<br>Decree No. 645/1993 | Import Duty Rates<br>Decree No. 223/1995 |
|--|--|--|
| less than 20%                              | 100%                                     | 65%                                      |
| 20% to 30%                                 | 80%                                      | 50%                                      |
| more than 30% and up to 40%                | 60%                                      | 35%                                      |
| more than 40% and up to 50% <sup>606</sup> | 40%                                      | 20%                                      |
| more than 50% and up to 60% <sup>607</sup> | 40%                                      | 10%                                      |
| more than 60%                              | 0%                                       | 0%                                       |

8.478 As the above table demonstrates, in the case of tariff incentives for passenger car parts, by creating new gradations of local content rates (i.e., the 40-50 per cent range and the 50-60 per cent range), Decree No. 223/1995 extends the range of the incentives available. For example, in the case of an assembler of passenger cars with a local content of 41 per cent, under Decree No. 645/1993, that assembler would have had to boost its local content to over 60 per cent in order to obtain the incremental benefit of an import duty rate of 0 per cent. Because 60 per cent local content may be an unattainable goal, the assembler would have had no incentive to increase local content beyond 41 per cent.<sup>608</sup> However, under Decree No. 223/1995, the assembler need not pass the 60 per cent local content target in order to obtain an additional subsidy; instead, it can reduce its import duty rate from 20 per cent to 10 per cent by achieving a local content rate of only 51 per cent.

8.479 Decree No. 82/1996 also extends the scope of the pre-WTO tariff incentives. Under Decree No. 82/1996, the producer or assembler of a "national motor vehicle" pays no import duties on imported parts if the vehicle has a local content of 20 per cent in the first year or 40 per cent in the second year. In the case of passenger cars, a producer or assembler of a passenger car with a local content rate of 20 per cent would have paid import duties at the rate of 80 per cent under Decree No. 645/1993, while a producer or assembler of a car with a local content rate of 40 per cent would have paid import duties at the rate of 60 per cent. Clearly, the adjustment of import duty rates from 80 per cent and 60 per cent to zero constitutes an extension of the scope of the tariff subsidy.

8.480 Second, Indonesia has extended the scope of its pre-WTO tax incentives. Recall that under Decree No. 647/1993, passenger cars with a cylinder capacity of less than 1600cc and jeeps were subject to a preferential luxury tax rate of 20 per cent, provided that the local content of such vehicles exceeded 60 per cent. Thus, Decree No. 647/1993 constituted an import substitution subsidy with respect to jeeps and certain passenger cars, the amount of the subsidy being the difference between the

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<sup>606</sup> Decree No. 645/1993 only had a category of 40% to 60%.

<sup>607</sup> Decree No. 645/1993 only had a category of 40% to 60%.

<sup>608</sup> Indeed, most observers consider the attainment of 60% local content for passenger cars as extremely problematic. "In Defence of the National Car Project," Business Times (Singapore), 10 June 1996 (US Exhibit 14, pp. 72-74).

preferential 20 per cent rate and the 35 per cent rate applicable to the corresponding vehicles with a local content of 60 per cent or less.

8.481 However, Regulation No. 36/1996 increased the amount of the tax subsidy and expanded the types of vehicles eligible for the subsidy. Under Regulation No. 36/1996, the luxury tax is reduced from 20 per cent to zero for motor vehicles with a local content in excess of 60 per cent. In addition, instead of limiting the tax subsidy to jeeps, Regulation No. 36/1996 makes the tax exemption applicable to all light commercial vehicles. Finally, a “national motor vehicle” is subject to a luxury tax of zero even though it is only required to have a local content of 20 per cent in the first year and 40 per cent in the second year.

8.482 In summary, that Indonesia has significantly extended the scope of its pre-WTO local content subsidies. In so doing, Indonesia has acted inconsistently with the provisions of Article 28.2 of the SCM Agreement.

8.483 Indonesia has not contested the United States' description of the precise manner in which Indonesia extended the scope of these subsidies. Indonesia makes two arguments in response: (1) because Article 27.3 does not contain an express standstill provision comparable to the standstill provision concerning export subsidies in Article 27.4, the drafters must have intended to preclude a standstill provision for local content subsidies; and (2) local content subsidies used by developing country Members are not “inconsistent with the provisions of the Agreement” within the meaning of Article 28.1. The United States submits that both arguments are wrong.

8.484 The first argument ignores the text of Article 28 and the drafting history of Article 27.3. With respect to the text, Article 28, by its terms, applies to all Members, not merely developed country Members. If the drafters had intended that Article 28 apply only to developed country Members, presumably they would have said so explicitly. Instead, the provisions of Article 28 apply to all Members, except as modified by other provisions of the Agreement. While Article 27.3 may modify the deadlines in Article 28.1(b) for eliminating subsidies that are inconsistent with the SCM Agreement, Article 27.3 does not modify the notification requirements of Article 28.1(a) or the standstill requirements of Article 28.2.

8.485 Concerning the drafting history of Article 27.3, in the discussion of the TRIMs Agreement, above, the United States has demonstrated how Article 27.3 was a last minute insertion into the text of the SCM Agreement that was intended to avoid prohibiting those local content subsidies that would be permitted under the transition provisions of the TRIMs Agreement. In making this last minute insertion, not all of the necessary conforming changes were made. For example, Article 27.7 of the SCM Agreement clarifies that the expedited procedures of Article 4 do not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. Article 27.7 should have been revised to include a reference to local content subsidies, but it was not, and one must read this omitted reference into Article 27.7, as all the parties in this case have done.

8.486 Therefore, the absence of a standstill provision in Article 27.3 comparable to the provision in Article 27.4 should not be interpreted as a deliberate decision by the drafters to exclude developing country local content subsidies from the general standstill obligation of Article 28.2. This is especially true in light of the comparable standstill provision in Article 5.4 of the TRIMs Agreement.

8.487 Turning to Indonesia's argument that local content subsidies of developing country Members are not “inconsistent with” the provisions of the SCM Agreement, “inconsistent with” simply is not a synonym for “prohibited by.” If the drafters had intended that Article 28.1 encompass only subsidies that are prohibited by the SCM Agreement, they easily could have used the more precise phrase “prohibited by”.

8.488 Finally, Indonesia's limited interpretation of Article 28 is inconsistent with the object and purpose of the SCM Agreement, which was to increase disciplines on the use of export and local content subsidies. Although the deadline for elimination of these subsidies is phased in for certain classes of economies, nowhere is there a provision in the SCM Agreement that expressly condones the unilateral extension of, or increase in, these types of subsidies during the phaseout period. To the contrary, the only two provisions in the SCM Agreement that expressly address this issue, Articles 27.4 and 28.2, condemn such extensions or increases.

8.489 In summary, Indonesia has failed to rebut the existence of a violation of Article 28.2 of the SCM Agreement.

2. Response of Indonesia

8.490 **Indonesia** responds to the claim under Article 28.2 of the SCM Agreement by arguing that Article 27.3 of the Agreement permits Indonesia, as a developing country, to maintain the subsidies granted under the 1993 and February 1996 Programmes. The following are **Indonesia's** arguments in this regard:

(a) Indonesia is subject to Article 27.3

8.491 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, as noted, 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". As discussed above, Indonesia, as a developing country, is within the ambit of Article 27.3 of the Subsidies Agreement, and thus benefits from an exemption from the prohibition of Article 3.1(b) for a five year period.

(b) Article 27.3 does not preclude the introduction or expansion of domestic content subsidies

8.492 Article 27.3 does not preclude Indonesia, as a developing country, from introducing or expanding domestic content subsidies. The Article states in full:

The 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.

Article 27.4 in contrast precludes a "developing country Member referred to in paragraph 2(b)" [of Article 27] (i.e., developing countries other than least-developed countries and countries with per capita GNP of less than \$1,000 per annum) from "increas[ing] the level of its export subsidies."

8.493 Under the rules of treaty interpretation reflected in the Vienna Convention on the Law of Treaties, the inclusion of a prohibition on new or expanded export subsidies under Article 27.4 and the absence of any such prohibition as to domestic content subsidies under Article 27.3 can only mean that there is no such preclusion under Article 27.3. If the drafters of the Subsidies Agreement had intended to preclude the introduction or expansion of domestic content subsidies, they would have done so expressly in Article 27.3, as they did with respect to export subsidies in Article 27.4.

- (c) The domestic content subsidy is not within the scope of Article 27.4 because it is not an "export" subsidy and Indonesia Is an Annex VII developing country

8.494 The relevant part of Article 27.4 reads as follows:

27.4 Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. (Emphasis added; footnote omitted.)

8.495 By its terms Article 27.4 applies only to "export" subsidies. "Export subsidies" is a term of art referring to subsidies defined in Article 3.1(a) of the Subsidies Agreement:

subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I. (Footnotes omitted.)

