

### XIII. INTERIM REVIEW<sup>637</sup>

13.1 On 6 April 1998, Indonesia requested the Panel to review, in accordance with Article 15.2 of the DSU, certain aspects of the interim report that had been transmitted to the parties on 24 March 1998. On 7 April 1998, the European Communities, Japan and the United States also requested the Panel to review the interim report. None of the parties requested the Panel to hold an additional meeting.

13.2 We have reviewed the arguments and drafting suggestions presented by the four parties, and finalized our report, taking into account those comments by the parties which we considered justified. In this context we have clarified the wording of certain paragraphs addressing some factual aspects of the various pieces of legislation under examination and revised paragraphs 2.1, 2.3, 2.28, 2.37, 2.44, 3.1, 2.44, 3.1, 3.4(a), 5.126, 6.100, 7.87 to 7.91, 7.161, 7.163, 8.13, 8.160, 8.199, 8.332, 8.393, 8.418, 8.443, 8.444, and 10.4 to 10.12 of the descriptive part and paragraphs 14.10, 14.86, 14.92, 14.107 and 14.115 of the findings accordingly. Some parties have also raised arguments with regard to the description of their claims. We have carefully reviewed the claims of the complainants, as identified in the originals of their requests for establishment of panels, and revised paragraphs 14.15, 14.18, 14.20, 14.21, 14.94, 14.124, 14.125 and 14.148 accordingly. We have also revised paragraphs 14.210 to 14.213 of the findings to more accurately characterize the arguments of the European Communities. Further, we have decided in light of comments from the European Communities to delete paragraphs 14.198 and 14.199 and to modify paragraph 14.247. In addition, we have made other minor modifications including those to paragraphs 14.9, 14.38, 14.68, 14.73, 14.76, 14.77, 14.94, 14.95, 14.133, 14.134, 14.149, 14.152, 14.176 and 15.1(a).

13.3 Finally, we would like to address the issue of the confidentiality of the interim report. When, on 24 March 1998, we transmitted our interim report to the parties, we clearly indicated that such report was confidential. Indeed all panel proceedings remain confidential until the panel report is circulated to WTO Members. According to paragraph (h) of Appendix 1 of the Council Decision on Procedures for the Circulation and Derestriction of WTO Documents<sup>638</sup> it is possible to maintain the restricted nature of any such panel report for 10 days after circulation to Members. We had also explicitly emphasized at our first meeting with the parties that the panel proceedings were confidential and that we expected all delegations to treat the present proceedings with utmost circumspection and discretion. This was accepted by the parties. We are seriously concerned to find out that parties (leaks from Japan and the United States have been brought to our attention) have not respected this obligation and have disclosed aspects of the interim report. We consider that this lack of respect of a specific requirement imposed by the Panel affects the rights of the parties and the integrity of the dispute settlement process, and should not remain unmentioned.

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<sup>637</sup>Pursuant to Article 15.3 of the DSU, the findings of the panel report shall include a discussion of the arguments made at the interim review stage. Consequently the following section entitled Interim Review is part of the Findings of this Panel Report.

<sup>638</sup> Decision adopted by the General Council on 18 May 1996, WT/L/160/Rev.1.

XIV. FINDINGS<sup>639</sup>

A. Preliminary Rulings

1. Presence of private lawyers as representatives of a party to the dispute

14.1 As further detailed in paragraphs 4.1 to 4.35 of the Descriptive Part, in connection with the first substantive meeting of the Panel with the parties, Indonesia announced that two private lawyers were members of its delegation. Following a request by the United States to exclude those lawyers from the meeting, the Panel heard the arguments of the parties on this issue. On 3 December 1997, the Chairman announced the following ruling on behalf of the Panel:

“I wish to inform the parties that having carefully reviewed the letters received in the preliminary matter before us, and having heard the arguments of the parties, the Panel does not agree with the United States’ request to exclude from meetings of the Panel certain persons nominated by the Government of Indonesia as members of its delegation. We conclude that it is for the Government of Indonesia to nominate the members of its delegation to meetings of this Panel, and we find no provision in the WTO Agreement or the DSU, including the standard rules of procedure included therein, which prevents a WTO Member from determining the composition of its delegation to WTO panel meetings. Nor does past practice in GATT and WTO dispute settlement point us to a different conclusion in this case. In particular, we note that unlike in this present case, the working procedures of the Bananas III Panel contained a specific provision requiring the presence only of government officials.

We would like to emphasize that all members of parties' delegations -- whether or not they are government employees -- are present as representatives of their governments, and as such are subject to the provisions of the DSU and of the standard working procedures, including Articles 18.1 and 18.2 of the DSU and paragraphs 2 and 3 of those procedures. In particular, parties are required to treat as confidential all submissions to the Panel and all information so designated by other Members; and, in addition, the Panel meets in closed session. Accordingly, we expect that all delegations will fully respect those obligations and will treat these proceedings with the utmost circumspection and discretion. I would ask the four Heads of Delegation to confirm that all members of their delegations are present as representatives of their governments, and as such will abide by all of the applicable provisions; and therefore that the governments are responsible for the actions of their representatives.”<sup>640</sup>

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<sup>639</sup> Throughout this report, we have based our analysis on the ordinary meaning to be given to the terms of the provisions under examination in their context and in the light of their object and purpose. In our analysis of the scope and purpose of these provisions we have also taken into account past GATT and WTO panel reports and Appellate Body reports when we considered them relevant and applicable to the present dispute. We are aware, however, that they are not binding, except with respect to resolving the particular dispute between the parties to that dispute. Appellate Body Report on Japan - Taxes on Alcoholic Beverages, WT/DS8, 10, 11, adopted on 1 November 1996, p. 14, hereafter called *Alcoholic Beverages* (1996).

<sup>640</sup> The Panel in referring to *Bananas III*, referred to the Appellate and Panel Reports on EC - Regime for the Importation, Sale and Distribution of Bananas, WT/DS27, adopted on 25 September 1997.

14.2 The parties accepted these prescriptions by the Panel and the four Heads of Delegation confirmed that all members of their delegations were present as representatives of their governments, and as such would abide by all of the applicable provisions.

2. The alleged loan to PT TPN as a measure covered by the terms of reference of this panel

14.3 At the first meeting of the Panel with the parties, on 3 December 1997, Indonesia raised a preliminary objection to the United States' claim with respect to a \$US 690 million loan to PT TPN, on the basis that this loan was not within the Panel's terms of reference. The arguments of the parties can be found in paragraphs 4.36 to 4.50 of the Descriptive Part of this report. After hearing the arguments of the parties, the Chairman announced the following ruling on behalf of the Panel:

“In its first submission, the United States alleges that the Government of Indonesia directed certain government-owned and private banks to provide PT TPN with a \$690 million loan as a component of the National Motor Vehicle Programme. The United States claims that this government-directed loan is inconsistent with Article III:4 of GATT 1994 and Article 2 of the TRIMs Agreement, and that it is a specific subsidy which causes or threatens to cause serious prejudice to the interests of the United States. Indonesia in its first submission alleges that the loan is not within the Panel's terms of reference and asks us to so rule. At its first meeting, we invited the parties to address this issue.

We note that this Panel has standard terms of reference. Therefore, in determining whether a measure is before us, we must examine the United States' request for establishment of a panel, which is found in document WT/DS59/6. Consistent with the findings of the Appellate Body in Bananas III, we have carefully examined that request to ensure its compliance with both the letter and spirit of Article 6.2 of the Dispute Settlement Understanding. We conclude that the \$690 million loan was not "identified as a specific measure" in that document as required by Article 6.2 of the DSU. Indeed the United States states that the loan was not identified in the U.S. request, because it had not yet been made. Rather, the United States suggests that the loan is properly before the Panel because it is one aspect of the National Car Programme, which the United States considers to be the subject of its request. In our view, however, the United States in its request has clearly identified the measures to be considered by the Panel, and those measures do not include this loan. Accordingly, we conclude that the loan in question is not within the terms of reference of this Panel.”

14.4 Consequently, we do not address any claims related to the said \$690 million loan in our findings.

3. Business proprietary information

14.5 At three points in its first submission, the United States indicated that it had further information relevant to its serious prejudice claims but that this information was "business proprietary" and that the United States was reluctant to provide it to the Panel in the absence of "adequate procedures" to protect such information.

14.6 At the first meeting of the Panel, Indonesia expressed concern that the United States would submit this information only in its second submission, thereby denying Indonesia an opportunity to

respond in its second submission. Accordingly, Indonesia requested the Panel to require the United States to submit its confidential data immediately. Indonesia further stated that it must be given an opportunity to review and respond fully to the data and to any additional argumentation based thereon. The arguments of the parties can be found in paragraphs 4.51 to 4.60 of the Descriptive Part of this panel report.

14.7 The Panel considered the request by Indonesia and on 3 December 1997 the Chairman announced the following ruling on behalf of the Panel:

“We encourage all parties to submit relevant data to the Panel as early as possible. However, we have concluded that it would not be appropriate for us to require the United States to submit the information in question in the context of this meeting. It is a matter for each party to decide when and if to submit information and argumentation within the schedule set forth by the Panel. In this respect, we note that there is no rule in the DSU or our working procedures that requires parties to submit all factual information in their first submissions. In fact, factual information is often provided in second submissions or in response to questions from a panel as the issues in the case come into sharper focus. We see no reason to deviate from that approach in this case.

This does not mean that we do not take seriously Indonesia's concern that it be allowed an opportunity to review and respond to any new data and to any additional argumentation based thereon. We note that, at the second meeting of the Panel, parties will be able to address any new data and related argumentation presented in each others' second submissions. If, however, any party considers at the time of that meeting that it has not had an adequate opportunity to address any such data and argumentation, the party should so inform us at that time. I can assure you that the Panel will take all reasonable steps to insure that all parties have had a full opportunity to respond to the factual information and argumentation submitted to the Panel.

Finally, we would like to remind all parties that Article 18.2 of the DSU does allow parties to designate information as confidential. Such designation will be respected by this Panel, the WTO Secretariat and the other parties to the dispute. Accordingly, we encourage all parties to submit to the Panel such information as they consider may be helpful to the resolution of this dispute. In this respect, we note that the parties agree that the complainants alleging serious prejudice must demonstrate its existence by positive evidence. If the United States considers that the information in question is necessary in order to meet that burden, and if it believes that Article 18.2 is inadequate, the United States may propose to the Panel in writing, at the earliest possible moment, a procedure that it considers sufficient to protect the information in question.”

14.8 The United States did not propose or request the Panel to adopt any such procedure.

4. Whether the National Car programme has expired and should therefore not be examined by this panel

14.9 On 25 February 1998, Indonesia sent to the Chairman of the Subsidies Committee a letter in which it indicated that on 21 January 1998 the National Car programme was terminated and that regulations and decrees thereunder had been revoked. For Indonesia, the Presidential Instruction

establishing the National Car programme was therefore “obsolete”. A copy of that letter was officially notified to the Chairman of this Panel. Upon request of the Panel, all parties have commented on this notification by Indonesia.<sup>641</sup> We note that this communication from Indonesia came after the deadline of 30 January 1998 set by the Panel for submitting information and arguments in this case. Further, the complainants challenge whether the National Car programme has effectively been terminated and have requested the Panel to rule on all claims before it. In any event, taking into account our terms of reference, and noting that any revocation of a challenged measure could be relevant to the implementation stage of the dispute settlement process, we consider that it is appropriate for us to make findings in respect of the National Car programme. In this connection, we note that in previous GATT/WTO cases, where a measure included in the terms of reference was otherwise terminated or amended after the commencement of the panel proceedings, panels have nevertheless made findings in respect of such a measure.<sup>642</sup> We shall therefore proceed to examine all of the claims of the complainants.

## B. Claims

### 1. Claims of the complainants

14.10 The various Indonesian measures at issue in this dispute are described in paragraphs 2.3 to 2.43 of the Descriptive Part of this report. For the purpose of these findings, we shall generally categorize and refer to the measures as those adopted pursuant to the 1993 car programme,<sup>643</sup> the February 1996 car programme<sup>644</sup> and the June 1996 car programme<sup>645</sup>. When we refer to the “Indonesian car programmes”, especially in the discussion on the general relationship between the provisions of the SCM Agreement and Article III of GATT, we include all the measures adopted pursuant to all three car programmes. When we refer to the National Car programme we refer to

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<sup>641</sup> See paragraphs 4.61 to 4.110 of the Descriptive Part.

<sup>642</sup> See, e.g. Panel Report on United States - Measures Affecting Imports of Wool Shirts and Blouses from India, WT/DS33, adopted on 23 May 1997, (hereafter called “Shirts and Blouses”), the US restriction was withdrawn shortly before the issuance of the panel report; Panel Report on EEC - Restrictions on Imports of Dessert Apples, Complaint by Chile, adopted on 22 June 1989, BISD 36S/93; Panel Report on EEC-Restrictions on Imports of Apples, Complaint by the United States, adopted on 22 June 1989, BISD 36S/135; Panel Report on United States - Prohibition of Imports of Tuna and Tuna Products from Canada, adopted on 22 February 1982, BISD 29S/91; Panel Report on EEC - Restrictions on Imports of Apples from Chile, adopted on 10 November 1980, BISD 27S/98; and Panel Report on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49. In the Panel Report on United States - Section 337 of the Tariff Act of 1930, BISD 36S/345, adopted on 7 November 1989 (hereafter called “Section 337”), the challenged measure was amended during the panel process but the panel refused to take into account such amendment. We note that this is also the line taken by the Appellate Body in Argentina - Measures Affecting Imports of Footwear, Textiles, Apparels and Other Items, WT/DS56, adopted on 22 April 1998, para. 64.

<sup>643</sup> Including the Decree of the Minister of Industry No. 114/M/S/6/1993, dated 9 June 1993 and its amendments; Decree of Minister of Finance No. 645/KMK.01/1993, dated 10 June 1993; Decree of Minister of Finance No. 647/KMK.04/1993, dated 10 June 1993; Decree of Minister of Finance No. 223/KMK.01/1995, dated 23 May 1995.