The term does not include domestic content subsidies, which are defined separately in Article 3.1(b).

8.496 The distinction between export and domestic content subsidies is also explicit in Article 27, which sets out special and differential treatment for each of the two types of subsidies. Articles 27.2 and 27.4 deal with export (Article 3.1(a)) subsidies, while Article 27.3 deals with domestic content (Article 3.1(b)) subsidies. Accordingly, the condition set out in Article 27.4 does not apply to Indonesia's Article 3.1(b) domestic content subsidy.

8.497 Moreover, even if Article 27.4 did apply to domestic content subsidies (which, to repeat, it does not), the preclusion against increasing the level of subsidies would not apply to Indonesia. Article 27.4 applies to "[a]ny developing country Member referred to in paragraph 2(b) [of Article 27]." By its terms it does not apply to Article 27.2(a) developing country Members—those "referred to in Annex VII" of the Subsidies Agreement.<sup>609</sup> Indonesia is an Annex VII developing country Member - it is so listed in paragraph (b) of that Annex. For this reason as well, Indonesia's domestic content subsidy is not covered by the provisions of Article 27.4.

- (d) The domestic content subsidy is not within the scope of Article 28.2 because it is not inconsistent with the SCM Agreement

8.498 Article 28.2, regarding extension of subsidy programmes, does not apply to Indonesia as a developing country. Article 28 is a phase-out provision for subsidy programmes that existed on the date the WTO entered into force and that were inconsistent with the Subsidies Agreement. The Article reads in full:

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<sup>609</sup> Complainants cannot successfully assert that the second sentence of Article 27.4 is not limited to developing country Members referred to in paragraph 2(b) of Article 27. The first sentence of Article 27.4 expressly refers to paragraph 2(b) countries. The third sentence refers to desired extension of the eight-year phase-out requirement for export subsidies. It can apply only to paragraph 2(b) countries because paragraph 2(a) (i.e., Annex VII) countries are not required to phase out their export subsidies within eight years. In addition, the second sentence itself speaks of eliminating export subsidies "within a period shorter than that provided for in this paragraph." (Emphasis added.) That period can only be the eight-year period for phase-out of export subsidies by paragraph 2(b) countries. Accordingly, analysis of the text of the second sentence of Article 27.4 and of its context confirm that the entirety of Article 27.4 applies only to paragraph 2(b) countries.



28.1 Subsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement shall be:

- (a) notified to the Committee not later than 90 days after the date of entry into force of the WTO Agreement for such Member; and
- (b) brought into conformity with the provisions of this Agreement within three years of the date of entry into force of the WTO Agreement for such Member and until then shall not be subject to Part II.

28.2 No Member shall extend the scope of any such programme, nor shall such a programme be renewed upon its expiry. (Emphasis added.)

8.499 Article 28.2 applies only to subsidy programmes which are inconsistent with the provisions of the Subsidies Agreement. Thus, the reference in Article 28.2 to "any such programme" can only refer to subsidy programmes which are "inconsistent" with the Agreement and must be "brought into conformity" with its provisions.

8.500 Indonesia's domestic content subsidies under the 1993 incentive programme were in effect on 1 January 1995 (the date the WTO Agreement entered into force) and were not then (and are not now) inconsistent with the provisions of the Subsidies Agreement. Only subsidies which are prohibited are inconsistent with the Subsidies Agreement. A Member shall "neither grant nor maintain" a prohibited subsidy (Article 3.2), and if one is found to exist, the Member is to "withdraw the subsidy without delay" (Article 4.7). "Actionable" subsidies (including subsidies by developing countries that are not prohibited by virtue of Article 27.3), on the other hand, are not inconsistent with the Agreement. They may be granted, but if they are subsequently determined to result in adverse effects to the interests of another member, "the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy" (Article 7.8). In other words, actionable subsidies are consistent with the Agreement, but any adverse trade effects caused by them must be remedied.

## IX. ARTICLE X CLAIMS

### A. Claims Under Article X:3(a) of GATT 1994

#### 1. Claims Raised by Japan

9.1 **Japan** claims that the extended National Car Programme was administered in violation of Article X:3(a) of GATT 1994. The following are **Japan's** arguments in support of this claim:

- (a) Article X:3(a) of the GATT 1994 requires uniform, impartial and reasonable administration of regulations

9.2 Article X:3(a) of GATT 1994 establishes that:

Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.

Laws, regulations, decisions and rulings under Article X:1 include, in particular, those pertaining "to rates of duty, taxes or other charges".

9.3 The Appellate Body report in the EC - Bananas III case emphasized that Article X:3(a) does "not apply to the laws, regulations, decisions and rulings themselves, but rather to the administration of those laws, regulations, decisions and rulings." <sup>610</sup>

(b) Indonesia granted benefits to automobiles imported by PT Timor in violation of Article X:3(a) of GATT 1994

9.4 In June 1996, Indonesia authorized PT Timor to import automobiles duty free in accordance with the provisions of Presidential Decree No. 42, although the counter-purchase requirement, which is clearly set out in the Decree of the Minister of Trade and Industry No. 142/MPP/Kep/6/1996<sup>611</sup>, was obviously not met. The Indonesian trade statistics show that it is quite unlikely that TPN and Kia have met the 25% counter-purchase requirement, which is clearly set forth in the governmental decree.<sup>612</sup> Following this authorization, almost 40,000 automobiles were imported duty free, and sales of those automobiles were also exempted from the luxury tax as discussed. These facts constitute violations of Article X:3(a) of GATT 1994, for the following reasons.

9.5 First, Presidential Decree No.42/1996<sup>613</sup> and the Decree of the Minister of Trade and Industry No.142/MPP/Kep/6/1996 fall within the scope of Article X:1 of GATT 1994, since they are obviously regulations pertaining "to rates of duty, taxes or other charges".

9.6 Second, Indonesia granted authorization to PT Timor, resulting in exemptions from duties and the luxury tax, clearly in violation of the Presidential Decree No. 42 and the Decree of the Minister of Trade and Industry No.142/MPP/Kep/6/1996. In other words, Indonesia administered its regulations in a partial and unreasonable manner.

9.7 Therefore, Indonesia granted benefits to automobiles imported by PT Timor in violation of Article X:3(a) of GATT 1994.

2. Response of Indonesia

9.8 **Indonesia** argues that Japan's contention that the provision of "Pioneer Status" to TPN violated Article X:3(a) of GATT 1994 is incorrect. The following are **Indonesia's** arguments in this regard.

(a) Japan's contention that the provision of "Pioneer Status" to TPN violated Article X:3(a) of GATT 1994 is incorrect

9.9 Japan erroneously claims that Indonesia has acted inconsistently with the obligations of Article X:3(a) of the General Agreement to administer laws, regulations, decisions and rulings in a uniform, impartial and reasonable manner. Indonesia has not violated Article X:3(a).

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<sup>610</sup> Report of the Appellate Body on EC - Bananas III, para. 200.

<sup>611</sup> Decree of the Minister of Trade and Industry No.142/MPP/Kep/1996 (Japan Exhibit 43).

<sup>612</sup> During the period from January 1996-December 1996, the total amount of automotive parts and components exported from Indonesia to Korea was \$5,777,843, which includes not only parts and components for "Sedan/S515-1500cc", but also for other models produced by Kia Motors and for vehicles produced by other Korean companies (see Japan Exhibit 50). On the other hand, the value of the National Cars imported from Kia Motors during the period from June 1996 through December 1996 was \$131,242,800 (see Japan Exhibits 30 and 31). Accordingly, it is quite obvious that, as far as the period from June 1996 through December 1996 is concerned, the value of the counter-purchase by Kia could never amount to 25 per cent of the import value of the National Cars (i.e. \$32,810,700).

<sup>613</sup> Presidential Decree No.42/1996 (Japan Exhibit 9).

9.10 First, as discussed in the context of GATT Article I (See Section VII.D), the June 1996 programme expired, as scheduled, on June 30 1997, and will not be renewed. Since the programme and the authority under which it was granted have terminated, there is no basis for an affirmative determination by the Panel.

9.11 Second, TPN was designated to build and produce a national car in Decision of the State Minister for the Mobilization of Investment Funds No. 02/SK/1996 (5 March 1996).<sup>614</sup> The decision was based on:

- TPN's request to be selected to build a car (TPN Letter No. 071/PD/TPN/II/96 (28 February 1996))<sup>615</sup>;
- TPN's obtaining domestic investment approval (No. 607/I/PMDN/1995 (9 November 1995))<sup>616</sup>; and
- TPN's fulfillment of all the criteria and requirements to be designated to build a national car as set out in Decree of the State Minister for Mobilization of Investment Funds No. 1/SK/1996 (27 February 1996)<sup>617</sup>, which in turn implements Instruction of the President No. 2/1996 (19 February 1996).<sup>618</sup>

9.12 Like Kia, any Japanese company could have sought to participate in the National Car Programme. None have done so. If they had, they would have been judged by the same criteria applied to TPN (those of Instruction of the President No. 2/1996 and the regulations and decrees implementing the Instruction). The programme would have been administered in a uniform, impartial and reasonable manner. Accordingly, no basis exists for Japan's contention that Indonesia acted inconsistently with the obligations of Article X:3(a) of the General Agreement.

- (b) Indonesia has complied fully with the letter and the spirit of Article X, which, in any case, does not establish substantive obligations

9.13 Indonesia has administered the laws, decrees, regulations and decisions regarding the National Car Programme in a uniform, impartial manner, in accordance with Article X:3 of GATT 1994. Japan nonetheless insists that its manufacturers still do not understand the subsidies and Indonesia's administration of them. Extraordinary. Japan's producers understand them well enough to have increased their combined share of all of Indonesia's passenger car markets, including the market in which the Timor competes, by over 40 per cent. Such growth is unprecedented. Moreover, Japan's car makers accomplished this by outcompeting the European Communities and United States manufacturers whose market share they acquired, and who, presumably, do understand the subsidies, insofar as neither the United States nor the European Communities has seen fit to pretend ignorance.

9.14 Finally, Japan's rebuttal is nothing more than a description of the housekeeping related to a terminated measure. The description demonstrates nothing partial, not uniform or unreasonable. The Government cannot understand why Japan insists on continuing to advance an obviously flawed claim under Article X.

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<sup>614</sup> See Indonesia Exhibit 5.

<sup>615</sup> See Indonesia Exhibit 14.

<sup>616</sup> See Indonesia Exhibit 15.

<sup>617</sup> See Indonesia Exhibit 4.

<sup>618</sup> See Indonesia Exhibit 1.

- (c) The Government of Indonesia did not establish the National Car Programme for the sole benefit of TPN

9.15 Much of Japan's Article X claim is based on its erroneous and unsupported assertion that the National Car Programme was created solely for the benefit of TPN. As the Government already has demonstrated, this assertion is false. The programme was created to benefit Indonesia and was made available to any qualifying company. TPN was chosen on the basis of the strength of its proposal. In particular, it was found that TPN's proposal to produce the "Timor" S515 car using technology from Kia Motors of South Korea met the requirements set forth in Decree of the Minister of Industry and Trade No. 31/1996.

- (d) The Government of Indonesia is addressing properly the issue of whether TPN has complied with the relevant decrees; in any case, this is a matter of internal enforcement of Indonesian law, not of compliance with Article X of GATT 1994

9.16 Japan also purposefully conflates the terms and relationships among the Decrees with their enforcement, in a vain attempt to further distort Indonesia's conduct. In this regard, Indonesia noted in its Second Submission that it was examining whether TPN had complied with the decrees, and that if the Government found that TPN had not complied, it would take appropriate action as provided for in the decrees.<sup>619</sup> Indonesia subsequently submitted a letter containing the results of this examination, which indicated that TPN had not fulfilled the requirements of the decrees. Accordingly, the Minister of Finance would instruct the Director-General of Customs to demand payment by TPN of the 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.

### 3. Rebuttal Arguments made by Japan

9.17 The following are **Japan's** rebuttal arguments to Indonesia's responses to the claims raised under Article X:3(a) of GATT 1994:

9.18 The Government of Indonesia, in granting benefits under the National Car Programme to a company that does not meet its own regulatory requirements, violates GATT Article X:3(a). Japan has specifically stated that Indonesian trade data indicates that the 25 per cent counter-purchase requirement was not satisfied.

9.19 Indonesia did not make any meaningful response to Japan's arguments. Instead, it stated irrelevantly that "[PT Timor] was designated to build and produce a national car in Decision of the State Minister for the Mobilization of Investment Funds No.02/SK/1996" and that "[I]ike Kia, any Japanese company could have sought to participate in the National Car Programme." It is obvious that neither of these points addresses in any way the Article X:3 violations established by the Government of Japan.

9.20 Indonesia only tries to evade the real issue, alleging, for example, that "Japan ... purposefully conflates the ... Decrees with their enforcement". However, the obligation of GATT Article X:3(a) specifically concerns the administration or enforcement of regulations. Japan cannot fathom why Indonesia would believe that the manner in which it enforces the National Car Programme is not an issue for GATT Article X:3(a).

9.21 Moreover, Indonesia has acknowledged that "preliminary data suggests" that Japan is correct in arguing that PT Timor did not meet the National Car Programme's requirements. Indonesia also

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<sup>619</sup> See Indonesia Exhibit 43 at p. 3.

acknowledged that nonetheless it failed to complete a compliance audit, although the June 1996 Programme allegedly expired more than five months ago. Nor has Indonesia asked PT Timor to return the benefits or presented a schedule on when the audit will be completed. The Government of Japan thus concludes that the delay in auditing is another clear indication of the Government of Indonesia's unreasonable administration of the National Car Programme, and also itself constitutes a violation of GATT Article X:3(a).<sup>620</sup>

9.22 Indonesia essentially admitted that it granted benefits to TPN without considering its own regulations. To be eligible for benefits under the June 1996 Programme, Presidential Decree No. 42 requires that National Cars from Korea must be made by Indonesian workers and must fulfil the 25% counter-purchase requirement. However, Indonesia states in its answers to Japan's questions, with regard to the first requirement, that the "Government currently is verifying the data". And more strikingly, with regard to the second requirement, the Indonesian Government informed Japan just one day before the Second Panel Meeting of its own verification on 9 January 1998 which confirmed that TPN has not met that requirement. Therefore, it is clear that Indonesia granted authorization to TPN without reviewing its compliance, or even the plausibility of compliance, with the requirements.

9.23 Finally, the Government of Japan notes that it requires a considerable stretch of the imagination to regard 40,000 automobiles as being produced "by Indonesian workers" when allegedly only 100 Indonesian nationals have been sent to Korea and they were sent as "trainees" at that. Furthermore, the press reported that a member of the Indonesian Parliament, who visited Korea in August 1996, found only three Indonesian workers at Kia.<sup>621</sup>

## B. Claims under Article X:1 of GATT 1994

### 1. Claims Raised by Japan

9.24 **Japan** claims that the extended National Car Programme also violates Article X:1 of GATT 1994, which requires publication of trade regulations. The following are **Japan's** argument in support of this claim:

9.25 Article X:1 of GATT 1994 establishes that:

Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining ... to rates of duty, taxes or other charges ... shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. ...

9.26 Indonesia has never clearly set out the requirements for the Imported National Cars, and also administered the relevant regulations partially and unreasonably. The lack of clarity is most striking with respect to Decree of the Minister of Industry and Trade No.31/MPP/SK/2/1996, issued in February 1996, including the requirement that National Cars be "domestically produced" and local content requirements<sup>622</sup>, and also with respect to the meaning of "by Indonesian personnel" under Presidential Decree No.42/1996.<sup>623</sup> Indonesia not only failed to make the requirements clear in the

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<sup>620</sup> As indicated above and in Section X, **Indonesia** has submitted to the Panel a letter concerning the results of the audit (Indonesia Exhibit 47).

<sup>621</sup> Jakarta Post, "Kia Motors lacks Indonesian staff: House member" (30 January 1997) (Japan Exhibit 73), Jakarta Post, "Timor sends only 100 supervisors to Kia plant: Tunky" (31 January 1997) (Japan Exhibit 74), Far Eastern Economic Review, "The Timor Gap" (27 February 1997) (Japan Exhibit 75).

<sup>622</sup> Decree of the Minister of Industry and Trade No.31/MPP/SK/2/1996 (Japan Exhibit 28).

<sup>623</sup> Presidential Decree No.42/1996 (Japan Exhibit 9).

published regulations, but even failed to clearly explain the requirements during the consultations with Japan.

9.27 In particular, Indonesia has made clear that the conditions stipulated in the Decree of the Minister of Industry and Trade No. 31/1996 also must be also met, in addition to the conditions of Decree 42/1996.<sup>624</sup> However, Imported National Cars obviously can never meet the conditions set out in Decree 31/1996, in particular paragraph a of Article 1, which requires them to be "domestically produced by using facilities owned by national industrial companies or Indonesian statutory bodies with total shares belonging to Indonesian citizens." (Emphasis added.)