<sup>644</sup> Including the Presidential Instruction No. 2 and all of the implementing regulations and decrees (e.g. Government Regulation No. 20/1996, Decree of the Minister of Industry and Trade No. 31/MAP/S/2/1996, Decree of the Minister of Finance No. 82/KMK.01/1996), Decree of the State Minister for Mobilisation of Investment Funds/Chairman of the Investment Coordinating Board No.01/SK/1996, 27 February 1996, Decision of the State Minister For the Mobilization of Investment Funds/Chairman of the Capital Investment Co-Ordinating Board, Number 02/SK/1996, 5 March 1996.

<sup>645</sup> Including the Presidential Decree No.42, 4 June 1996, Government Regulation No. 36/1996, Decree of the Minister of Industry and Trade No. 142/MAP/KEP/6/1996 and Decree of the Minister of Finance No. 404/KMK.01/1996.

the measures adopted pursuant to the February and June 1996 car programmes. Our use of these general references is not intended to preclude discussion of the WTO compatibility of more specific aspects of the various car programmes. We note, however, that Japan considers that most of Government Regulation No.20/1996 and Government Regulation No. 36/1996 are not related to the National Car Programme. We also note that Government Regulation No. 36/1996 has affected the level of benefits under the 1993 car programme.

14.11 We understand from the requests for establishment of the panel that the claims of the complainants are as follows:

(i) Local-content requirements

14.12 The European Communities and the United States claim that the local content requirements of the 1993 car programme (to which are linked tax benefits for finished motor vehicles incorporating a certain percentage value of domestic products and customs duty benefits for imported parts and components used in motor vehicles incorporating a certain percentage value of domestic products) violate the provisions of Article III:4 of the General Agreement on Tariff and Trade of 1994 (hereafter, "GATT")<sup>646</sup> and Article 2 of the Agreement on Trade-Related-Investment Measures (hereafter "TRIMs Agreement").

14.13 Japan, the European Communities and the United States claim that the local content requirements of the February 1996 car programme (to which are linked tax benefits for National Cars incorporating a certain percentage value of domestic products and customs duty benefits for imported parts and components used in National Cars) violate the provisions of Article III:4 of GATT and Article 2 of the TRIMs Agreement.

(ii) Tax discrimination

14.14 The European Communities and the United States claim that the tax benefits of the 1993 car programme in favour of certain domestic cars violate the provisions of Article III:2 of GATT.

14.15 The European Communities, Japan and the United States claim that the tax benefits of the February 1996 car programme in favour of National Cars violate the provisions of Article III:2 of GATT. The European Communities and the United States claim that the tax benefits of the June 1996 car programme in favour of National Cars violate the provisions of Article III:2 of GATT.

14.16 The European Communities claim that the tax benefits on finished motor vehicles of the 1993 and the February and June 1996 car programmes, because of the local content requirements, also provide an indirect tax benefit on parts and components of the finished motor vehicles, in violation of Article III:2 of GATT.

(iii) MFN discrimination

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<sup>646</sup> Throughout this draft, "GATT" will be used when referring to GATT 1994. When references are made to GATT 1947, the Panel will be referring to the General Agreement on Tariff and Trade of 1947 which was terminated on 31 December 1995 by the Decision of 8 December 1994 adopted by the Preparatory Committee for the WTO and the CONTRACTING PARTIES TO GATT 1947, PC/12-L/7583. In discussions involving the comparison between provisions of GATT 1947 and parallel provisions in the WTO Agreement (including GATT 1994), we may use the expression GATT 1994 and GATT 1947.

14.17 Japan, the European Communities and the United States claim that the tax benefits accorded to National Cars produced in Korea, under the June 1996 car programme, violate Article I of GATT.

14.18 Japan, the European Communities and the United States claim that the customs duty benefits accorded to National Cars produced in Korea under the June 1996 car programme violate Article I:1 of GATT.

14.19 Japan and the European Communities claim that the customs duty benefits accorded on certain parts and components used for the production in Indonesia of National Cars under the February 1996 car programme violate Article I of GATT.

14.20 The European Communities claim as well that the customs duty benefits on certain parts and components used for the production of finished motor vehicles in Indonesia under the 1993 car programme, violate Article I of GATT. We note, however, that the European Communities have not further argued this claim.

(iv) Absence of notification and partial administration

14.21 Japan claims that the National Car programme violates Article X:1 of GATT, because it was not published promptly in such a manner as to enable governments and traders to become acquainted with it, and Article X:3(a) of GATT, because it has not been administered in a uniform, impartial and reasonable manner.

(v) Serious prejudice

14.22 The European Communities and the United States claim that the February and June 1996 car programmes constitute specific subsidies which cause serious prejudice to their interests within the meaning of Article 6 of the SCM Agreement.

(vi) Extension of the scope of existing subsidies

14.23 The United States claims that the introduction of the National Car programme and certain modifications to the 1993 car programme represent an extension of the scope of existing subsidy programmes in violation of Article 28 of the SCM Agreement.

(vii) National treatment violation with respect to the acquisition and maintenance of trademarks, and the use of trademarks

14.24 The United States claims that the provisions of the National Car programme discriminate against nationals of other WTO Members with respect to the acquisition and maintenance of trademarks, and the use of trademarks as specifically addressed in Article 20, in violation of Article 3 of the TRIPS Agreement.

(viii) Introduction of special requirements in respect of the use of trademarks

14.25 The United States claims that the provisions of the National Car programme which were introduced by Indonesia during its transition period under the TRIPS Agreement put special requirements on nationals of other WTO Members in respect of the use of their trademarks inconsistent with Article 20 of the TRIPS Agreement and are thus in violation of Indonesia's obligations under Article 65.5 of that Agreement.

## 2. Indonesia's general defence

14.26 The general defense of Indonesia to these claims is that the SCM Agreement is *lex specialis* to this dispute. For Indonesia this principle means that because the measures at issue are subsidies, they are governed exclusively by Article XVI of GATT and the SCM Agreement.

14.27 More specifically, we understand Indonesia's argument to be two-fold. First, in support of its defense that the only law applicable to this dispute is the SCM Agreement, Indonesia submits that:

1. There is a general conflict<sup>647</sup> between Article III of GATT and the SCM Agreement (i.e. there is a conflict between the entirety of the SCM Agreement and the entirety of Article III). Indonesia in its second submission expands this argument to include claims under Article I of GATT as well;
2. The application to this dispute of Article III of GATT would reduce the SCM Agreement to "inutility"<sup>648</sup>;
3. General rules of treaty interpretation require rethinking the scope of Article III:8(b);
4. Since Article III is not applicable, the TRIMs Agreement is not applicable.

Second, we understand that Indonesia argues that should Article III and/or the TRIMs Agreement be considered to apply to this dispute, there are specific conflicts between some of the provisions of the SCM Agreement, on the one hand, and some provisions of Article III on which the complainants base their claims, on the other hand. For Indonesia, any and all conflicts should be resolved in favour of the SCM Agreement which, according to Indonesia, permits the car programmes under examination. We shall first address Indonesia's argument that the only law applicable to this dispute is the SCM Agreement.

### C. Is the SCM Agreement the only "Applicable Law" to this Dispute?

#### 1. General considerations

14.28 In considering Indonesia's defence that there is a general conflict between the provisions of the SCM Agreement and those of Article III of GATT, and consequently that the SCM Agreement is the only applicable law, we recall first that in public international law there is a presumption against conflict.<sup>649</sup> This presumption is especially relevant in the WTO context<sup>650</sup> since all WTO

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<sup>647</sup> In these findings, when we refer to general conflict we mean a conflict that is alleged to exist between the entirety of the SCM Agreement and the entirety of Article III, Article I or the TRIMs Agreement, as discussed in Section C of this report. We consider whether there is a specific conflict between any specific provision of the SCM Agreement and Article III:2 of GATT in Section E hereafter.

<sup>648</sup> The Appellate Body Report on United States - Standards for Reformulated and Conventional Gasoline (hereafter called Gasoline) stated at page 23: "An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.", WT/DS2/AB/R, adopted on 20 May 1996.

<sup>649</sup> In international law for a conflict to exist between two treaties, three conditions have to be satisfied. First, the treaties concerned must have the same parties. Second, the treaties must cover the same substantive subject matter. Were it otherwise, there would be no possibility for conflict. Third, the provisions must conflict, in the sense that the provisions must impose mutually exclusive obligations. "... [T]echnically

agreements, including GATT 1994 which was modified by Understandings when judged necessary, were negotiated at the same time, by the same Members and in the same forum. In this context we recall the principle of effective interpretation<sup>651</sup> pursuant to which all provisions of a treaty (and in the WTO system all agreements) must be given meaning, using the ordinary meaning of words. Second, we note that Article III, which does not require the existence of any trade effect for it to be violated, occupies a particularly important place in the rules governing the multilateral trading system as it serves, inter alia, as a guarantee of the effectiveness of negotiated tariffs. The Appellate Body in its report on Japan - Taxes on Alcoholic Beverages stated:

“The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the WTO Agreement”.<sup>652</sup>

We also note that Article III and Article XVI have co-existed since the inception of the GATT system of rules. In light of the above, we will approach allegations of conflicts with caution.

## 2. Is there a general conflict between the SCM Agreement and Article III of GATT?

14.29 As noted, Indonesia in part bases its argument that the SCM Agreement is the only applicable law in this dispute on an assertion that the SCM Agreement in its entirety conflicts with Article III in its entirety. In considering Indonesia's arguments, we recall that for a conflict to exist between two agreements or two provisions thereof, they must cover the same substantive matter. Otherwise there is no conflict since the two provisions have different purposes.<sup>653</sup> We recall also that Article III, which prohibits discrimination between imported and domestic products, and Article XVI, which regulates subsidies to producers, have been part of GATT 1947 since its inception. This implies that the drafters of GATT 1947 intended these two sets of provisions to be

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speaking, there is a conflict when two (or more) treaty instruments contain obligations which cannot be complied with simultaneously. ... Not every such divergence constitute a conflict, however. ... Incompatibility of contents is an essential condition of conflict”. (7 Encyclopedia of Public International Law (North-Holland 1984), page 468). The *lex specialis derogat legi generali* principle “which [is] inseparably linked with the question of conflict”(Idem., page 469) between two treaties or between two provisions (one arguably being more specific than the other), does not apply if the two treaties “.. deal with the same subject from different point of view or [is] applicable in different circumstances, or one provision is more far-reaching than but not inconsistent with, those of the other” (Wilfred Jenks, “The Conflict of Law-Making Treaties”, The British Yearbook of International Law (BYIL) 1953, at 425 et seq.). For in such a case it is possible for a state which is a signatory of both treaties to comply with both treaties at the same time. The presumption against conflict is especially reinforced in cases where separate agreements are concluded between the same parties, since it can be presumed that they are meant to be consistent with themselves, failing any evidence to the contrary. See also E.W. Vierdag, “The Time of the "Conclusion" of a Multilateral Treaty: Article 30 of the Vienna Convention on the Law of Treaties and Related Provisions ”, BYIL, 1988, at 100; Sir Robert Jennings/Sir Arthur Watts (ed.), Oppenheim's International Law, Vol. I., Parts 2 to 4, 1992, at 1280; Sir Gerald Fitzmaurice, “The Law and procedure of the International court of Justice”, BYIL , 1957, at 237; Sir Ian Sinclair, The Vienna Convention on the Law of Treaties, 1984, at 97.

<sup>650</sup> In this context we note that the WTO Agreement contains a specific rule on conflicts which is however limited to conflicts between a specific provision of GATT 1994 and a provision of another agreement of Annex 1A. We do not consider this interpretative note in this section of the report because we are dealing with Indonesia's argument that there is a general conflict between Article III and the SCM Agreement, while the note is concerned with specific conflicts between a provision of GATT 1994 and a specific provision of another agreement of Annex 1A.

<sup>651</sup> This would correspond to the ruling of the Appellate Body when it stated that a treaty may not be interpreted so as to reduce whole clauses to “inutility”. See footnote 12 supra.

<sup>652</sup> Alcoholic Beverages(1996), Appellate Body Report, p.16.

complementary. Indeed, this is confirmed by an examination of the respective coverage of the two provisions.

14.30 Article III has always been a provision that is concerned with (and prohibits) discrimination between imported and domestic products. By contrast, the provisions of Article XVI of GATT 1947 have dealt generally with the regulation of subsidies to producers. Article XVI of GATT 1947 did not address the issue of discrimination between imported and domestic products that may occur when using such subsidies. When such discrimination arose, it was prohibited by the relevant provisions of Article III. Subsidies which discriminated in favour of domestic products fell within the prohibition of the provisions of Article III by virtue of such discrimination. In this sense we agree with the 1992 Malt Beverages<sup>654</sup> panel which discussed the relationship between the GATT rules on Article III and XVI and the related purpose of Article III:8(b):

“5.8 The Panel noted that in contrast to Article III:8(a), where it is stated that “this Article shall not apply to ... [government procurement]”, the underlined words are not repeated in Article III:8(b). The ordinary meaning of the text of Article III:8(b), especially the use of the words “shall not prevent”, therefore suggests that Article III does apply to subsidies, and that Article III:8(b) only clarifies that the product-related rules in paragraphs 1 through 7 of Article III “shall not prevent the payment of subsidies exclusively to domestic producers (emphasis added)”.

14.31 Has this situation changed with the expansion of rules regulating subsidies now contained in the SCM Agreement? Indonesia argues that the SCM Agreement now provides for an all encompassing definition and system of remedies for subsidies that would consequently exclude the relevance and application of the national treatment provisions of Article III.