9.28 Second, regarding "the local content requirements as stipulated by the Minister of Industry and Trade" in Article 1 of Presidential Decree No.42/1996, the Government of Indonesia has stated<sup>625</sup> that they correspond to those stipulated in Article 3 of the Decree of the Ministry of Industry and Trade No.31/MPP/SK/2/1996 (i.e., "at the end of the first year, they shall reach the local content rate of more than 20 per cent"). However, the Government of Indonesia further stated that "satisfaction of the 25 per cent counter-purchase requirement [as set out in the Decree of the Minister of Trade and Industry No.142/MPP/Kep/6/1996] will be treated as equivalent to achieving 20 per cent local content," and PT Timor "should export and Kia Motors should purchase automotive parts and components amounting to 25 per cent of the C&F value of imported cars in the one-year period."<sup>626</sup> Accordingly, the Government of Indonesia seems to indicate that imported automobiles are treated as satisfying "local content requirements," as long as the 25 per cent counter-purchase requirement is met by its producer, even if the producer does not use any of such parts and components, imported from Indonesia, to assemble the automobiles for export to Indonesia, without regard to Presidential Decree No.42/1996.

9.29 Third, Article 1 of Presidential Decree No.42/1996 requires that the National Cars be produced "by Indonesian personnel," but the Government of Indonesia has not provided any explanation about what extent of participation by Indonesian workers is necessary to meet the requirement.<sup>627</sup> In this connection, the Government of Indonesia has stated only that PT Timor "reported that, through the end of October 1996, 100 workers had been dispatched to Korea. The workers participate in production as trainees."<sup>628</sup>

9.30 As explained above, Presidential Decree No.42/1996 and its implementing regulations fall within the scope of Article X:1. Accordingly, it should be concluded that Indonesia has not published all the regulations necessary to make the requirements sufficiently clear, or that it has at least not published its regulations "in such a manner as to enable governments and traders to become acquainted with them," either of which constitutes a violation of Article X:1 of GATT 1994.

9.31 In addition, Indonesia also has ignored its obligation to publish trade regulations "promptly". Most of the regulations related to the National Car Programme, including Presidential Instruction

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<sup>624</sup> Japanese Questionnaire regarding the Indonesian National Car Programme (Japan Exhibit 44), Question No.9; Indonesia's Answer to Questions Submitted by Japan (Japan Exhibit 45), Answer No.9. See also Additional Questions from the Government of Japan concerning Indonesian Automobile Programme (Japan Exhibit 46), Questions Nos.IV.3 and IV.4; Answer of the Republic of Indonesia to Additional Questions submitted by the Government of Japan (Japan Exhibit 47) Answers Nos.IV.3. and IV.4.

<sup>625</sup> *Id.*, at Question and Answer No.12 between Japan and Indonesia (Japan Exhibits 44 and 45).

<sup>626</sup> *Id.*, at Questions and Answers No.13, 22 and 23 between Japan and Indonesia (Japan Exhibits 44 and 45).

<sup>627</sup> Question and Answer No.9. between Japan and Indonesia (Japan Exhibits 44 and 45); see also additional question and answer No.IV.5. between Japan and Indonesia (Japan Exhibits 46 and 47).

<sup>628</sup> Question and Answer No.4. between Japan and Indonesia (Japan Exhibits 44 and 45); see also additional Question and Answer No.IV.2. between Japan and Indonesia (Japan Exhibits 46 and 47).

No.2/1996<sup>629</sup> and Presidential Decree No. 42/1996<sup>630</sup>, are enforced as of the date of issuance, and there was no prior public notification regarding the new regulations before the date of issuance. However, these regulations deeply affect exporters and investors, and it was necessary for the companies to get the relevant information well in advance in order to adapt to the new regulations, for example, in order to get benefits after meeting stipulated requirements. This reinforces the conclusion that Indonesia violated its obligations under GATT Article X:1.

## 2. Indonesia's Response to the Claim under Article X:1

9.32 In response to the claim raised under Article X:1, Indonesia argues that Japan's contention that Indonesian regulations were not published promptly as required by Article X:1 of GATT 1994 is erroneous. The following are Indonesia's arguments in this regard:

9.33 Japan erroneously contends that Indonesia did not clearly set out the requirements for the June 1996 programme and that this violates the publication requirement of GATT Article X:1. Contrary to Japan's assertion, Decree of the Minister of Industry and Trade No. 31/MPP/SK/2/1996, dated 19 February 1996<sup>631</sup>, and all other decrees relevant to the June 1996 programme set out fully the requirements and conditions of that programme.

9.34 Even if that were not the case, though, there would be no violation of Article X:1. By its terms, the objectives of this Article are limited to (1) prompt publication, (2) "in such a manner as to enable governments and traders to become acquainted with them." As required by Indonesian law, all regulations and decrees are published in the State Gazette promptly after their promulgation. This official, readily accessible publication fully satisfies the procedural requirement of enabling governments and traders to become acquainted with regulations and decrees. Article X:1 is a transparency requirement, not a substantive obligation to meet one country's subjective, substantive standard as to whether another country's regulation is "clear".

9.35 Japan also erroneously claims that Article X:1 requires publication of official documents prior to their effective date. There is no such requirement. Indeed, the words "shall be promptly published" clearly envision publication after entry into force.

9.36 For these reasons there is no basis for Japan's contention that Indonesia did not act in conformity with Article X:1 of the General Agreement.

9.37 Responding to Japan's arguments and questions, Indonesia stated that Decree No. 31 is irrelevant to the June 1996 Programme.<sup>632</sup>

## 3. Rebuttal Arguments made by Japan

9.38 **Japan** makes the following rebuttal arguments to Indonesia's responses to the claim raised under Article X:1:

9.39 The Government of Indonesia, in not publishing its measures promptly and "in such a manner as to enable governments and traders to become acquainted with them", violates GATT Article X:1. As demonstrated, the Government of Japan, as well as Japanese traders, still cannot know several

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<sup>629</sup> Presidential Instruction No.2/1996 (Japan Exhibit 8).

<sup>630</sup> Presidential Decree No.42/1996 (Japan Exhibit 9).

<sup>631</sup> See Indonesia Exhibit 2.

<sup>632</sup> See Indonesia Exhibit 43, question 1.

important requirements under the June 1996 Programme, for example, what the term "produced by Indonesian workers" exactly means.

9.40 Indonesia's First Submission does not make any meaningful argument in response. Rather, it simply argues that:

- (i) GATT "Article X:1 is a transparency requirement, not a substantive obligation to meet one country's subjective, substantive standard as to whether another country's regulation is 'clear' "; and
- (ii) "all regulations and decrees are published in the State Gazette promptly after their promulgation".

9.41 Indonesia's defences cannot prevail, however, because they are inconsistent with the text of Article X:1. Several important measures by Indonesian government pertaining to require merits on imports were not published "in such a manner as to enable governments and traders to become acquainted with them".

9.42 Japan has identified the specific points that need clarification or further elaboration so as "to enable governments and traders to become acquainted with" the National Car Programme, but Indonesia has not addressed these issues. Thus, critical aspects of the National Car Programme remain unknowable. It must be stressed, however, that belated clarification at this stage would not be "prompt" any more and thus could not cure the insufficiency of the publication at an earlier stage.

9.43 In particular, Indonesia confirmed that it still cannot explain the meaning of the requirement of Presidential Decree No. 42 that National Cars imported from Korea must be "made ... by Indonesian workers". Japan asked whether this means that imported National Cars must be made exclusively by Indonesian workers or, if not, what percentage of participation is required. Even at this very late stage, however, Indonesia could not answer such a basic question.

9.44 Furthermore, the discussion at the first Panel meeting revealed some additional facts which constitute another violation of GATT Article X:1. At the first Panel meeting, the European Communities asked: (i) where is the decision of the Minister of Industry and Trade granting Pioneer status to PT Timor, and (ii) where is the decision granting National Car status to the Timor S-515? The Government of Indonesia: (i) in responding to the first question, circulated Decree of the Director General for Metal, Machinery and Chemical Industries No.002/SK/DJ-ILMK/II/1996 of 27 February 1996, and (ii) as to the second question, responded that there existed a letter (No. 1039/DJ-ILMK/X/1997 of 21 October 1997) and indicated that it would submit an English translation. However, the Government of Japan had never seen these documents in any publication accessible before the meeting in December 1997. In other words, these regulations were not published promptly in such a manner as to enable the Government of Japan to become acquainted with them.

9.45 Therefore, the Government of Japan submits, in addition to its argument that the Government of Indonesia did not comply with GATT Article X:1 with respect to the June 1996 Programme, that it also violated Article X:1 in connection with the February 1996 Programme.