14.32 While it is true that the obligations in Section A of Article XVI of GATT 1947 in respect of subsidies were limited compared to those provided in the new SCM Agreement, Article XVI of GATT 1947 did provide for a comprehensive framework regulating the provision of subsidies and so does the SCM Agreement today. Section A of Article XVI of GATT 1947 applied to “subsidies in general”; whereas Section B provided additional remedies for export subsidies. The mere fact that in the SCM Agreement the remedies against subsidies have been strengthened is not a sufficient reason to conclude that in the WTO Agreement the structural relationship between the rules on national treatment on products and the rules on subsidies to producers have been altered. Moreover, the fact that the SCM Agreement, unlike Article XVI of GATT 1947, contains a definition of subsidies does not suggest a different conclusion. The absence of a definition of “subsidy” in GATT 1947 did not make Article XVI of GATT 1947 inapplicable.

14.33 As was the case under GATT 1947, we think that Article III of GATT 1994 and the WTO rules on subsidies remain focused on different problems. Article III continues to prohibit discrimination between domestic and imported products in respect of internal taxes and other domestic regulations, including local content requirements. It does not “proscribe” nor does it “prohibit” the provision of any subsidy per se. By contrast, the SCM Agreement prohibits subsidies which are conditional on export performance and on meeting local content requirements, provides remedies with respect to certain subsidies where they cause adverse effects to the interests of another Member and exempts certain subsidies from actionability under the SCM

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<sup>653</sup> We recall our discussion in footnote 13 above on the conditions for a conflict to exist.

<sup>654</sup> Panel Report on United States - Measures Affecting Alcoholic Malt Beverages, BISD 39S/206, adopted on 19 June 1992, hereafter called Malt Beverages .

Agreement. In short, Article III prohibits discrimination between domestic and imported products while the SCM Agreement regulates the provision of subsidies to enterprises.

14.34 Contrary to what Indonesia claims, the fact that a government gives a subsidy to a firm does not imply that the subsidy itself will necessarily discriminate between imported and domestic products in contravention of Article III of GATT. Article III:8(b) of GATT makes clear that a government may use the proceeds of taxes collected equally on all imported and domestic products in order to provide a subsidy to domestic producers (to the exclusion of producers abroad).<sup>655</sup>

14.35 Finally, the fact that, as a result of the Uruguay Round, the SCM Agreement to some extent covers subject matters that were already covered by other GATT disciplines is not unique. This situation is similar to the relationship between GATT 1994 and GATS. In *Periodicals*<sup>656</sup> and in *Bananas III*<sup>657</sup>, the defending parties argued that since a set of rules on services exists now in GATS, the provisions of Article III:4 of GATT on distribution and transportation have ceased to apply. Twice the Appellate Body has ruled that the scope of Article III:4 was not reduced by the fact that rules on trade in services are found in GATS: “The entry into force of the GATS, as Annex 1B of the WTO Agreement, does not diminish the scope of application of the GATT 1994.”<sup>658</sup>

14.36 Accordingly, we consider that Article III and the SCM Agreement have, generally, different coverage and do not impose the same type of obligations.<sup>659</sup> Thus there is no general conflict between these two sets of provisions.

3. Would the application of Article III of GATT to this dispute reduce the SCM Agreement to “inutility”?

14.37 Indonesia argues that general rules of treaty interpretation preclude finding that a subsidy permissible under the SCM Agreement is proscribed by Article III because, if Article III were applicable to this dispute, the entire SCM Agreement would be reduced to “inutility”. We note initially that in most cases the subsidies regulated under the SCM Agreement will not be covered by the provisions of Article III:2 or III:4. For instance, Article III:2 would not cover direct transfers of funds, e.g., loans and grants to firms, as this Article is concerned only with the application of indirect taxes on products. Subsidies in these forms may be contrary to Article III:4 to the extent that they are linked to measures which affect the internal sale, purchase, use, etc. of domestic goods. The provision of raw materials by a government at a subsidised price would not

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<sup>655</sup> See in support of this *Malt Beverages*, op. cit.: “5.10 ... Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due.”

<sup>656</sup> Panel and Appellate Body Reports on *Canada - Certain Measures Concerning Periodicals*, WT/DS31, adopted on 30 July 1997, hereafter called *Periodicals*.

<sup>657</sup> Panel and Appellate Body Reports on *EC - Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27, adopted on 25 September 1997, hereafter called *Bananas III*.

<sup>658</sup> *Periodicals*, op.cit., Appellate Body Report, p.19.

<sup>659</sup> This conclusion is confirmed, amongst other provisions, by the footnote to Article 32.1 of the SCM Agreement which recognizes that actions against subsidies remain possible under GATT 1994. Article 32.1 of the SCM Agreement reads as follows: “No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement”. The footnote 56 to this Article reads as follows: “This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate”.

be contrary to either Article III:2 or Article III:4, unless it also contained a condition that affected as such the internal sale, offering for sale, etc. of goods.

14.38 The same distinction is applicable to tax measures. When subsidies to producers result from exemptions or reductions of indirect taxes on products, Article III:2 of GATT is relevant. In contrast, subsidies granted in respect of direct taxes are generally not covered by Article III:2, but may infringe Article III:4 to the extent that they are linked to other conditions which favour the use, purchase, etc. of domestic products.

14.39 This is to say that the only subsidies that would be affected by the provisions of Article III are those that would involve discrimination between domestic and imported products. While Article III of GATT and the SCM Agreement may appear to overlap in respect of certain measures, the two sets of provisions have different purposes and different coverage. Indeed, they also offer different remedies, different dispute settlement time limits and different implementation requirements. Thus, we reject Indonesia's argument that the application of Article III to subsidies would reduce the SCM Agreement to "inutility".

14.40 We note further that Indonesia's argument would imply that every time a measure involves tax discrimination in respect of products, that measure should be considered a subsidy governed exclusively by the SCM Agreement to the exclusion of Article III:2. It appears to us that this line of argument would reduce Article III:2 to "inutility", since the very explicit (and arguably only) purpose of Article III:2 is to deal with tax discrimination in respect of products.

#### 4. Article III:8(b) of GATT

14.41 In line with its two previous arguments, Indonesia maintains the view that "the payment of subsidies" in Article III:8(b) of GATT must refer to all subsidies identified in Article 1 of the SCM Agreement, not merely to the subset of "direct" subsidies. Under this approach, any measure which constitutes a subsidy within the meaning of the SCM Agreement would not be subject to Article III of GATT. In Indonesia's view, only this interpretation avoids rendering the SCM Agreement meaningless.

14.42 Article III:8(b) of GATT provides as follows:

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

14.43 We consider that the purpose of Article III:8(b) is to confirm that subsidies to producers do not violate Article III, so long as they do not have any component that introduces discrimination between imported and domestic products. In our view the wording "payment of subsidies exclusively to domestic producers" exists so as to ensure that only subsidies provided to producers, and not tax or other forms of discrimination on products, be considered subsidies for the purpose of Article III:8(b) of GATT. This is in line with previous GATT panels<sup>660</sup> and WTO Appellate Body<sup>661</sup> reports.

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<sup>660</sup> Panel Report on EEC - Payments and Subsidies Paid to Processors and Producers of Oil Seeds and Related Animal-feed Proteins, BISD 37S/86, adopted on 25 January 1990; Panel Report on Italian

14.44 We recall also that the type of interpretation sought by Indonesia was explicitly excluded by the drafters of Article III:8(b) when they rejected a proposal by Cuba at the Havana Conference to amend the Article so as to read:

“The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article [XVI]”.<sup>662</sup>

14.45 The arguments submitted by Indonesia that its measures are only governed by the SCM Agreement clearly do not find any support in the wording of Article III:8(b) of GATT. On the contrary, Article III:8(b) confirms that the obligations of Article III and those of Article XVI (and the SCM Agreement) are different and complementary: subsidies to producers are subject to the national treatment provisions of Article III when they discriminate between imported and domestic products.

14.46 We find, therefore, that Article III of GATT is generally applicable to the measures at issue in the present dispute.

5. Is the TRIMS Agreement applicable to this dispute?

14.47 Indonesia argues that the TRIMs Agreement is not applicable to this dispute. For Indonesia, since Article III does not apply to the measures under examination, being in conflict with the SCM Agreement, the TRIMs Agreement does not apply either. Indonesia also argues that its car programmes are subsidies and therefore cannot be trade-related investment measures.

14.48 We note that we have found above that the provisions of Article III are generally relevant and applicable to the present dispute. We therefore reject Indonesia's argument that the TRIMs Agreement is not applicable to the measures under examination because Article III does not apply to those measures. We must now proceed to examine whether the Indonesian car programmes under examination can be covered at the same time by the provisions of the TRIMs Agreement and those of the SCM Agreement.

14.49 In considering this issue of whether a measure covered by the SCM Agreement can also be subject to the obligations contained in the TRIMs Agreement, we need to examine whether there is a general conflict between the SCM Agreement and the TRIMs Agreement. We note first that the interpretive note to Annex IA of the WTO Agreement is not applicable to the relationship between the SCM Agreement and the TRIMs Agreement. The issue of whether there might be a general conflict between the SCM Agreement and the TRIMs Agreement would therefore need to be examined in the light of the general international law presumption against conflicts and the fact that under public international law a conflict exists in the narrow situation of mutually exclusive obligations for provisions that cover the same type of subject matter.

14.50 In this context the fact that the drafters included an express provision governing conflicts between GATT and the other Annex 1A Agreements, but did not include any such provision regarding the relationship between the other Annex 1A Agreements, at a minimum reinforces the presumption in public international law against conflicts. With respect to the nature of

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Discrimination Against Agriculture Machinery, BISD 7S/6, adopted on 23 October 1958; and Malt Beverages, op.cit..

<sup>661</sup> Periodicals, op.cit..

<sup>662</sup> E/CONF.2/C.3/6, page 17; E/CONF.2/C.3/A/W.32, page 2.

obligations, we consider that, with regard to local content requirements, the SCM Agreement and the TRIMs Agreement are concerned with different types of obligations and cover different subject matters. In the case of the SCM Agreement, what is prohibited is the grant of a subsidy contingent on use of domestic goods, not the requirement to use domestic goods as such. In the case of the TRIMs Agreement, what is prohibited are TRIMs in the form of local content requirements, not the grant of an advantage, such as a subsidy.

14.51 A finding of inconsistency with Article 3.1(b) of the SCM Agreement can be remedied by removal of the subsidy, even if the local content requirement remains applicable. By contrast, a finding of inconsistency with the TRIMs Agreement can be remedied by a removal of the TRIM that is a local content requirement even if the subsidy continues to be granted. Conversely, for instance, if a Member were to apply a TRIM (in the form of local content requirement), as a condition for the receipt of a subsidy, the measure would continue to be a violation of the TRIMs Agreement if the subsidy element were replaced with some other form of incentive. By contrast, if the local content requirements were dropped, the subsidy would continue to be subject to the SCM Agreement, although the nature of the relevant discipline under the SCM Agreement might be affected. Clearly, the two agreements prohibit different measures. We note also that under the TRIMs Agreement, the advantage made conditional on meeting a local content requirement may include a wide variety of incentives and advantages, other than subsidies. There is no provision contained in the SCM Agreement that obliges a Member to violate the TRIMs Agreement, or vice versa.

14.52 We consider that the SCM and TRIMs Agreements cannot be in conflict, as they cover different subject matters and do not impose mutually exclusive obligations. The TRIMs Agreement and the SCM Agreement may have overlapping coverage in that they may both apply to a single legislative act, but they have different foci, and they impose different types of obligations.

14.53 In support of this finding, we agree with the principles developed in the *Periodicals*<sup>663</sup> and *Bananas III*<sup>664</sup> cases concerning the relationship between two WTO agreements at the same level within the structure of WTO agreements. It was made clear that, while the same measure could be scrutinized both under GATT and under GATS, the specific aspects of that measure to be examined under each agreement would be different. In the present case, there are in fact two different, albeit linked, aspects of the car programmes for which the complainants have raised claims. Some claims relate to the existence of local content requirements, alleged to be in violation of the TRIMs Agreement, and the other claims relate to the existence of subsidies, alleged to cause serious prejudice within the meaning of the SCM Agreement.

14.54 To respond to an argument raised by Indonesia in the context of its discussion of the relationship between Article III of GATT and the SCM Agreement, we do not consider that the

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<sup>663</sup> In *Periodicals*, op. cit., the Appellate Body stated at page 19: "The entry into force of the GATS, as Annex 1B of the WTO Agreement, does not diminish the scope of application of the GATT 1994".

<sup>664</sup> In *Bananas III*, the Appellate Body stated in paragraph 221: "The second issue is whether the GATS and the GATT are mutually exclusive agreements. (...) Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods. certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. (...) [W]hile the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different".

application of the TRIMs Agreement to this dispute would reduce the SCM Agreement, and Article 27.3 thereof, to “inutility”. On the contrary, with Article 27.3 of the SCM Agreement, those subsidy measures of developing countries that are contingent on compliance with TRIMs (in the form of local content requirement) and that are permitted during the transition period provided under Article 5 of the TRIMs Agreement, are not prohibited by Article 3.1(b) of the SCM Agreement, for the transition period specified in Article 27.3 of the SCM Agreement.

14.55 We find that there is no general conflict between the SCM Agreement and the TRIMs Agreement. Therefore, to the extent that the Indonesian car programmes are TRIMs and subsidies, both the TRIMs Agreement and the SCM Agreement are applicable to this dispute.

## 6. Conclusion

14.56 In view of the above findings, we reject Indonesia’s general defense that the only applicable law to this dispute is the SCM Agreement. We consider rather that the obligations contained in the WTO Agreement are generally cumulative, can be complied with simultaneously and that different aspects and sometimes the same aspects of a legislative act can be subject to various provisions of the WTO Agreement.

14.57 We now turn to the claims of the complainants.

### D. Claims of Local Content Requirements

14.58 The European Communities and the United States claim that the 1993 car programme, by providing for local content requirements linked to tax benefits for finished cars incorporating a certain percentage value of domestic products, and to customs duty benefits for imported parts and components used in cars incorporating a certain percentage value of domestic products, violates the provisions of Article 2 of the TRIMs Agreement, and Article III:4 of the GATT.

14.59 Japan, the European Communities and the United States also claim that the 1996 car programme, by providing for local content requirements linked to tax benefits for National Cars (which by definition incorporate a certain percentage value of domestic products), and to customs duty benefits for imported parts and components used in National Cars, violates the provisions of Article 2 of the TRIMs Agreement and Article III:4 of the GATT.

#### 1. The relationship between the TRIMs Agreement and Article III of GATT

14.60 Since the complainants have raised claims that the local content requirements of the car programmes violate both the provisions of Article III:4 of GATT and Article 2 of the TRIMs Agreement, we must consider which claims to examine first. For Indonesia, this issue does not arise because it argues that the TRIMs Agreement does not add anything to Article III; it merely interprets Article III, elaborates the principles developed in the FIRA<sup>665</sup> panel report and applies them to trade-related investment measures. In deciding which claims to examine first, we must, initially, address the relationship between Article III of GATT and the TRIMs Agreement.

14.61 In this regard, we note first that on its face the TRIMs Agreement is a fully fledged agreement in the WTO system. The TRIMs Agreement is not an “Understanding to GATT 1994”,

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<sup>665</sup> Panel Report on Canada: Administration of the Foreign Investment Review Act, BISD 30S/140, adopted on 7 February 1984, hereafter called FIRA.

unlike the six Understandings which form part of the GATT 1994.<sup>666</sup> The TRIMs Agreement and Article III:4 prohibit local content requirements that are TRIMs and therefore can be said to cover the same subject matter. But when the TRIMs Agreement refers to “the provisions of Article III”, it refers to the substantive aspects of Article III; that is to say, conceptually, it is the ten paragraphs of Article III that are referred to in Article 2.1 of the TRIMs Agreement, and not the application of Article III in the WTO context as such. Thus if Article III is not applicable for any reason not related to the disciplines of Article III itself, the provisions of Article III remain applicable for the purpose of the TRIMs Agreement. This view is reinforced by the fact that Article 3 of the TRIMs Agreement contains a distinct and explicit reference to the general exceptions to GATT. If the purpose of the TRIMs Agreement were to refer to Article III as applied in the light of other (non Article III) GATT rules, there would be no need to refer to such general exceptions.<sup>667</sup>

14.62 Moreover, it has to be recognized that the TRIMs Agreement, in addition to interpreting and clarifying the provisions of Article III where trade-related investment measures are concerned, has introduced special transitional provisions including notification requirements.<sup>668</sup> This reinforces the conclusion that the TRIMs Agreement has an autonomous legal existence, independent from that of Article III. Consequently, since the TRIMs Agreement and Article III remain two legally distinct and independent sets of provisions of the WTO Agreement, we find that even if either of the two sets of provisions were not applicable the other one would remain applicable. And to the extent that complainants have raised separate and distinct claims under Article III:4 of GATT and the TRIMs Agreement, each claim must be addressed separately.

14.63 As to which claims, those under Article III:4 of GATT or Article 2 of the TRIMs Agreement, to examine first, we consider that we should first examine the claims under the TRIMs Agreement since the TRIMs Agreement is more specific than Article III:4 as far as the claims under consideration are concerned. A similar issue was presented in *Bananas III*, where the Appellate Body discussed the relationship between Article X of GATT and Article 1.3 of the Licensing Agreement and concluded that the Licensing Agreement being more specific it should have been applied first.<sup>669</sup> This is also in line with the approach of the panel and the Appellate

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<sup>666</sup> The General Agreement on Tariffs and Trade 1994 ("GATT") is defined as to consist of: (a) the provisions in the General Agreement on Custom duties and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (excluding the Protocol of Provisional Application), as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement; (b) the provisions of a series of the legal instruments (protocols and decisions) set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement; (c) six Understandings on the interpretation of provisions of GATT 1994; and (d) the Marrakesh Protocol to GATT 1994.

<sup>667</sup> We note that a similar drafting technique was used with the TRIPS Agreement which cross-refers to provisions of other international treaties.

<sup>668</sup> We note that Indonesia has put emphasis on a particular statement of the *Bananas III* panel concerning the relationship between Article III of GATT and the TRIMs Agreement. We consider that that statement has to be understood in the particular context of that dispute between two developed countries (no transition period was therefore applicable) where the panel had already reached a conclusion that the measure at issue violated Article III:4 of GATT. Therefore there was no need to further discuss the TRIMs Agreement since any action to remedy the inconsistency found under Article III:4 of GATT would necessarily remedy inconsistencies under the TRIMs Agreement. In the present case, we have to address the legal relationship between these two agreements.

<sup>669</sup> The Appellate Body in *Bananas III* stated in paragraph 204: “Although Article X:3(a) of the GATT 1994 and Article 1.3 of the Licensing Agreement both apply, the Panel, in our view, should have applied the Licensing Agreement first, since this agreement deals specifically, and in detail, with the administration of

Body in the Hormones<sup>670</sup> dispute, where the measure at issue was examined first under the SPS Agreement since the measure was alleged to be an SPS measure.

## 2. The application of the TRIMS Agreement

14.64 Article 2.1 of the TRIMs Agreement provides that

“ ... no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.”

By its terms, Article 2.1 requires two elements to be shown to establish a violation thereof: first, the existence of a TRIM; second, that TRIM is inconsistent with Article III or Article XI of GATT. No claims have been raised with reference to a violation of Article XI of GATT.

14.65 Article 2.1 of the TRIMs Agreement refers to Article III generally. It is our view that the complainants have limited their TRIMs inconsistency claims to the aspects of the Indonesian car programmes that would violate the provisions of the TRIMs Agreement which prohibit any advantage conditional on meeting local content requirements. In other words, while the complainants have claimed that some other aspects of the same car programmes also violate the provisions of Article III:2 of GATT, they have not claimed that the tax discrimination aspects of the measures per se violate the TRIMs Agreement. Therefore, we will examine under the TRIMs Agreement, only the consistency of the local content requirements made effective through the custom duty and tax benefits of these car programmes. Later, we shall examine the consistency of the tax discrimination aspects per se of these car programmes with the provisions of Article III:2 of GATT.

14.66 We note also that Article 2.2 of the TRIMs Agreement provides:

“2.2 An Illustrative List of TRIMs that are inconsistent with the obligations of national treatment provided for in paragraph 4 of Article III of GATT 1994 ... is contained in the Annex to this Agreement.

14.67 The United States and the European Communities claim that any measure that falls within the description of Item 1(a) of the Illustrative List of the TRIMs Agreement constitutes per se a TRIM inconsistent with Article 2 of the TRIMs Agreement. For the United States, if any Member, in whatever context, requires the purchase by an enterprise of a domestic product in order to obtain an advantage, that requirement by definition has investment consequences for such an enterprise, bringing the measure within the coverage of the TRIMs Agreement and confirming its violation thereof. The United States adds that, even if the identification of a relationship to investment were necessary to prove an inconsistency with the TRIMs Agreement, the Indonesian measures under examination fulfil such a condition, because the measures necessitate an investment in Indonesia (as a producer of motor vehicles or motor vehicle parts and components) to qualify for the various tax and customs duty incentives.

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import licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3(a) of the GATT 1994.”

<sup>670</sup> Panel and Appellate Body reports on EC - Measures Concerning Meat and Meat Products (Hormones) Complaints by the United States and Canada, WT/DS26 and DS48, adopted on 13 February 1998, hereafter called Hormones.

14.68 Japan rather argues that two elements must be shown to establish a violation of Article 2 of the TRIMs Agreement: first, there must be a TRIM; second, the measure in question must be inconsistent with Article III of GATT (or with Article XI of GATT).

14.69 The European Communities and Japan submit as well that the central aspect of the various measures included in the Indonesian car programmes is to develop domestic manufacturing capability of automobiles and automotive parts and components, and that they thereby qualify as “investment” measures. For these complainants, the Indonesian car programmes are “trade related” because they encourage the use of domestic over imported parts and thereby affect trade.

14.70 Indonesia argues that, while its subsidies may at times indirectly affect investment decisions of the recipient of the subsidy or other parties, these decisions are not the object, but rather the unintended result, of the subsidy. Indonesia adds that many subsidies will result indirectly in increased investment. Indonesia adds that these subsidies have not been adopted as investment regulations. Therefore, for Indonesia, the measures under examination are not trade-related investment measures. Indonesia also supports the argument put forward by India, a third party, that the TRIMs Agreement is basically designed to govern and provide a level playing field for foreign investment, and that therefore measures relating to internal taxes or subsidies cannot be construed to be trade-related investment measures.

14.71 We note that the arguments presented by the parties reflect different views on whether any requirement by an enterprise to purchase or use a domestic product in order to obtain an advantage, by definition falls within the Illustrative List or whether the TRIMs Agreement requires a separate analysis of the nature of a measure as a trade-related investment measure before proceeding to an examination of whether the measure is covered by the Illustrative List. However, if we were to consider that the measures in dispute in this case are in any event trade-related investment measures, it would not be necessary to decide this basic issue of interpretation. We note in this regard that the United States and the European Communities have also argued in the alternative that, even if it is necessary to show a relationship of a measure to investment, any such requirement would be satisfied in the case under consideration.

14.72 Therefore, we will first determine whether the Indonesian measures are TRIMs. To this end, we address initially the issue of whether the measures at issue are “investment measures”. Next, we consider whether they are “trade-related”. Finally, we shall examine whether any measure found to be a TRIM is inconsistent with the provisions of Article III and thus violates the TRIMs Agreement.

(a) Are the Indonesian measures “investment measures”?

14.73 We note that the use of the broad term “investment measures” indicates that the TRIMs Agreement is not limited to measures taken specifically in regard to foreign investment. Contrary to India’s argument, we find that nothing in the TRIMs Agreement suggests that the nationality of the ownership of enterprises subject to a particular measure is an element in deciding whether that measure is covered by the Agreement. We therefore find without textual support in the TRIMs Agreement the argument that since the TRIMs Agreement is basically designed to govern and provide a level playing field for foreign investment, measures relating to internal taxes or subsidies cannot be construed to be a trade-related investment measure. We recall in this context that internal tax advantages or subsidies are only one of many types of advantages which may be tied to a local content requirement which is a principal focus of the TRIMs Agreement. The TRIMs Agreement is not concerned with subsidies and internal taxes as such but rather with local content requirements, compliance with which may be encouraged through providing any type of advantage.

Nor, in any case, do we see why an internal measure would necessarily not govern the treatment of foreign investment.

14.74 We next consider whether the Indonesian measures are investment measures. In this regard, we consider the following extracts (emphases added) from the official Indonesian legislation relevant and instructive.

14.75 With regard to the 1993 car programme, we note:

- The "considerations section" of the Decree of the Ministry of Industry announcing the 1993 car programme states:

"a. that within the framework of supporting and promoting the development of the automotive industry and/or the component industry in the future, it is deemed necessary to regulate the local content levels of domestically produced motor vehicles or components in connection with the grant of incentives in the imposition of import duty rates;

b. that in order to further strengthen domestic industrial development by taking into account the trend of technological advance and the increase of the capability and mastering of industrial design and engineering, it is necessary to improve the relevant existing regulations already laid down."<sup>671</sup>

- The "considerations section" of the 1995 amendment to the 1993 car programme states:

"That in the framework of further promoting of the development of the motor vehicles industry and /or domestically produced components, it is considered necessary to amend..."<sup>672</sup>

14.76 With regard to the February 1996 car programme, we note the following:

- The title of the Presidential Instruction for the National Car programme (No.2) is "The Development of the National Automobile Industry".<sup>673</sup>

- Paragraph a) of the "Considering" section of the Government Regulation No.20 states:

"that in the effort to promote the growth of the domestic automotive industry, it is deemed necessary to enact regulations concerning the Sales Tax on Luxury Goods upon the delivery of domestically produced motor vehicles".<sup>674</sup>

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<sup>671</sup> Decree of the Ministry of Industry No 114/M/S/6/1993, 9 June 1993.

<sup>672</sup> Decree of the Minister of Industry no 108/M/S/5/1995, on the amendment of the attachment I to Decree of the Minister of Industry Number 114/M/S/6/1993, 23 May 1995.

<sup>673</sup> Instruction of the President of the Republic of Indonesia No.2 of 1996, 19 February 1996.

<sup>674</sup> Government Regulation No. 20 of 1996, 19 February 1996.

- In addition, the State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board issued a decree entitled “Investment Regulations within the Framework of the Realisation of the Establishment of the National Automobile Industry”<sup>675</sup> which emphasized that the new measures were intended to promote investment, stating in its fifth considering:

“5. that it is therefore necessary to issue a decree for the regulation of investment in the national automobile industry.”

- Article 2 of that same Investment Regulation by the Minister of State for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board provides:

“In order to realise the development of the national automobile industry as meant in Article 1:

1. ...
2. In the endeavour to realise the development of such national car industry, the investment approval will be issued to the automobile industry sector with tax facilities in accordance with legal provisions enacted specifically for such purpose.”

- The Decision relating to the investment facilities regarding the Determination of PT. Timor Putra National to Establish and Produce a National Car, entitled “Decision of the State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board” states:

“1. That in implementing a national car industry it is deemed necessary to determine investment approval for a car industry which will build and produce a national car.

2. That in the framework of investment for the car industry, PT.Timor Putra National has submitted an application and working program to build a national car industry and has obtained domestic investment approval (PMDN) NO.607/PMDN/1995, dated 9 November 1995”.<sup>676</sup>

14.77 With regard to the June 1996 car programme, we note that the “Considering” section of the Decree of the President of the Republic No. 4267<sup>677</sup> on the Extension (June) to the February 1996 car programme provides:

“a. that the development of the national car is aimed at improving the nation’s self-reliance ... and to achieve this solid preparations and continuous support are necessary;

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<sup>675</sup> Decree of the State Minister for Mobilisation of Investment Funds/Chairman of the Investment Coordinating Board No.01/SK/1996, 27 February 1996.

<sup>676</sup> Decision of the State Minister For the Mobilization of Investment Funds/Chairman of the Capital Investment Co-Ordinating Board; Number 02/SK/1996, 5 March 1996.