X. ADDITIONAL ARGUMENTS REGARDING WHETHER THE JUNE 1996 PROGRAMME IS AN EXPIRED MEASURE, AND THE IMPLICATIONS IF SO

A. Arguments of Indonesia

10.1 **Indonesia** argues, in responding to all of the claims pertaining to the June 1996 programme that this programme has expired, and therefore is not relevant to the work of the Panel. Indonesia further argues that TPN will be required by law to repay all benefits received under the programme, because the counterpurchase requirements of the programme were not met. In support of this argument, Indonesia submitted a letter containing the results of an audit of TPN's compliance with these requirements. **Indonesia's** arguments in this regard are as follows:

10.2 The exemptions once granted are now being removed. The benefits conferred by the subsidy (duties and luxury taxes) having been removed, the subsidy no longer exists and all arguments relating to the June 1996 measures should be ignored by the Panel.

10.3 Also, with respect to claims under Article I of the General Agreement, complainants argued that the June 1996 measures were still in effect because the luxury tax would not be foregone on the unsold cars until they were sold. This is not correct. The tax is due when the duties are due and then the consumer reimburses the company at the time of sale (TPN, of course, was exempt from this requirement). Secondly, TPN failed the Sucofindo audit and, thus, none of the remaining cars will receive the luxury tax exemption. So, even accepting Complainants' position, the June 1996 measures have terminated. Thus, the Panel should reject Complainants' Article I arguments.

10.4 **Indonesia** further argued, in response to a question from the panel, as follows:

1. Enforcement Procedures

10.5 The results of the audit performed by Sucofindo have been provided to the Minister of Industry and Trade. He will review the report, then will notify the Minister of Finance of TPN's failure.

10.6 The Minister of Finance will then instruct the Director-General of Customs to take appropriate action. This instruction will be forwarded to the District Office of the port of entry through which the Timor's were imported, and that 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.

10.7 TPN will have 30 days to respond to this demand. Within that period it may either pay the amount due or file a protest with the Director-General of Customs. If it does not respond within 30 days, the District Office will send a second letter demanding payment within 14 days. If TPN does not respond, action will be taken to collect the amount demanded.

10.8 If TPN files a protest with the Director-General, he will render a decision whether to uphold, reject or modify the decision of the District Office within 60 days.

10.9 If the Director-General upholds the District Office, TPN must pay the amount due within 60 days or petition for review by the Tax Dispute Settlement Body. The decision of this independent review authority is binding. TPN would be required to pay the duties and luxury tax amounts determined to be due before it would be eligible to appeal to the Body. The payment is required to be in cash.

10.10 As required by Article 38 of the Customs Law, payment by TPN must, in addition to the principal due, include interest at the statutory rate of 2 per cent per month beginning with the date of the letter from the District Office demanding payment. (This is a severe penalty. As noted by the US at paragraph 91 of its First Submission and in the Ford/GM letter (US Exhibit 38), the historical Indonesian CPI increase is 8 to 10 per cent per year. (This, rather than temporary, aberrational short-term interest rates caused by a short-term currency depreciation, should be the benchmark.)

2. Effect of Non-Fulfilment of Conditions for the First Year of the Programme

10.11 Decree of the Minister of Finance No. 82/KMK.01/1996 provides:

If the obligation to fulfil the local content levels for national automotive industrial companies as determined by the Minister of Industry and Trade at a certain stage is not met, the national automotive industrial enterprise concerned shall pay the import levies owing at the relevant stage before being allowed to continue enjoying the facilities referred to in paragraph (2).

10.12 As provided in this Decree, the benefits of exemption from customs duties and luxury sales tax will be suspended once it is "determined" that TPN has not met the requirements of the National Car Programme for the first year. This will occur 30 days after the District Office demands TPN to pay the customs import duties and luxury sales tax. From that time until such time as TPN pays the duties and luxury sales tax determined to be due, it will not be entitled to release CKD's or parts from customs control unless it pays the duties and taxes normally owing in cash. Once it pays this amount, it will resume entitlement to the exemption.

B. Arguments of the United States

10.13 The **United States** presents a rebuttal to the argument that the measure has expired and therefore is not relevant to the Panel's work in the context of its claims under Article I:1 of GATT 1994. (See Section VII.E.3) In addition, with respect to the implications, if any of an eventual repayment by TPN of the benefits under the programme, the **United States** makes the following arguments:

10.14 As a factual matter it simply is not established that the tariff and tax benefits conferred on TPN under Decree No. 42/96 ever will be reimbursed. As the discussion during the question and answer period at the 13 January session made clear, it will take some time before it is established that TPN is even required to reimburse the Government of Indonesia (GOI). First, the relevant GOI authorities must issue a bill to TPN, an action which apparently has yet to be done and for which there apparently is no set deadline. According to Indonesia, this will not happen until the audit report is first reviewed by the Minister of Industry and Trade, who then refers the matter to the Minister of Finance.

10.15 The issuance of a bill then triggers a 30-day period in which TPN can file an administrative appeal with the Director General of Customs. Once this is done, the Director General then has 60 days in which to rule on the appeal. Thereafter, assuming the Director General denies TPN's appeal, TPN has 60 days within which to initiate proceedings before the Indonesian Tax Dispute Settlement Office. Indonesia did not answer the US question regarding the typical duration of this last process, although Indonesia did aver that there are no further appeals permitted from decisions of the Tax Dispute Settlement Office.

10.16 Moreover, a wholly separate question is whether, at the end of what appears to be a lengthy process, the money owed actually will be reimbursed to the GOI. Bear in mind that as of the time this Panel got underway, the amount owed in import duties alone was in excess of **US\$736 million**, and

this does not include the amounts owed in unpaid luxury taxes. It also does not include interest, which, according to the Indonesia consists of 2 per cent a month, notwithstanding that Indonesia appears to have entered into a period of hyperinflation. TPN already has taken out a \$690 million loan (although only a portion of the loan has been drawn down) that it was able to obtain only due to the direct intervention of GOI officials at the highest level. How is TPN going to repay such sums? If TPN cannot repay these amounts, will the GOI waive repayment? At the second meeting of the Panel, Indonesia confirmed that the GOI, like most governments, has the authority to waive repayment of duties and taxes owed. Moreover, putting aside any statutory or regulatory waiver authority, one must assume that because the subsidies were granted pursuant to Presidential Decree, their repayment also can be waived pursuant to Presidential Decree.

10.17 The fact of the matter is that it may take years before this issue is sorted out, and it would be unfair to the United States to defer the Panel's issuance of its report before the issue is resolved. At this point, the United States believes that the proper approach is to treat the subsidies as if they are not subject to repayment. TPN has had the benefit of the subsidies since Decree No. 42/96 became operational, it still has the subsidies, and it has priced the Timor Kia Sephia and caused serious prejudice to the interests of the United States by means of those subsidies. If TPN ultimately has to repay the subsidies, then Indonesia will be in the convenient position of having complied with what we hope will be the Panel's recommendation that Indonesia withdraw this particular subsidy. If TPN does not repay the subsidies, then that is something that can be dealt with at the implementation stage of this dispute. It would be truly perverse, however, to allow the subsidies bestowed under Decree No. 42/96 to escape scrutiny due to the conveniently timed announcement (the day before the second meeting of the Panel) of the results of an audit, an audit that apparently only triggers, rather than ends, a lengthy domestic internal process.

## XI. CLAIMS RAISED UNDER THE TRIPS AGREEMENT

### A. Claims raised by the United States

11.1 The **United States** claims that the 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. The following are the **United States'** arguments in support of these claims:

11.2 A distinguishing feature of the National Motor Vehicle programme is the requirement that, in order to receive the benefits of that programme, the "national motor vehicle" must bear a unique Indonesian trademark owned by Indonesian nationals. Presidential Instruction No. 2/1996, in referring to the "national automobile industry," sets forth as one of the criteria for that industry the "us[e] of trade marks created by relevant industrial companies". In establishing the requirements for a "national motor vehicle," Decree No. 31/1996 mandates the "use [of] trade marks created by relevant industrial companies themselves and not yet registered by other parties in Indonesia, and owned by Indonesian companies/citizens ...". This requirement discriminates against foreign-owned trademarks and their owners, and is inconsistent with Articles 3, 20 and 65 of the TRIPS Agreement.

11.3 Article 3 of the TRIPS Agreement requires national treatment in the protection of intellectual property rights, including trademarks.<sup>633</sup> In pertinent part, Article 3.1 provides the following:

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<sup>633</sup> Article 3 refers to "intellectual property," which is defined in Article 1.2 of the TRIPS Agreement as "all categories of intellectual property that are the subject of Sections 1 through 7 of Part II." Section 2 of the TRIPS Agreement is entitled "Trademarks."

1. Each Member shall accord to the nationals of other Members treatment no less favourable than it accords to its own nationals with regard to the protection of intellectual property ... (footnote omitted).

11.4 Footnote 3 to Article 3.1 provides as follows:

For the purposes of Articles 3 and 4, “protection” shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in this Agreement. (emphasis added).