<sup>677</sup> Presidential Decree No.42 Concerning the Production of National Automobiles, 4 June 1996.

b. that the preparation for domestic production of national cars require the availability of huge financing and therefore will be carried out in stages;

c. that in connection with the preparations, it is considered necessary to establish a policy on the implementation stage of the production of national cars.”

- The “Considering” section of the Government Regulation No. 3667<sup>678</sup> states:

“That within the framework of promoting the development of the automotive industry in the increased use of domestically produced automotive components, it is deemed necessary to grant Sales Tax on Luxury Goods facilities to the group of luxury goods upon delivery of certain motor vehicles”

- The Elucidation to the Government Regulation No. 36 states:

“Within the framework of speeding up the realisation of production of national motor vehicles using domestically made automotive components, it is necessary to promote the domestic automotive industry in order to further its growth particularly in the face of global competition. One of the endeavours which can be exerted is the provision of a tax incentive in the form of exemption from the assessment of Sales Tax on Luxury Goods on the delivery of certain motor vehicles which have achieved certain levels of local content.”

14.78 We note also that Indonesia indicates<sup>679</sup> that the objectives of the National Car programme include the following:

- To improve the competitiveness of local companies and strengthen overall industrial development;
- To develop the capacity of multiple-source auto parts and components;
- To encourage the development of the automotive industry and the automotive component industry;
- To bring about major structural changes in the Indonesian automobile industry;
- To encourage the transfer of technology and contribute to large-scale job creation;
- To encourage car companies to increase their local content, resulting in a rapid growth of investment in the automobile industry.

14.79 Indonesia has also stated that PT TPN is a “domestic capital investment company”.<sup>680</sup>

14.80 On the basis of our reading of these measures applied by Indonesia under the 1993 and the 1996 car programmes, which have investment objectives and investment features and which refer

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<sup>678</sup> Government Regulation No. 36/1996: The Amendment of Government Regulation No.50 of 1994 Regarding the Implementation of Law No.8 of 1993 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods as amended by Law No.11 of 1994, as Lastly Amended by Government Regulation No. 20 of 1996, 4 June 1996.

<sup>679</sup> See paragraph 6.51 of the Descriptive Part.

<sup>680</sup> See paragraph 6.50 of the Descriptive Part.

to investment programmes, we find that these measures are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components in Indonesia. Inherent to this objective is that these measures necessarily have a significant impact on investment in these sectors. For this reason, we consider that these measures fall within any reasonable interpretation of the term “investment measures”. We do not intend to provide an overall definition of what constitutes an investment measure. We emphasize that our characterization of the measures as “investment measures” is based on an examination of the manner in which the measures at issue in this case relate to investment. There may be other measures which qualify as investment measures within the meaning of the TRIMs Agreement because they relate to investment in a different manner.

14.81 With respect to the arguments of Indonesia that the measures at issue are not investment measures because the Indonesian Government does not regard the programmes as investment programmes and because the measures have not been adopted by the authorities responsible for investment policy, we believe that there is nothing in the text of the TRIMs Agreement to suggest that a measure is not an investment measure simply on the grounds that a Member does not characterize the measure as such, or on the grounds that the measure is not explicitly adopted as an investment regulation. In any event, we note that some of the regulations and decisions adopted pursuant to these car programmes were adopted by investment bodies.

(b) Are the Indonesian measures “trade-related”?

14.82 We now have to determine whether these investment measures are “trade-related”. We consider that, if these measures are local content requirements, they would necessarily be “trade-related” because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade.

(c) Illustrative List of the TRIMs Agreement

14.83 An examination of whether these measures are covered by Item (1) of the Illustrative List of TRIMs annexed to the TRIMs Agreement, which refers amongst other situations to measures with local content requirements, will not only indicate whether they are trade-related but also whether they are inconsistent with Article III:4 and thus in violation of Article 2.1 of the TRIMs Agreement.

14.84 The Annex to the TRIMs Agreement reads as follows:

“ANNEX  
ILLUSTRATIVE LIST

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:

- (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production;”

14.85 We note that all the various decrees and regulations implementing the Indonesian car programmes operate in the same manner. They provide for tax advantages on finished motor vehicles using a certain percentage value of local content and additional customs duty advantages on imports of parts and components to be used in finished motor vehicles using a certain percentage value of local content. We also note that under the June 1996 car programme, the local content envisaged in the February 1996 car programme could be performed through an undertaking by the foreign producer of National Cars to counter-purchase Indonesian parts and components.

14.86 For instance, the Decision to issue the Decree of the Minister of Industry Concerning The Determination of Local Content Levels of Domestically Made Motor Vehicles or Components attached to the Decree of the Ministry of Industry announcing the 1993<sup>681</sup> car programme states in its Article 2:

“(1) The Automotive Industry and/or the Components Industry may obtain certain Incentives within the framework of importing needed Components, Sub-Components, basic materials and semi-Finished Goods, originating in one source as well as various sources (multi sourcing), if the production has reached/can achieve certain Local Content levels. (...)”

(3) The Local Content levels of domestically made Motor Vehicles and/or Components which are eligible for Incentives including their Incentive rates shall be those listed in Attachment I to this decree.” (emphasis added)

The Instruction of the President of the Republic of Indonesia No.2 of 1996 of the National Car programme (dated 19 February 1998) states in its “INSTRUCT ... SECONDLY:

“WITHIN the framework of establishment of the National Car Industry:

1. The Minister of Industry and Trade will foster, guide and grant facilities in accordance with provisions of laws in effect such that the national car industry:

- a. uses a brand name of its own;
- b. uses components produced domestically as much as possible;
- c. is able to export its products.” (emphasis added)

More specifically Regulation No. 20/1996 established the following sales tax structure where passenger cars of more than 1600cc and jeeps with local content of less than 60% would pay 35% tax; passenger cars of less than 1600cc, jeeps with local content of more than 60%, and light commercial vehicles (other than jeeps using gas) would pay 20% tax; and National Cars would pay 0% tax.<sup>682</sup> We recall that one of the requirements for designation as a “National Car” is that the local content rate must be 20% at the end of the first year, 40% at the end of the second year and 60% at the end of the third year.<sup>683</sup>

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<sup>681</sup> Decree of the Ministry of Industry No. 114/M/S/6/1993, 9 June 1993.

<sup>682</sup> See paragraphs 2.28 et seq. of the Descriptive Part. Regulation No. 36/1996 increased the tax incentive available by providing that passenger cars and light commercial vehicles with a local content in excess of 60% would pay 0% tax. See paragraphs 2.36 et seq. of the Descriptive Part.

<sup>683</sup> See paragraphs 2.24 et seq. of the Descriptive Part.

14.87 We also note with reference to the June 1996 car programme, that the Decree of the President of the Republic of Indonesia Number 42 of 1996<sup>684</sup> on the production of National Cars provides in Article 1:

“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.”

The Decree of the Minister of Industry and Trade adopted pursuant to this Presidential Decree 42 states in Articles 1, 2 and 3:

“Article 1

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.

Article 2

The procurement of Indonesian made parts and components shall be performed through a system of counter purchase of parts and components of motor vehicles by the overseas company carrying out the production and reexporting of national cars to Indonesia.

Article 3

The value of the Counter purchase referred to in Article 2 shall be fixed at the minimum of 25% (twenty-five percent) of the import value of the national cars assembled abroad (C&F value)”.

14.88 We believe that under these measures compliance with the provisions for the purchase and use of particular products of domestic origin is necessary to obtain the tax and customs duty benefits on these car programmes, as referred to in Item 1(a) of the Illustrative List of TRIMs.

14.89 We need now to decide whether these tax and customs duty benefits are “advantages” in the meaning of the chapeau of paragraph 1 of that Illustrative List. In the context of the claims under Article III:4 of GATT, Indonesia has argued that the reduced customs duties are not internal regulations and as such cannot be covered by the wording of Article III:4. We do not consider that the matter before us in connection with Indonesia’s obligations under the TRIMs Agreement is the customs duty relief as such but rather the internal regulations, i.e. the provisions on purchase and use of domestic products, compliance with which is necessary to obtain an advantage, which advantage here is the customs duty relief. The lower duty rates are clearly “advantages” in the meaning of the chapeau of the Illustrative List to the TRIMs Agreement and as such, we find that the Indonesian measures fall within the scope of the Item 1 of the Illustrative List of TRIMs.

14.90 Indonesia also argues that the local content requirements of its car programmes do not constitute classic local content requirements within the meaning of the FIRA panel (which involved a binding contract between the investor and the Government of Canada) because they leave companies free to decide from which source to purchase parts and components. We note that the Indonesian producers or assemblers of motor vehicles (or motor vehicle parts) must satisfy the local content targets of the relevant measures in order to take advantage of the customs duty and tax benefits offered by the Government. The wording of the Illustrative List of the TRIMs Agreement makes it clear that a simple advantage conditional on the use of domestic goods is

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<sup>684</sup> The Decree of the Minister of Industry and Trade Number: 142/MPP/Kep/6/1996 Regarding the Production of the National Car, 5 June 1996.

considered to be a violation of Article 2 of the TRIMs Agreement even if the local content requirement is not binding as such. We note in addition that this argument has also been rejected in the Panel Report on Parts and Components.<sup>685</sup>

14.91 We thus find that the tax and tariff benefits contingent on meeting local requirements under these car programmes constitute “advantages”. Given this and our earlier analysis of whether these local content requirements are TRIMs and covered by the Illustrative List annexed to the TRIMs Agreement, we further find that they are in violation of Article 2.1 of the TRIMs Agreement.

14.92 We note that a violation of Article 2.1 of the TRIMs Agreement may be justified under Articles 3, 4 or 5 of the TRIMs Agreement.<sup>686</sup> However, Indonesia has not invoked any of the general exceptions of GATT as referred to in Article 3 of the TRIMs Agreement, nor the provisions available to developing countries referred to in Article 4. In addition, Indonesia does not claim that the measures in dispute benefit from the transitional period under Article 5 of the TRIMs Agreement.<sup>687</sup>

### 3. Article III:4 of GATT

14.93 The complainants have claimed that the local content requirements under examination, and which we find are inconsistent with the TRIMs Agreement, also violate the provisions of Article III:4 of GATT. Under the principle of judicial economy<sup>688</sup>, a panel only has to address the claims that must be addressed to resolve a dispute or which may help a losing party in bringing its measures into conformity with the WTO Agreement. The local content requirement aspects of the measures at issue have been addressed pursuant to the claims of the complainants under the TRIMs Agreement. We consider therefore that action to remedy the inconsistencies that we have found with Indonesia’s obligations under the TRIMs Agreement would necessarily remedy any inconsistency that we might find with the provisions of Article III:4 of GATT. We recall our conclusion that non applicability of Article III would not affect as such the application of the TRIMs Agreement. We consider therefore that we do not have to address the claims under Article III:4, nor any claim of conflict between Article III:4 of GATT and the provisions of the SCM Agreement.

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<sup>685</sup> In Parts and Components, the panel recognized that requirements that an enterprise voluntarily accepts to gain government-provided advantages are nonetheless “requirements” (italics in original): “5.21 The Panel noted that Article III:4 refers to “all laws, regulations or requirements affecting (the) internal sale, offering for sale, purchase, transportation, distribution or use.” The Panel considered that the comprehensive coverage of “all laws, regulations or requirements affecting” the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, . . . but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute “requirements” within the meaning of that provision . . .” Panel Report on EEC - Regulation on Imports of Parts and Components, BISD 37S/132, adopted on 16 May 1990.

<sup>686</sup> We recall our view that Article III:8(b) of GATT does not constitute a defense to any measure providing discrimination between imported and domestic products, including local content requirements. See paragraph 14.43 supra.

<sup>687</sup> Article 5 of the TRIMs Agreement offers a transitional period to developing countries that allows them to maintain any notified TRIM, existing 180 days prior to 1 January 1995. Such TRIMs are to be phased out by 1 January 2000. Notifications under Article 5 were required to be made by 31 March 1995. We note that on 23 May 1995, Indonesia made a notification with respect to its 1993 Incentive System to the TRIMs Committee under Article 5 of the TRIMs Agreement. On 28 October 1996, Indonesia notified the TRIMs Committee that it was withdrawing its notification related to automobiles because it considered that this programme was not a TRIM.

<sup>688</sup> As defined by the Appellate Body in *Shirts and Blouses*, op. cit., pp. 17-20.

E. Claims of Tax Discrimination

14.94 The three complainants claim that the sales tax benefits under the February 1996 car programmes are in violation of Article III:2 of GATT. The United States and the European Communities also claim that the sales tax benefits of the 1993 and of the June 1996 car programmes are inconsistent with Article III:2. Finally the European Communities claim that since the 1993 and the 1996 programmes provide for a level of tax applicable on a finished product which is a function of its local content level, imported parts and components are, as a result, subject “indirectly” to a tax which is in excess of that indirectly applied on domestic like parts and components.

14.95 We note that Indonesia has not submitted much evidence or argument against the claims of the complainants that the car programmes tax, directly or indirectly, imported like or directly competitive products in violation of the national treatment obligation of Article III:2. Indonesia did state that most (but not all) parts and components were tailor-made and that imported cars were not like domestic cars. However, Indonesia did not argue that these imported products were not or could not be directly competitive or substitutable to domestically produced products.

14.96 Rather, Indonesia’s main defense to these claims under Article III:2 would appear to be that there is a conflict between Article III:2 of GATT and the SCM Agreement and that to apply Article III:2 to subsidies would reduce the SCM Agreement to “inutility”. We shall first examine this defense by Indonesia.

1. Is there a conflict between the provisions of the SCM Agreement and Article III:2 of GATT?

14.97 Indonesia argues that there is a conflict between Article III:2 and the SCM Agreement in that the obligations contained in Article III:2 of GATT and the SCM Agreement are mutually exclusive.<sup>689</sup> For Indonesia, the obligations under both agreements cannot be complied with at the same time without the need to renounce explicit rights or authorizations contained in the SCM Agreement to maintain the subsidies at issue absent serious prejudice to like products. Indonesia refers to the interpretative note to Annex 1A of GATT and the Bananas III test. All parties have entered into lengthy argumentation on the relevance, application and consequences of these provisions.

14.98 In examining this issue, we need not decide whether the test suggested by the Bananas III panel report with regard to the interpretative note to Annex 1 A is the correct one in the WTO context. Indonesia argues that there is a conflict because the SCM Agreement “explicitly authorizes” Members to provide subsidies that are prohibited by Article III:2 of GATT. Assuming that such “explicit authorization” is the correct conflict test in the WTO context, we find that, whether or not the SCM Agreement is considered generally to “authorize” Members to provide actionable subsidies so long as they do not cause adverse effects to the interests of another member, the SCM Agreement clearly does not authorize Members to impose discriminatory product taxes. Nor does a focus on Article 27.3 suggest a different approach. Whether or not Article 27.3 of the SCM Agreement can be reasonably interpreted to “authorize”, explicitly or implicitly, the provision of subsidies contingent on the use of domestic over imported goods (an issue we do not here decide), Article 27.3 is unrelated to, and cannot reasonably be considered to “authorize”, the imposition of discriminatory product taxes.

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<sup>689</sup> See paragraphs 5.145 to 5.204 of the Descriptive Part.

14.99 We also recall that the obligations of the SCM Agreement and Article III:2 are not mutually exclusive. It is possible for Indonesia to respect its obligations under the SCM Agreement without violating Article III:2 since Article III:2 is concerned with discriminatory product taxation, rather than the provision of subsidies as such. Similarly, it is possible for Indonesia to respect the obligations of Article III:2 without violating its obligations under the SCM Agreement since the SCM Agreement does not deal with taxes on products as such but rather with subsidies to enterprises. At most, the SCM Agreement and Article III:2 are each concerned with different aspects of the same piece of legislation.<sup>690</sup>

14.100 We find, therefore, that Article III:2 is applicable to the present dispute.

14.101 We shall now examine the validity of the complainants' claims under Article III:2 of GATT.

2. Article III:2 of GATT

14.102 Article III:1 and III:2 of GATT provide as follows:

“ National Treatment on Internal Taxation and Regulation

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.\*

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.\*”

The Note Ad to Article III:2 provides:

“Paragraph 2

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.”

14.103 It has been established<sup>691</sup> that Article III:2 contains two standards, depending on whether the imported and domestic goods are considered to be “like products” subject to the requirements of the first sentence of Article III:2, or whether the imported and domestic goods are rather considered as being “directly competitive or substitutable goods” subject to the requirements of the

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<sup>690</sup> We refer to our discussion on this matter in Section C above, paragraphs 14.28 ff supra.

<sup>691</sup> *Alcoholic Beverages*(1996), op. cit., Appellate Body Report, p. 17.

second sentence of Article III:2. If a complainant raises a claim under the first sentence of Article III:2, it must establish that the imported products are taxed “in excess” of any domestic like products. If a complainant raises a claim under the second sentence of Article III:2, it must establish that the imported products are “not similarly taxed” to the domestic “directly competitive or substitutable goods” and that the dissimilar taxation is “applied ... so as to afford protection to domestic production”.

(a) Article III:2, first sentence

14.104 The European Communities submit a series of categories of goods which, it argues should be considered “like products” for the purposes of applying Article III:2, first sentence, in the present case.<sup>692</sup> The European Communities argue that the tax exemptions provided by the various car programmes under examination are not based on any factor which in itself affects the properties, nature or quality of the products concerned or their end uses. Rather the exemptions are based on the country of manufacture of the products; or on their level of local content; or on whether a motor vehicle is a National Car and has complied with certain local content requirements or has incorporated a certain percentage of “counter-purchased” parts and components exported from Indonesia; or on the characteristics of the car manufacturers.

14.105 Japan claims that the tax benefits of the 1996 car programmes violate Article III:2, first sentence but limits its claim of like products to National Cars and like imported automobiles. The United States claims that National Cars and other Indonesian cars with more than 60 per cent local content are like imported motor vehicles. Both Japan and the United States argue that such imported products are taxed in excess of domestic like products.

14.106 Indonesia does not specifically argue that the complainants have not demonstrated the elements necessary to establish a violation of Article III:2 (i.e. like products and differential taxation)<sup>693</sup>, but rather argues that Article III:2 of GATT is inapplicable because it prohibits what the SCM Agreement permits. We have already rejected this argument from Indonesia.

14.107 To establish a violation of Article III:2, first sentence, complainants must prove that imported products are taxed “in excess” of domestic like products. In examining the claims of the complainants, we note that Indonesia does not dispute that pursuant to the 1993 and 1996 car programmes imported motor vehicles are taxed in excess of the domestic products at issue. For instance, more specifically, under the 1996 car programmes, National Cars are completely exempted from sales tax, and under the 1993 car programme (as modified by Regulation No. 36/1996) domestic passenger cars below 1600cc with greater than 60% local content are exempted from sales tax while imported sedans or domestic sedans with 60% or less local content are subject to a sales tax of 35%.

14.108 Turning to the “like product” issue, in applying this test, we note that the term “like product” is not defined in GATT. Past panels have recognized that the term has different meanings in different GATT provisions, depending on the context and the object and purpose of those

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<sup>692</sup> See paragraph 5.16 of the Descriptive Part.

<sup>693</sup> We recall, on the issue of burden of proof, that the complainant parties bear the burden of proof in that they must establish a prima facie case of inconsistency with a provision before the burden of showing consistency with that provision is taken on by the defendant party. But, as noted by the Appellate Body in the Hormones report: “It is also well to remember that a prima facie case is one which, in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the prima facie case”. Appellate Body Report on Hormones, op.cit., para. 104.

provisions.<sup>694</sup> In this connection, it is useful to recall the Appellate Body's discussion of Article III in *Alcoholic Beverages*(1996)<sup>695</sup>:

"The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures ynot be applied to imported or domestic products so as to afford protection to domestic production"<sup>696</sup> ... Moreover, it is irrelevant that "the trade effects" of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products<sup>697</sup>."

14.109 In *Alcoholic Beverages*(1996)<sup>698</sup> and *Periodicals*<sup>699</sup>, the Appellate Body endorsed the basic approach set out in the 1970 Report of the Working Party on Border Tax Adjustment:

"... the interpretation of the term [like product] should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a similar product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end uses in a given market; consumers' tastes and habits, which change from country to country; the products properties, nature and quality"<sup>700</sup>.

14.110 Applying these criteria to the case at hand, we note that Japan specifically claims that, for purposes of Article III:2, four models of Japanese cars that have been sold in the Indonesian market are like the National Car (i.e. the Timor, which is based on the Kia Sephia<sup>701</sup>). Those cars are the Toyota Corolla, the Mitsubishi Lancer, the Honda Civic and the Suzuki Baleno. In support thereof, it notes the similar engine sizes: 1500cc for the Timor, 1600cc for the others. We note that the evidence before us demonstrates that these cars are categorized similarly in market segmentation studies, with the Baleno in Segment B (Supermini Segment), the Corolla and Civic in Segment C1 (lower end of the Lower Medium Segment) and the Lancer in Segment C2 (upper end of the Lower

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<sup>694</sup> Panel Report on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, adopted on 10 November 1987, BISD 34S/83, para. 5.6, hereafter called *Alcoholic Beverages* (1987).

<sup>695</sup> *Alcoholic Beverages*(1996), op. cit., Appellate Body Report, p.16.

<sup>696</sup> Panel Report on Section 337, op. cit., para. 5.10.

<sup>697</sup> Panel Report on United States - Taxes on Petroleum and Certain Imported Substances, BISD 34S/136, para. 5.1.9, hereafter called *Superfund*.

<sup>698</sup> Appellate Body Report on *Alcoholic Beverages*(1996), op. cit., p.20.

<sup>699</sup> Appellate Body Report on *Periodicals*, op. cit., p.21.

<sup>700</sup> Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para 18. In *Alcoholic Beverages*(1996), the Appellate Body noted that "We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of 'likeness' is meant to be narrowly squeezed". Appellate Body Report on *Alcoholic Beverages* (1996), op.cit., p.21.

<sup>701</sup> The DRI's Global Automotive Group, a company whose clients appear to include all major auto manufacturers, including KIA, PT TPN's National Car partner, identifies models sold in the Indonesian market by the more common model names used in other markets. However, it is clear from the data provided by DRI that the "Sephias" referred to in the Asian Forecast are in fact Timors imported from Korea or assembled in Indonesia. Thus under the DRI's classification the Timor falls within Segment C1 (lower end of the Lower Medium Segment).

Medium Segment).<sup>702</sup> In particular, at least as to the imported models in Segment C1, it appears to us that these models of cars have the same end uses and the same basic properties, nature and quality. Given that these models are in the same market segments, there would not appear to be any relevant differences in respect of consumers' tastes and habits sufficient to render these products unlike. We note, however, that both the Corolla and the Civic are imported into Indonesia in CKD (completely knocked down) form. In our analysis of determining the likeness of products pursuant to complainants' claims under the SCM Agreement, we have examined whether a CKD kit can be "like" a finished car. We consider that, in the present case, the same analysis is appropriate to the determination of like products under Article III:2, first sentence. From the evidence submitted, it is not clear whether the Civics sold in Indonesia can be considered to be imports of like products from Japan, as data provided by Indonesia in the Annex V (SCM) context indicate that the Honda models sold in Indonesia received benefits under the 1993 car programme, implying that these models have more than 20% local content. However, we need not decide whether the Civic is or is not an imported like product, since we find that there is at least one model in market Segment C1, the Corolla, that does appear not to have received any such benefit, indicating that its percentage of Indonesian local content, if any, is minimal. In our view, this evidence is sufficient to establish a presumption<sup>703</sup> of likeness between the Timor and Corolla for purposes of Article III:2. Since Indonesia has submitted no evidence or argument to rebut the presumption of likeness for the purposes of Article III:2, we find that imported products like the National Car exist for purposes of Article III:2.

14.111 While the European Communities and the United States did not identify specific car models that they alleged to be like products to the National Car or other Indonesian cars for Article III:2 purposes, we note that they did so for purposes of their claims under the SCM Agreement. In connection therewith<sup>704</sup>, we found after a detailed examination that several models in Segment C1 (Ford Escort, Peugeot 306 and Opel Optima) were like the Timor. We believe that in the present case the same facts which support a finding of likeness for the purpose of the SCM Agreement also support a finding of likeness for the purpose of the first sentence of Article III:2 of GATT.

14.112 More importantly, we note that because of the structure of the tax regime under examination, any imported like products would necessarily be taxed in excess of domestic like products. In considering the broader arguments put forward by the complainants that the tax measures in dispute violate Article III:2 because they discriminate not on the basis of factors affecting the properties, nature, qualities or end use of the products, but on origin-related criteria, we recall that the Appellate Body decisions in *Alcoholic Beverages(1996)* and *Periodicals* suggest that the term "like products" as used in Article III:2 should be interpreted narrowly.<sup>705</sup> We note, however, that in this case the "like products" issue is not the same as the "like products" issue in the *Alcoholic Beverages(1996)* case. There, the internal tax imposed on domestic shochu was the same as that imposed on imported shochu; the higher tax imposed on imported vodka was also imposed on domestic vodka. Identical products (not considering brand differences) were taxed identically. The issue was whether the differences between the two products shochu and vodka, as

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<sup>702</sup> This market segmentation is based on the analysis made by the DRI's Global Automotive Group. As further developed in paragraphs 14.177 et seq. hereafter we have relied on this DRI study as an important element of our analysis for the purpose of determining the likeness of products pursuant to the claims under the SCM Agreement. We find that in this case the criteria used by DRI in arriving at its market segmentation are appropriate to the determination of like products under Article III:2, first sentence.

<sup>703</sup> *Shirts and Blouses*, op. cit., Appellate Body Report, p.14.

<sup>704</sup> See paragraphs 14.193 *infra*.

<sup>705</sup> *Alcoholic Beverages(1996)*, op. cit., Appellate Body Report, pp.19-20; *Periodicals*, op. cit., Appellate Body Report, p.22.

defined for tax purposes, were so minor that shochu and vodka should be considered to be like products and therefore subject to the requirement of Article III:2, first sentence, that one should not be taxed in excess of the other. Here, the situation is quite different. The distinction between the products, which results in different levels of taxation, is not based on the products per se, but rather on such factors as the nationality of the producer or the origin of the parts and components contained in the product. As such, an imported product identical in all respects to a domestic product, except for its origin or the origin of its parts and components or other factors not related to the product itself, would be subject to a different level of taxation.

14.113 In Periodicals, the Appellate Body recognized the possibility of using hypothetical imports to determine whether a measure violates Article III:2, although in that case the Appellate Body rejected the hypothetical example used by the Panel.<sup>706</sup> But this case is different. Under the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product. Appropriate hypotheticals are therefore easily constructed. An imported motor vehicle alike in all aspects relevant to a likeness determination would be taxed at higher rate simply because of its origin or lack of sufficient local content.<sup>707</sup> Such vehicles certainly can exist (and, as demonstrated above, do in fact exist). In our view, such an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2, without the need to demonstrate the existence of actually traded like products.<sup>708</sup> This is directly in accord with the broad purposes of Article III:2, as outlined by the Appellate Body in paragraph 14.108, *infra*.

14.114 Thus, by providing for the imposition of taxes on imported products in excess of taxes imposed on domestic like products, the tax provisions of the Indonesian car programmes violate the provisions of the first sentence of Article III:2 of GATT.

(b) Article III:2, second sentence

14.115 In light of the foregoing finding under Article III:2, first sentence, we consider that it would not be necessary to examine the same programmes under Article III:2, second sentence. We note, however, that any imported motor vehicle that would be directly competitive or substitutable to a domestic product at issue, would not be taxed similarly to a National Car or to a finished motor

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<sup>706</sup> Periodicals, *op. cit.*, Appellate Body Report, pp. 20-21.