11.5 In addition, Article 20, which deals specifically with trademarks, prohibits the imposition of special requirements on the use of a trademark. In pertinent part, Article 20 provides the following:

The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings...

11.6 The grant of significant benefits under the National Motor Vehicle programme to producers of a “national motor vehicle” bearing a unique, Indonesian trademark is inconsistent with both Article 3 and Article 20. First, these benefits result in a significant commercial disadvantage to companies that do business under an established or foreign-owned trademark, and the only way for such companies to “level the playing field” is to cease the use of their own mark and attempt to acquire an Indonesian trademark consistent with the requirements of the National Motor Vehicle programme. As a result, foreign nationals are provided with treatment less favorable than that provided Indonesian nationals, contrary to Article 3 of the TRIPS Agreement.

11.7 Second, the ineligibility for benefits under the National Motor Vehicle programme of firms using an established or foreign-owned trademark constitutes a special requirement on the use of a trademark in the course of trade that is prohibited by Article 20 of the TRIPS Agreement.

11.8 Moreover, these measures are inconsistent with the transitional arrangements of Article 65 of the TRIPS Agreement. Article 65.2 provides as follows:

A developing country Member is entitled to delay for a further period of four years the date of application, as defined in paragraph 1, of the provisions of this Agreement other than Articles 3, 4 and 5. (emphasis added).

11.9 Under Article 65.2, Indonesia is currently subject to the requirements of Article 3. Therefore, its violation of Article 3 is not protected by the four-year transition period of Article 65.2.

11.10 In addition, Article 65.5 of the TRIPS Agreement provides as follows:

A Member availing itself of a transitional period under paragraphs 1, 2, 3 or 4 shall ensure that any changes in its laws, regulations and practices made during that period do not result in a lesser degree of consistency with the provisions of this Agreement.

Because the restrictions of the National Motor Vehicle programme regarding trademarks came into force after 1 January 1995 (the date of entry into force of the WTO Agreement), they are inconsistent with the standstill provisions of Article 65.5. Because they are inconsistent with Article 65.5, Indonesia’s violation of Article 20 is not protected by Article 65.2.

B. Response by Indonesia to the claims raised

11.11 **Indonesia** argues that the trademark usage provision of the National Car Programme is consistent with Articles 3, 20 and 65 of the TRIPS agreement, in responding to the claims raised under that Agreement. The following are **Indonesia's** arguments in this regard:

11.12 Presidential Instruction No. 2 of 1996 sets forth requirements for achieving "pioneer" status designation. One of the requirements is that the company receiving the designation use "a brand name of its own". In other words, to receive the subsidies available under the policy, a national car company must sell that car using a "new" brand name; the brand name cannot be one previously or concurrently registered in another country and used to sell cars.

11.13 Complainant United States asserts that the brand name requirement violates Indonesia's obligations under Articles 3, 20 and 65 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). As demonstrated below, this assertion is incorrect.

1. The brand name requirement is consistent with the national treatment obligation of Article 3 of the TRIPS Agreement

11.14 Article 3 of the TRIPS Agreement establishes a national treatment obligation covering intellectual property. According to Article 3:

Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property .... (Footnote omitted.)

11.15 Indonesia has complied with this directive. The brand name requirement applies in exactly the same fashion to Indonesian and non-Indonesian companies. Neither may use a pre-existing, pre-registered brand name for a national car. Indonesian and non-Indonesian companies must meet the same requirement—they must establish a new brand name for a national car.

11.16 Thus, the fact that an Indonesian national car cannot be called a "Ford Mustang" or a "Chrysler LeBaron" or a "Chevrolet Camaro" or a "Cadillac Coupe DeVille" is irrelevant. It does not indicate that Article 3 has been violated because the brand-name requirement applies to all parties in precisely the same fashion. No matter what companies make a national car, the cars must be sold under new, Indonesian-registered brand names.

2. The brand name requirement is consistent with the obligations of Article 20 of the TRIPS Agreement

11.17 Article 20 of the TRIPS Agreement sets forth specific "other requirements" concerning trademarks. As demonstrated below, however, none of these requirements is germane to the brand-name requirement. According to Article 20, "[t]he use of a trademark ... shall not be unjustifiably encumbered by special requirements" such as "use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings". In an official, legally mandated communication to its Congress,

the United States Government declared that the purpose of Article 20 is to safeguard the role of a trademark as an indication of the source of the trademarked product.<sup>634</sup>

11.18 Thus, Article 20 is not relevant to the brand-name requirement. Requiring a new trademark in order to receive the subsidies under the national car programme does not serve to deceive or confuse people regarding the source of the trademarked product. It does not encumber an existing trademark with specified "special requirements".

11.19 Moreover, even if Article 20 were not limited to unjustified encumbrances on existing trademarks, it still would not apply to the required use of a new trademark. The United States characterizes the brand name requirement as precluding the use of US trademarks, a very substantial infringement were it true. Had the negotiators meant Article 20 to cover an infringement as substantial as that alleged by complainant United States, they would have specified so in the text of the Article. However, they did not. Article 20 deals with the encumbering of trademark usage through ties to other trademarks or requirements that reduce brand-name recognition. But, these important issues are not raised by the brand name requirement at issue here.

11.20 Moreover, as discussed below, under the provisions of Article 65.2, Indonesia currently is exempt from Article 20.

### 3. Article 65 exempts Indonesia from certain provisions of the TRIPS Agreement

11.21 Article 65 establishes the schedule for when Member countries must comply with the TRIPS Agreement. All Members are given a one-year grace period (generally calculated from 1 January 1995 (the date of entry into force of the WTO Agreement)) before they must comply with the TRIPS Agreement.<sup>635</sup> Developing country Members receive an additional four-year grace period before they must comply with the TRIPS Agreement (apart from certain, specified articles).<sup>636</sup>

11.22 Thus, under Article 65, Indonesia has until 1 January 2000 before it must comply with the vast majority of the TRIPS Agreement. Because Article 3 is one of the specified exceptions, Indonesia is not exempt from complying with the national treatment obligation. However, the Article 65.2 exemption does apply to Article 20. Therefore, in addition to the reasons demonstrated above, due to the Article 65.2 grace period, Indonesia cannot now be found to have violated Article 20 of the TRIPS Agreement.

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<sup>634</sup> In the "Statement of Administrative Action," which the United States Government was required by law to submit to its Congress as part of the US process for implementing the WTO agreements, the United States describes the purpose of Article 20 of the TRIPs Agreement as follows:

Article 20 safeguards the role of a trademark as an indication of the source of the trademarked product or service by prohibiting imposition of special requirements, such as use with another trademark, that could impair this role. Member countries may, however, require the firm or person producing the goods or services to include its trademark along with, but not limited to, the trademark distinguishing the goods or services at issue.

Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statement of Administration Action and Required Supporting Statements, House Document 103-316, Vol.I at 984, 103d Cong., 2d Sess. (27 September 1994) (emphasis added).

<sup>635</sup> See TRIPS Agreement, Article 65.1.

<sup>636</sup> See TRIPS Agreement, Article 65.2. A review of Article 65.5 demonstrates that the length of this period is not shortened by Article 65.5 as the United States asserts. Even if it were, as established above, the brand name requirement does not violate the provisions of the TRIPS Agreement and, thus, Article 65.5 is not implicated.

4. A US car company would not have been precluded from being a National Car producer

11.23 As demonstrated before, the United States TRIPS complaint reduces to the argument that a United States company cannot be a national car producer. Had a United States company made an acceptable offer to TPN, that company's mark would not have been infringed or derogated because the US company would have remained free to sell its cars in Indonesia, under the US brand, at the same time it participated with TPN. The cars would, in any case, not be identical. The US car, manufactured by a US entity, would occupy a much different (higher) slot in the Indonesian market than would the National Car built by an Indonesian company. Also, as with the Sephia versus the Timor, the cars' specifications likely would differ significantly.

C. Rebuttal arguments made by the United States

11.24 The following are the **United States'** rebuttal arguments to Indonesia's response to the claims raised on the basis of provisions of the TRIPS Agreement:

11.25 With respect to the TRIPS Agreement, Indonesia claims that there is no violation of Article 3 because the brand name requirement of the National Car Programme applies in the same manner to Indonesian and foreign companies. This is simply false, because according to the relevant implementing measures, only Indonesian companies are eligible for the National Car Programme, and only Indonesian companies may obtain a "national car" trademark. This is blatant discrimination against foreign nationals.

11.26 Moreover, in its discussion of Article 3, Indonesia conveniently omits footnote 3 to that article, which states that "protection" for purposes of Articles 3 and 4 includes "those matters affecting the use of intellectual property rights specifically addressed in this Agreement". (Emphasis added).