<sup>707</sup> Thus, although there is no evidence in the record of such actual imports, it can be found that any imported motorcycles of 250 cc or less, which are like Indonesian made motorcycles of 250 cc or less, would be taxed in excess of the latter; any imported combines, minibuses, vans and pick-ups, which are like Indonesian made combines, minibuses, vans and pick ups, including those with a local content of 60 % or more, would be taxed in excess of the latter; any imported buses, which are like Indonesian made buses, would be taxed in excess of the latter; any imported sedans and station wagons of less than 1,600 cc, which are like Indonesian made sedans and station wagons of less than 1,600 cc, including those with a local content of 60 % or more, would be taxed in excess of the latter.

<sup>708</sup> This finding is in accord with a number of previous panel reports concluding that differences in producers' characteristics, which do not affect the products' characteristics, cannot justify a different tax treatment of the products involved. See, e.g., Malt Beverages, at para 5.19 ("beer produced by large breweries is not unlike beer produced by small breweries"); Gasoline, at para. 6.11 ("Article III:4 of the General Agreement deals with the treatment to be accorded to like products; its wording does not allow less favourable treatment dependent on the characteristics of the producer."); Panel Report on United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco, adopted 4 October 1994, DS44/R, para. 97 ("The Panel thus considered that the system for calculation of the BDA on imported tobacco itself, not just the manner in which it was currently applied, was inconsistent with Article III:2 because it carried with it the risk of discriminatory treatment of imports in respect of internal taxes.")

vehicle that meets a certain local content value. Indeed the large tax differential (for instance under the 1996 car programmes, National Cars are completely exempted from sales tax and under the 1993 car programme - as modified by Regulation No. 36/1996 - domestic sedans below 1600cc and with greater than 60% local content are exempted from sales tax while imported sedans or domestic sedans with 60% or less local content are subject to a sales tax of 35%) is clear evidence that the relevant products are not similarly taxed. Finally, the nature of the discrimination, which is to promote a national industry by giving it advantages vis-à-vis imported products, is clearly designed so as to afford protection to domestic production, contrary to the second sentence of Article III:2 of GATT.

14.116 We find therefore that the various measures adopted pursuant to the Indonesian car programmes under examination, are inconsistent with Article III:2 first and second sentences, in that the structure of the tax scheme is such that imported products are taxed in excess of domestic like products and imported products which are directly competitive or substitutable to domestic products are also necessarily not similarly taxed so as to afford protection to the domestic production of such products.

14.117 In the light of the foregoing finding, we consider it unnecessary to address the European Communities' claim that imported parts and components are subject "indirectly" to a tax which is in excess of that indirectly applied on domestic like parts and components since the sales tax applicable on a finished product varies according to its local content level.

### 3. Article III:8(b) of GATT

14.118 Although it does not do so explicitly, Indonesia could be viewed as claiming that should Article III:2 be applicable, those of its measures which are subsidies should be exempted from Article III through the application of Article III:8(b).<sup>709</sup>

14.119 In our view, with regard to subsidies to producers, Article III:8(b) should be interpreted to mean that:

- 1) if the subsidy benefit to producers derives from indirect taxes, there must be a prior collection on a non-discriminatory basis of such taxes;
- 2) the subsidies must have been provided directly to the producers, that is to say that Article III:8(b) does not cover a financial advantage that benefits producers indirectly (for example subsidies paid to consumers of products, produced by domestic producers).

14.120 In this sense, we agree with the statement of the Appellate Body in the recent Periodicals case where it approved the reasoning of the Malt Beverages case on Article III:8(b).

"We [the Appellate Body] agree with the panel in United States - Malt Beverages that:

5.10 Article III:8(b) limits, therefore, the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules

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<sup>709</sup> We have already discussed the scope and purpose of Article III:8(b) in Section C of this report. We consider that one of the purposes of Article III:8(b) is to confirm the respective scopes of Article III and Article XVI (and now the SCM Agreement).

makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.”<sup>710</sup> (emphasis added)

We also agree with the following passage of Malt Beverages:

“5.9 ... Any fiscal burden imposed by discriminatory internal taxes on imported goods is likely to entail a trade-distorting advantage for import-competing domestic producers, the prohibition of discriminatory internal taxes in Article III:2 would be ineffective if discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8(b).”

14.121 We find therefore that subsidies that result from product-tax discrimination are subject to the prohibitions of Article III:2 of GATT. This is to say that the Indonesian measures involving tax exemptions and reductions, here on finished motor vehicles including National Cars, are fully subject to the prohibition against product-tax discrimination of Article III:2.

14.122 Thus, Article III:8(b) of GATT does not provide Indonesia with a defense to the claims that its car programmes violate the provisions of Article III:2 of GATT.

#### F. Claims of MFN Discrimination

14.123 The three complainants claim that the sales tax exemptions of the June 1996 car programme violate Article I:1 of GATT because they confer advantages of the type covered by Article I:1 which are conditional (25% counter-purchase requirement) and available de facto only to imports of motor vehicles from Korea but not to imports of like products from other WTO Members.

14.124 Japan, the European Communities and the United States also claim that the customs duties exemptions of the June 1996 car programme violate Article I:1 of GATT because they confer advantages of the type covered by Article I:1 which are conditional (25% counter-purchase requirement) and available de facto only to imports of motor vehicles from Korea but not to imports of like products from other WTO Members.

14.125 Japan and the European Communities claim that the customs duty exemptions on parts and components of the February 1996 car programme violate Article I:1 of GATT because they confer advantages of the type covered by Article I:1 which are conditional (only if used in National Cars) and available de facto only to imports of parts and components from Korea since the only National Car assembled in Indonesia is a replica of the Kia Sephia from Korea, and this, to the detriment of imports of “like” parts and components from other Members.

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<sup>710</sup> Periodicals, op. cit., Appellate Body Report, p. 34.

14.126 The European Communities also argue that the sales tax exemption provided to National Cars assembled in Indonesia under the February 1996 car programme violates Article I:1 of GATT because it provides an “indirect advantage” to parts and components assembled in National Cars; therefore this indirect advantage (covered by Article I of GATT) benefits mainly, if not exclusively, imports of parts and components originating in Korea since the only National Car assembled in Indonesia is a replica of the Kia model Sephia from Korea, and this is to the detriment of imports of “like” parts and components from other Members.<sup>711</sup>

14.127 Indonesia argues that its measures are subsidies governed exclusively by the SCM Agreement and therefore are not subject to Article I of GATT for the same reasons as it argued that Article III of GATT is not applicable to this dispute.

14.128 Indonesia also notes that in all past cases where panels found de facto discrimination violations, 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. For Indonesia, 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.

14.129 Indonesia also adds that the June 1996 car programme has expired and will not be renewed. For Indonesia all claims related to this June 1996 car programme are therefore moot. The complainants respond that the government of Indonesia does not forego its sales tax until a car is sold and that since there are still some 20,000 cars not yet sold and/or imported, the Panel should examine the measure. In response to additional questions from the Panel after the second meeting, Indonesia argued that PT TPN, the only company entitled to benefits under the June 1996 car programme, failed the “SUCOFINDO audit”<sup>712</sup> and, thus, none of the remaining cars will receive the customs duty or tax exemption.

14.130 Indonesia also argues that the National Car and components and parts imported for it, are not “like” any passenger vehicles, components or parts imported from the territories of complainants as the parts and component are tailor-made for the Indonesian National Cars.

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<sup>711</sup> However the European Communities does not appear to have made such a claim (for what they label measure (d)) in their request for a panel. We note also that in their request for establishment of a panel the European Communities claimed that the import duty relief (what they label measure (a)) of the 1993 car programme violate the provisions of Article I:1 of GATT. However the European Communities did not further argue such latter claims in their submissions and oral presentations to the Panel.

<sup>712</sup> See paragraphs 10.1 to 10.12 of the Descriptive Part.

1. General defences of Indonesia

(a) Is the SCM Agreement the only agreement applicable to this dispute at the exclusion of Article I of GATT?

14.131 We have already discussed in Section C above why we consider that the SCM Agreement is not generally the only relevant and applicable agreement to the measures under examination. We found that the obligations contained in the WTO Agreement are generally cumulative and can be complied with simultaneously. We shall, therefore, now proceed to the examination of the claims of the complainants that aspects of the Indonesian car programmes violate the MFN obligations of Article I of GATT.

14.132 Before we do this, we must address the argument put forward by Indonesia that the Panel cannot or should not address the claims regarding the June 1996 car programme because that programme has expired and because in any case PT TPN has lost all its rights to any future benefits under that car programme.

(b) Are the Claims Related to the June 1996 Car Programme Moot?

14.133 In its various submissions Indonesia claims that the special one year permission granted to PT Timor under the June 1996 car programme was terminated and that any claims related thereto should be ignored by the Panel.

14.134 In paragraph 14.9 above, we found that generally panels have examined measures which were amended or terminated during the panel process and, notwithstanding Indonesia's allegation that the National Car programme was terminated, we decided to issue our report. In this context we note that when the present panel proceedings commenced Presidential Decree 42/96, Decree 142/1996 of the Ministry of Industry and Governmental Regulation 36/1996 had not been repealed.

14.135 We also note that in the recent Wool Shirts case, the panel faced a similar situation in that the United States withdrew its import restriction a few days after the interim review meeting. The panel concluded:

“in the absence of an agreement between the parties to terminate the proceedings, we think that it is appropriate to issue our final report regarding the matter set out in the terms of reference of this Panel in order to comply with our mandate [...] notwithstanding the withdrawal of the US restraint”.<sup>713</sup>

14.136 Under the circumstances, taking into account the terms of reference of this Panel, we consider that it is appropriate for us to address the measures under the June 1996 car programme. We shall proceed therefore to examine the claims of the complainants and the defense of Indonesia.

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<sup>713</sup> Panel Report on Shirts and Blouses, op. cit., para 6.2, affirmed by the Appellate Body.

2. Criteria for an Article I of GATT violation

14.137 Article I of GATT requires that any privileges granted to imports of any country be accorded immediately and unconditionally to the like products originating in or destined for the territories of all other Members.

“1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on 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 paragraphs 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 contracting parties.”

14.138 The Appellate Body, in *Bananas III*, confirmed that to establish a violation of Article I, there must be an advantage, of the type covered by Article I and which is not accorded unconditionally to all “like products” of all WTO Members. Following this analysis, we shall first examine whether the tax and customs duty benefits are advantages of the types covered by Article I. Second, we shall decide whether the advantages are offered (i) to all like products and (ii) unconditionally.

(a) Are the tax and customs duty benefits of the February and June 1996 car programmes advantages of the types covered by Article I?

14.139 The customs duty benefits of the various Indonesian car programmes are explicitly covered by the wording of Article I. As to the tax benefits of these programmes, we note that Article I:1 refers explicitly to “all matters referred to in paragraphs 2 and 4 of Article III”. We have already decided that the tax discrimination aspects of the National Car programme were matters covered by Article III:2 of GATT. Therefore, the customs duty and tax advantages of the February and June 1996 car programmes are of the type covered by Article I of GATT.

(b) Are these advantages offered “unconditionally” to all “like products”?

(i) “like products”

14.140 The European Communities, following the same logic it used for the like product definition in its Article III claims, submit that National Cars and their parts and components imported from Korea are to be considered “like” any motor vehicle and parts and components imported from other Members. The European Communities argue that imported parts and components and motor vehicles are all like the relevant domestic products since the definition of “National Cars” and their parts and components is not based on any factor which may affect per se the physical characteristics of those cars and parts and components, or their end uses. The United States argues that cars imported in Indonesia are like the Kia Sephia from Korea. Japan argues that parts and components and cars imported from Japan, or any other country, and those imported from Korea constitute “like products”.

14.141 We have found in our discussion of like products under Article III:2 that certain imported motor vehicles are like the National Car<sup>714</sup>. The same considerations justify a finding that such imported vehicles can be considered like National Cars imported from Korea for the purpose of Article I. We also consider that parts and components imported from the complainants are like imports from Korea. Indonesia concedes that some parts and components are exactly the same for all cars. As to the parts and components which arguably are specific to the National Car, Indonesia does not contest that they can be produced by the complainants’ companies. This fact confirms that the parts and components imported for use in the National Car are not unique. As before, we note in addition that the criteria for benefitting from reduced customs duties and taxes are not based on any factor which may affect per se the physical characteristics of those cars and parts and components, or their end uses. In this regard, we note that past panels interpreting Article I have found that a legislation itself may violate that provision if it could lead in principle to less favourable treatment of the same products.<sup>715</sup>

14.142 We find, therefore, that for the purpose of the MFN obligation of Article I of GATT, National Cars and the parts and components thereof imported into Indonesia from Korea are to be considered “like” other similar motor vehicles and parts and components imported from other Members.

(ii) “unconditional advantages”

14.143 We now examine whether the advantages accorded to National Cars and parts and components thereof from Korea are unconditionally accorded to the products of other Members, as required by Article I. The GATT case law is clear to the effect that any such advantage (here tax and customs duty benefits) cannot be made conditional on any criteria that is not related to the imported product itself.

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<sup>714</sup> We refer to our discussions in paragraphs 14.110 and 14.111 where we found that given that the Timor, Escort, 306, Optima and Corolla models are in the same market segments, there would not appear to be any relevant differences in respect of consumers’ tastes and habits sufficient to render these products unlike. In our view, this evidence is also sufficient to establish a presumption of likeness between the Timor, Corolla, Escort, 306 and Optima for purposes of Article I of GATT. Since Indonesia has submitted no evidence or argument to rebut the presumption of likeness for purposes of Article I of GATT, we find that at least these imported motor vehicles are like the National Car for purposes of Article I of GATT.

<sup>715</sup> See for instance the Panel Report on United States - Denial of Most-favoured-nation Treatment as to Non-rubber Footwear from Brazil, adopted on 19 June 1992, BISD 39S/128, para. 6.12.