11.27 In the context of that footnote, Indonesia's practices in respect of national car trademarks discriminate against foreign nationals and the protection accorded their rights in several respects. First, Indonesia discriminates in respect of the acquisition of a national car trademark. Indonesia admits that any trademark that could apply to a national car must be acquired by an Indonesian company, be that company a joint venture or a wholly-owned Indonesian company. This is a clear violation of national treatment.

11.28 Second, the requirement to use a "new" Indonesian trademark on a national car discriminates against owners of existing marks in respect of the maintenance of the mark. It is unlikely that the owner of the mark normally used (global mark) on the vehicle marketed as a "national car" in Indonesia will be able to use that mark without creating confusion (*i.e.*, confusion resulting from using different marks on the same car). Consequently, it is more likely that the global mark will be subject to cancellation for non-use in Indonesia. Finally, Indonesia discriminates in respect of the protection accorded global marks, because such a mark cannot be used on a national car.

11.29 Because the definition of "protection" as applied in TRIPS Article 3 applies the national treatment obligation in respect of use of intellectual property rights to matters specifically addressed in the TRIPs Agreement, use of a trademark is specifically addressed in the Agreement in Article 20. Although Article 3 and its footnote do not require that a practice violate both the national treatment obligation and the provision specifically addressing the particular use of the right, that is the situation in this case. Indonesia's practice violates both TRIPS Article 3 and Article 20.

11.30 The United States believes that Indonesia's practices violate Article 20 of the TRIPS Agreement, because they constitute a special requirement that unjustifiably encumbers use of the trademark in trade. One cannot use an existing trademark on a national car even though it tells the

consumer more about the actual source of the car than the new mark that must be obtained to qualify as a national car. Moreover, the benefits accruing from being a national car are such that marketing other cars (which carry a pre-existing trademark) is made difficult. This tactic is unjustifiable in that it is akin to saying that the Indonesian Government wants to develop a brand name, i.e., a trademark, and will do so by eliminating other brands of cars from the market.

11.31 Further regarding Article 20, Indonesia again engages in a convenient omission by deleting, in its quotation of Article 20, the phrase "in the course of trade". That phrase, however, is very important. If use of a previously or concurrently registered trademark precludes access to the benefits of the National Car Programme, that certainly discourages the use of the mark in the course of trade, thereby encumbering its use within the meaning of Article 20. At a minimum, there is de facto discrimination against foreign nationals and their trademarks, because Indonesian holders of a trademark satisfying the national car requirements are treated better than foreign holders of international marks. Put differently, the encumbrance imposed by the trademark requirement of the National Car Programme on previously or concurrently registered trademarks constitutes a ban - the ultimate encumbrance - on the use of such trademarks on certain products.

11.32 In addition, a requirement that a trademark owner use a different trademark from that which it uses in the rest of the world to obtain a special advantage in Indonesia could put the regular mark at risk of cancellation for non-use in Indonesia. Because the trademark owner would be choosing to use the unique Indonesian mark, it would not be able to argue that its non-use arose independently of its will.

11.33 In short, Indonesia's limited interpretation of the purpose of Article 20 is not borne out by the text. Moreover, Indonesia's citation to the US Statement of Administrative Action ("SAA") does not prove anything, because the SAA merely referred to one set of practices that could be dealt with under Article 20. It was not the purpose of this document to catalogue all the possible ways in which Article 20 could be violated, nor would it have been feasible to do so. In particular, the drafters of that document could not have foreseen the particular method used by Indonesia to violate Article 20.

11.34 Indonesia asserts that the Indonesian firms seeking National Car producer status "would have jumped at the chance to have an arrangement" with a US auto manufacturer. In other words, Chrysler, for example, could have stood in the shoes of Kia Motors, and could have been the supplier of the "Timor Chrysler Neon", even if it would not have been the recipient of the subsidies under the National Car Programme.

11.35 However, consider the price that Chrysler would have had to pay to be a supplier of the "Timor Chrysler Neon." It could have supplied TPN (or some other Indonesian company) with finished Neons or Neon kits, but, under the National Car Programme, it could do so only if it agreed to have the Neons rebadged as "Timors". If it agreed to such a deal, Chrysler would have had to forego all of the benefits that go along with selling a product, and establishing a product in a market, under its own trademark. Indonesian purchasers of our hypothetical "Neon National Car" would become familiar with, and develop a loyalty to, the Timor trademark, not the Chrysler trademark.

11.36 In short, the special trademark requirement of the National Car Programme constitutes an unjustifiable encumbrance on the use of a trademark in the course of trade. A foreign company with its own trademark that seeks to participate in the National Car Programme must relinquish its trademark rights. If it choose not to relinquish its trademark rights, it must face unfair competition in the market place.

11.37 It may well be true that Kia, given all of its problems, was willing to relinquish the rights guaranteed it by the TRIPS Agreement. However, the fact that Kia was willing to forego its rights



does not mean that it is acceptable, or consistent with the TRIPS Agreement, to impose such encumbrances on the rights of nationals of other Members.

11.38 Nor would a requirement that two trademarks be used on a product be legitimate under Article 20 of the TRIPS Agreement. The TRIPS negotiators intended to stop this type of practice, and, in particular, discussed a prior practice of India that required such linkages. Specific examples of linked trademarks that were discussed were "Lahil-Pepsi" and "Modi-Xerox."

11.39 Indeed, the express language of Article 20 condemns such a practice, by stating as follows: "The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark ...". (Emphasis added). Thus, even if the Indonesian authorities could allow a national car to bear two marks, including a mark owned by a foreign company (and the language of the relevant measures would seem to preclude this), such a practice would violate Article 20.

11.40 Article 20 of the TRIPS Agreement prohibits unjustifiable encumbrances, imposed through special requirements, on the use of a trademark in the course of trade. An illustrative list of such encumbrances follows. Prohibited encumbrances clearly must encompass measures that affect such a fundamental issue as the right or ability to use the trademark. If an existing trademark cannot be used on a National Car, even if that mark accurately reflects the source of the car or its arts, use of that mark clearly has been encumbered and, in the view of the United States, without justification other than a desire to limit access to the benefits of the National Car programme.

11.41 The United States believes that the focus under Article 20 should not be on the precise "special requirement", but on the effect of the requirement; i.e., does it unjustifiably encumber use of the trademark. The fact that the text of Article 20 includes "use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings" as one example of a special requirement clearly indicates that other special requirements can act as encumbrances on use of a mark in trade. While eliminating encumbrances that unjustifiably affect the ability of a trademark to distinguish the goods or services of one undertaking from another is a key objective of Article 20, it is not the sole objective. The right to register a trademark, even in its preferred form, without the right or ability to use it in trade in that form is meaningless.

11.42 Thus, the prohibition on use of an established or foreign-owned trademark on a National Car constitutes an unjustifiable encumbrance on the use of the trademark in the course of trade. The special requirement used to implement this unjustified encumbrance is essentially that a new mark, owned by an Indonesian national, be registered and used on the car. In the view of the United States, this is the ultimate encumbrance—it is a ban on use of the trademark on certain products.

11.43 Finally, with respect to the transitional rules in Article 65, Indonesia simply ignores the plain text of Article 65.5. That provision states that a Member availing itself of a transitional period, such as Indonesia here, shall ensure that "any changes in its laws, regulations and practices made during a [transitional period] do not result in a lesser degree of consistency with the provisions of this Agreement." Because the National Car Programme post-dates the entry into force of the WTO Agreement and violates Article 20, it is inconsistent with Article 65.5, and Indonesia must return to the pre-violation *status quo ante*.

## XII. THIRD PARTY ARGUMENTS

### A. India

12.1 **India** made the following arguments as a third party to the panel proceedings:

12.2 Relating to the alleged violation of the TRIMs Agreement by Indonesia, it is a matter of record that Indonesia had notified the measures already taken by it to the TRIMs Committee in May 1995. However, in October 1996 Indonesia on reexamination of their measures felt that they could not be termed as TRIMs and consequently they withdrew their above notification.

12.3 There are two procedural issues relating to this matter which the complainants have raised in this case on which we would like to comment before coming to the substantive issue. Firstly, it has been *implied* that a Member cannot withdraw a notification, once submitted to the WTO. This is an averment that we cannot accept. We strongly feel that Members have the right to both amend or to even withdraw any of their notifications, provided there are sufficient grounds justifying such action. Consequently, we feel that Indonesia was fully within its legal rights to withdraw the notification it had made to the TRIMs committee.

12.4 The second procedural issue, the mention of which we find in the complainants first submission, relates to the alleged ineligibility of Indonesia to benefit from certain transitional provisions simply because its notification was not submitted on time. We note that Indonesia's measures, as we will elaborate a little later, are not TRIMs. However, we would like to strongly state our position that delay in notifying a measure, no matter under which provision, cannot in any way be construed as diminishing the benefits that any Member may have by virtue of it being in a special category, such as a developing country. While 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. It is for this reason that we believe that any such procedural delays should not mitigate the benefits which any member may otherwise be eligible for, under a covered agreement.

12.5 Coming to the substance of the legal issue relating to the TRIMs Agreement, the complainants have stated that the measures taken by Indonesia are violative of Article 2 of the TRIMs Agreement. As we are all aware, Article 2.1 of the TRIMs Agreement states that "no member shall apply any TRIM that is inconsistent with the provision of Article III of GATT 1994". The emphasis here is no doubt on the application by Members of a measure which can be said to be a trade-related investment measure. It is therefore evident that we need to ab initio be clear whether the said measures taken by Indonesia come within the ambit of being trade related investment measures or not.

12.6 Going back to the drafting of the TRIMs Agreement, the Agreement is basically designed to govern and to provide a level playing field for foreign investment in third countries. It is evident that any measure taken by a country relating to its internal taxes or subsidies, as Indonesia has done, cannot therefore be construed to be a trade-related investment measure. This is particularly important when we view the fine print in the TRIMs Agreement which in fact does not add any new obligations to Members, since it merely states that a measure which is a trade-related investment measure should not be violative of Article III or XI of GATT 1994. This interpretation has been upheld in the recent report of the panel on the European Communities regime for the importation, sale and distribution of bananas in which it has been stated that "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".

12.7 Indonesia has pointed out in its submission that its measures are in the nature of subsidies specifically provided to the automobile industry and therefore come within the purview of the

Subsidies Agreement and not the TRIMs Agreement. We have carefully gone through the first submissions made by the complainants as well as the Republic of Indonesia. We would like to bring on record that we agree with what Indonesia has stated that the measures taken by it are entirely in the form of subsidies and their legality or otherwise therefore needs to be examined in the light of provisions of the Agreement on Subsidies and Countervailing Measures, and not the TRIMs Agreement. India strongly feels and has stated its position in earlier fora also, that subsidies should be governed solely by the Subsidies Agreement. There has been consistency in our stand and in the interpretation in various fora, that just as investment measures cannot be presumed to be a form of subsidization, subsidies too cannot be presumed to be trade related investment measures.

12.8 With regard to the interpretation of certain provisions of the Subsidies Agreement, we would like to wholeheartedly endorse what has been stated by Indonesia in its written submission. In particular, we would like to state that we entirely agree with Indonesia that (a) Article 27.3 of the Subsidies Agreement does not preclude the introduction or expansion of domestic content subsidies; (b) the domestic content subsidy is not within the scope of Article 27.4 of the Subsidies Agreement since it is not an export subsidy and since Indonesia is a developing country; and (c) the domestic content subsidy is not within the scope of Article 28.2 because it is not inconsistent with the Subsidies Agreement.

12.9 Coming to the second issue on which we would like to state our position, viz, that relating to Article I of GATT i.e., the provision for MFN treatment. It has been argued that, under the measures taken by Indonesia, the Kia car being produced in Korea has been granted special and differential treatment, as compared to cars being produced elsewhere, and is therefore violative of the MFN principle. We have carefully perused the regulations and decrees issued by the Republic of Indonesia in 1996. In none of these decrees do we find mention of any specific country, including Korea. It is therefore evident that while the presidential decree and other notifications refer to national motor vehicles, they do not in any way mandate preferential treatment of automobiles or their components or parts from any country. Purely from a legal view point, it is therefore clear, that the above referred regulations have not violated the MFN principle since they have not conferred any special privileges to cars or their parts being manufactured in a particular country.

12.10 In this context, we do not agree with the argument put forth by some of the complainants that even if a particular regulation does not mention a country by name, but its effect is to benefit a particular producer or a country, then it is violative of the MFN principle. We find no legal strength in this argument, since it is clear that any automobile manufacturer based in any country could have, and in fact can, avail of the specific benefits and subsidization programme introduced by Indonesia, provided they fulfil the conditions specified in the said regulation. The fact that no other country has so far approached the Republic of Indonesia in this regard cannot therefore be construed as an indication that the said provision has violated the MFN principle.

12.11 Before concluding, we would like to refer some of the arguments put forth by Indonesia regarding the steps taken by Indonesia to diversify production and to deregulate international trade so that the country could continue in its commitment towards economic reform. What is significant is that these steps were taken even though Indonesia's total external debt had reached US\$108 billion in 1995 and that the deficit in Indonesia's current account had more than doubled in one year to US\$6.8 billion in the same year. Although we agree that these statistics have no direct bearing on the issues for consideration before the Panel, we would like to highlight the fact that developing countries often need to take steps to bolster their economy and to overcome problems of imbalances in regional development. We would suggest that the multilateral trading system examines the initiatives taken by these countries in the overall pursuit of economic development in their context.

12.12 We all stand to gain from the WTO system if we develop reasonable and coherent interpretations detached from short-term economic and commercial interest. This would assist panels

in their search for the right interpretations, particularly in evolving areas such as the TRIMs Agreement and the Agreement on Subsidies and Countervailing Measures.

B. Korea

12.13 **Korea** made the following arguments as a third party to the panel proceedings:

1. Preliminary jurisdictional issue

12.14 One of the basic tenets of the DSU is to allow the complaining party with trade grievances to state perspicuously the alleged offending measures which it seeks to challenge and has declared inconsistent with WTO obligations. The obvious intent of this requirement is to provide the member state with an opportunity to effectively examine and respond to charges that the law or practice is a transgression to the WTO Agreements and, if necessary, take corrective measures to remedy the situation. This was confirmed in the Appellate Body ruling on the European Communities-Regime for the Importation, Sale and Distribution of Bananas which states that "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". The Drafters of the DSU, cognizant of the importance of identifying the measures to be challenged, inserted Article 6.2 which reads:

The request for the establishment of a panel shall ... identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

12.15 The United States discusses in detail how the US\$690 million loan made to Timor Putra Nasional contravenes Article III:4 of GATT 1994 and Article 2 of TRIMs Agreement. The United States further argues that the loan constitutes a specific subsidy which causes serious prejudice.

12.16 The loan to which the United States alludes, however, is not a part of the terms of reference because it was never specifically identified as a measure at issue in the 12 June 1997 request of the United States for the establishment of a panel. The most recent Appellate Body ruling in the Bananas case sheds light on the DSU Article 6.2 requirement. The Appellate Body states:

We do not agree with the Panel that "even if there was some uncertainty whether the panel request had met the requirements of Article 6.2, the first written submissions of the Complainants 'cured' that uncertainty because their submissions were sufficiently detailed to present all the factual and legal issues clearly" ... 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.

12.17 It is also noteworthy that the loan was provided after the creation of the panel. In the United States - Measures Affecting Alcoholic and Malt Beverages case, Canada endeavoured to reserve the right to invoke new measures which may arise during the panel deliberation. The panel concluded that its "terms of reference do not permit it to examine any new measure which may come into effect during the Panel's deliberations".

12.18 As the terms of reference do not identify the loan and the defect cannot subsequently be cured by a first submission, the panel should avoid ruling on any claims made by the United States in connection with the August 1997 loan.

2. Substantive Issues

12.19 First, as was rightly pointed out in the submissions of the parties to the dispute, nothing in the legislation by Indonesia establishing either the February 1996 or the June 1996 programme explicitly mandates preferential treatment of products from any specific country. A national car producer has the freedom to choose the origin of technology and of the component and parts used in the production.

12.20 Kia Motor Corporation has become a beneficiary of such preferential treatment by having simply been chosen by PT Timor Putra Nasional as a partner for a joint venture. The term 'joint venture' is used in a general descriptive sense and not as a legal characterization of the arrangement as provided for in the relevant laws of Indonesia.

12.21 Second, in its first submission, the Government of Indonesia argues that the exemptions and reductions of import duties and luxury tax for the producers of a national car is not inconsistent with the provisions of Subsidies and Countervailing Measures Agreement ("SCM"), because, under Article 27.3 of SCM, Indonesia is not subject to the provisions of Article 3.1(b) of SCM as a developing country for a period of five years.

12.22 If such an argument is accepted by the panel, Korea is of the view that Indonesia's import duties and luxury tax subsidies should not be regulated by Article I or III of GATT 1994, because, in the event of conflict between SCM and GATT 1994, the provisions of SCM shall prevail to the extent of the conflict as provided for in General Interpretative Note to multilateral agreements on trade in goods. A reference to Articles I and III of GATT 1994 and the SCM Agreement reflects a preliminary view of the Korean Government without prejudicing the positions on this particular issue of the parties directly involved.

12.23 Finally, as was accurately stated by Indonesia, the Sportage is not and will not become eligible for the National Car Programme. Therefore, complaints pertaining to Kia Sportage are irrelevant to the present case.