14.144 For instance, in the Panel Report on Belgian Family Allowances<sup>716</sup>, the panel condemned a measure which discriminated against imports depending on the type of family allowances that was in place:

“3. According to the provisions of paragraph 1 of Article I of the General Agreement, any advantage, favour, privilege or immunity granted by Belgium to any product originating in the territory of any country with respect to all matters referred to in paragraph 2 of Article III shall be granted immediately and unconditionally to the like product originating in the territories of all contracting parties. Belgium has granted exemption from the levy under consideration to products purchased by public bodies when they originate in Luxembourg and the Netherlands, as well as in France, Italy, Sweden and the United Kingdom. If the General Agreement were definitively in force in accordance with Article XXVI, it is clear that that exemption would have to be granted unconditionally to all other contracting parties (including Denmark and Norway). The consistency or otherwise of the system of family allowances in force in the territory of a given contracting party with the requirements of the Belgian law would be irrelevant in this respect, and the Belgian legislation would have to be amended insofar as it introduced a discrimination between countries having a given system of family allowances and those which had a different system or no system at all, and made the granting of the exemption dependent on certain conditions.” (emphasis added)

14.145 Indeed, it appears that the design and structure of the June 1996 car programme is such as to allow situations where another Member's like product to a National Car imported by PT PTN from Korea will be subject to much higher duties and sales taxes than those imposed on such National Cars. For example, customs duties as high as 200% can be imposed on finished motor vehicles while an imported National Car benefits from a 0% customs duty. No taxes are imposed on a National Car while an imported like motor vehicle from another Member would be subject to a 35% sales tax. The distinction as to whether one product is subject to 0 % duty and the other one is subject to 200% duty or whether one product is subject to 0% sales tax and the other one is subject to a 35% sales tax, depends on whether or not PT TPN had made a “deal” with that exporting company to produce that National Car, and is covered by the authorization of June 1996 with specifications that correspond to those of the Kia car produced only in Korea. In the GATT/WTO, the right of Members cannot be made dependent upon, conditional on or even affected by, any private contractual obligations in place.<sup>717</sup> The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty benefits accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members “immediately and unconditionally”.<sup>718</sup>

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<sup>716</sup> BISD 1S/59, adopted on 7 November 1952.

<sup>717</sup> For instance in the FIRA case, the Panel rejected Canada's argument that the situation under examination was the consequence of a private contract with an investor: “5.6 The Panel carefully examined the Canadian view that the purchase undertakings should be considered as private contractual obligations of particular foreign investors vis-à-vis the Canadian government. The Panel recognized that investors might have an economic advantage in assuming purchase undertakings, taking into account the other conditions under which the investment was permitted. The Panel felt, however, that even if this were so, private contractual obligations entered into by investors should not adversely affect the rights which contracting parties, including contracting parties not involved in the dispute, possess under Article III:4 of the General Agreement and which they can exercise on behalf of their exporters.” See FIRA, op. cit, para. 5.6.

<sup>718</sup> See Working Party Report on the Accession of Hungary, BISD 20S/34 adopted on 30 July 1973.

14.146 We note also that under the February 1996 car programme the granting of customs duty benefits to parts and components is conditional to their being used in the assembly in Indonesia of a National Car. The granting of tax benefits is conditional and limited to the only Pioneer company producing National Cars. And there is also a third condition for these benefits: the meeting of certain local content targets. Indeed under all these car programmes, customs duty and tax benefits are conditional on achieving a certain local content value for the finished car. The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty advantages accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members “immediately and unconditionally”.

14.147 For the reasons discussed above, we consider that the June 1996 car programme which introduced discrimination between imports in the allocation of tax and customs duty benefits based on various conditions and other criteria not related to the imports themselves and the February 1996 car programme which also introduce discrimination between imports in the allocation of customs duty benefits based on various conditions and other criteria not related to the imports themselves, are inconsistent with the provisions of Article I of GATT.

14.148 Since the European Communities did not properly claim that the tax benefits of the February 1996 car programme violated Article I<sup>719</sup>, we cannot address the related alleged claim that under the same 1996 February car programme imported parts and components from Korea are subject to an indirect tax advantage (covered by Article I).

#### G. Claims of Inadequate Publication and Partial Administration

14.149 Only Japan has raised claims under Article X of GATT. Japan claims that the National Car programme violates Article X:1 because Indonesia has failed to publish trade regulations “promptly” and “in such a manner as to enable governments and traders to become acquainted with them”. Japan further alleges that Indonesia has not set out the requirements for the National Car programme and has also failed to explain the requirements of its National Car programme during the consultations.

14.150 Japan also claims that the June 1996 National Car program was administered in violation of Article X:3(a) which requires uniform, impartial and reasonable administration of regulations, including those pertaining to rates of duty, taxes or other charges. Japan argues that in June 1996 Indonesia authorized PT Timor to import automobiles duty free, although the counter-purchase requirement mentioned in the Decree, was not met. For Japan, these facts constitute violations of Article X:3(a) since Indonesia administered its regulations in a partial and unreasonable manner.

14.151 Indonesia simply responds that Article X does not establish substantive obligations, but rather procedural and administrative obligations. In any case, Indonesia submits that it has published its regulations and decrees in the statute books and State Gazettes promptly after their adoption, and this is in conformity with Article X.

14.152 We have already found that the measures adopted pursuant to the National Car programme violate the provisions of Articles I and/or III of GATT. Therefore, we consider that it is not necessary to examine Japan’s claims under Article X of GATT.

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<sup>719</sup> As mentioned before in their request for establishment of panel the European Communities did not claim that the tax benefits under the February 1996 (what the European Communities had labelled the measure (d)) violated Article I. See paragraph (iii) of the EC’s request for establishment of panel.

H. Claims of Serious Prejudice under Part III of the SCM Agreement

14.153 We next turn to the complainants' serious prejudice claims. The European Communities and the United States contend that the tariff and luxury sales tax exemptions provided by Indonesia through the National Car programme<sup>720</sup> are specific subsidies which have caused serious prejudice to their interests within the meaning of Article 5(c) of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement").<sup>721</sup> Specifically, the complainants allege that the effect of alleged subsidies for the national car is (a) to displace or impede imports of like products of the European Communities and the United States into the Indonesian market and (b) a significant price undercutting by the subsidized national car as compared with like EC and US products in the Indonesian market. The European Communities further contend, in the alternative, that the alleged subsidies provided by Indonesia through the National Car programme threaten to cause serious prejudice to EC interests.<sup>722</sup> Indonesia argues that the tariff and tax benefits provided through the National Car programme do not cause or threaten to cause serious prejudice to the interests of the European Communities or the United States.

14.154 In addressing the EC and US claims, we will first consider whether the measures in question are specific subsidies within the meaning of the SCM Agreement. Next we will consider whether Indonesia, as a developing country Member, may be subject to claims that subsidies provided by it have caused serious prejudice to the interests of other Members. Finally, we must examine whether the European Communities and the United States have demonstrated by positive evidence that the measures in question have caused serious prejudice or, in the case of the European Communities, have threatened to cause serious prejudice, to their interests within the meaning of Part III of the SCM Agreement, either through displacement and impedance, price undercutting, or both. A threshold question with respect to this final phase of the analysis is to determine which EC and US products, if any, are like products to the National Car (the Timor) within the meaning of the SCM Agreement.

1. Are the measures specific subsidies?

14.155 As with any analysis under the SCM Agreement, the first issue to be resolved is whether the measures in question are subsidies within the meaning of Article 1 that are specific to an enterprise or industry or group of enterprises or industries within the meaning of Article 2. It is to be recalled that the measures in question are: import duty and luxury sales tax exemptions on CBU Timors imported by PT TPN from Korea, import duty exemptions on parts and components used or to be used in the assembly of the Timor in Indonesia, and luxury sales tax exemptions on Timors assembled in Indonesia. In this case, the European Communities, the United States and Indonesia agree that these measures are specific subsidies within the meaning of those articles. Specifically, they concur that the tariff and sales tax exemptions in question represent government revenue

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<sup>720</sup> Neither the European Communities nor the United States has made a claim of serious prejudice arising from measures adopted pursuant to the 1993 car programme.

<sup>721</sup> Japan's request for establishment of a panel noted Japan's view that the measures pursuant to the National Car programme cause serious prejudice to Japan's interests, but did not ask this Panel to make a finding on this issue. Rather, Japan reserved the right to request the establishment of a separate panel under Article 7.4 of the SCM Agreement with respect to this issue.

<sup>722</sup> In its first submission, the United States claimed that the National Car programme also threatened to cause serious prejudice with respect to US exports of light trucks to Indonesia. The US threat claim was, however, related to an allegedly government-directed \$690 million loan. The United States has informed us that, in light of our preliminary ruling that the loan is not within our terms of reference, the United States is no longer pursuing this claim.

forgone within the meaning of Article 1.1(a)(1)(ii) and that the measures confer a benefit on PT TPN within the meaning of Article 1.1(b) of the Agreement. All three parties reiterated this view in response to a written question from the Panel. Further, the European Communities, the United States and Indonesia agree that these subsidies are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b), and that they are therefore deemed to be specific pursuant to Article 2.3 of the Agreement.<sup>723</sup> In light of the views of the parties, and given that nothing in the record would compel a different conclusion, we find that the measures in question are specific subsidies within the meaning of Articles 1 and 2 of the SCM Agreement.

2. May the complainants bring a serious prejudice claim against Indonesia?

14.156 Article 27 of the SCM Agreement provides significant special and differential treatment for developing country Members of the WTO, including with respect to claims of serious prejudice arising from subsidies provided by developing country Members. Thus, Article 27.9 provides that

Regarding actionable subsidies granted or maintained by a developing country Member other than those referred to in paragraph 1 of Article 6, action may not be authorized or taken pursuant to Article 7 unless nullification or impairment of tariff concessions or other obligations under GATT 1994 is found to exist as a result of such subsidy, in such a way as to displace or impede imports of a like product into the market of the subsidizing developing country Member or unless injury to a domestic industry in the market of an importing Member occurs.

In other words, Article 27.9 provides that, in the usual case, developing country Members may not be subject to a claim that their actionable subsidies have caused serious prejudice to the interests of another Member. Rather, a Member may only bring a claim that benefits under GATT have been nullified or impaired by a developing country Member's subsidies or that subsidized imports into the complaining Member have caused injury to a domestic industry.

14.157 The complainants do not contest that Indonesia is a developing country Member entitled to the special and differential treatment provided by Article 27.9. Rather, they contend that Article 27.9 is not applicable in this case because the subsidies in question fall under the provisions of Article 6.1(a), i.e., that the ad valorem subsidization of the Timor exceeds 5 per cent. The European Communities further contend, in the alternative, that the subsidies fall under the provisions of Article 6.1(a) because, pursuant to Annex IV:4 to the Agreement, PT TPN is in a start-up situation and the overall rate of subsidization exceeds 15 per cent of the total funds invested. Accordingly, the complainants consider that they are authorized under Article 27.8 to bring a serious prejudice claim.

14.158 We agree that Article 27.8 allows a WTO Member to bring a serious prejudice claim with respect to subsidies provided by a developing country Member which fall within the scope of Article 6.1. Article 27.8 provides that:

There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of

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<sup>723</sup> See Section VIII:A of the Descriptive Part. The European Communities and the United States also consider the subsidies to be specific on the grounds that they are in fact made available to a single enterprise within a single sector.

paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6.

In other words, while a subsidy falling within the terms of Article 6.1 generally is presumed to cause serious prejudice to the interests of another Member, that presumption is not applicable where the subsidizing country is a developing country Member. Instead, while such a subsidy by a developing country Member may be subject to a serious prejudice challenge, a complainant does not benefit from a presumption of serious prejudice; rather, a complainant must demonstrate the existence of serious prejudice by positive evidence.

14.159 The question remains whether the subsidization challenged in this dispute satisfies the requirements of Article 6.1(a). That provision states that "[s]erious prejudice shall be deemed to exist in the case of . . . the total ad valorem subsidization<sup>14</sup> of a product exceeding five per cent . . . ." Footnote 14 states that "[t]he total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV." That Annex, in turn, sets forth a number of principles to be applied in calculating the total ad valorem subsidization for purposes of Article 6.1(a). Among the provisions of Annex IV is a special rule that, "[w]here the recipient firm is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidization exceeds 15 per cent of the funds invested."

14.160 In their first submissions, both the European Communities and the United States submitted a number of calculations intended to demonstrate that the terms of Article 6.1(a) were satisfied in this case. Thus, the European Communities provided calculations indicating that the ad valorem subsidization of Timors assembled in Indonesia ranged from 40 to 61 per cent, while the ad valorem subsidization of Timors imported from Korea ranged from 156 to 460 per cent. In the alternative, the European Communities calculate that, if PT TPN is in a start-up period, Article 6.1(a) applies because the overall rate of subsidization (219-225 per cent) exceeds 15 per cent of the total funds invested. The US calculations, excluding the alleged \$690 million loan found to be outside our terms of reference, indicate a rate of subsidization for Timors imported from Korea of between 54 and 166 per cent (depending on whether the import duty exemption on the Timors imported from Korea was expended in the year of receipt or allocated over a number of years), while the rate of subsidization for Timors assembled in Indonesia would be 49.37 per cent in 1998 and 44.65 per cent in 1999. The United States considered that the start-up provisions of Annex IV were not applicable in this case.

14.161 The calculations provided by the European Communities and the United States present a variety of issues under Article 6.1(a) and Annex IV. However, we do not need in this case to calculate the precise level of ad valorem subsidization. Rather, we need only determine whether the ad valorem rate of subsidization exceeds 5 per cent. This question is not in dispute here, since Indonesia calculates that the ad valorem subsidization conferred by the exemption from the luxury sales tax alone is 29.54 per cent for Timors imported from Korea, 26.20 per cent for Timors assembled at the Tambun plant, and 18.68 per cent for Timors to be assembled at the Karawang plant. Thus, the parties concur that the ad valorem subsidization exceeds 5 per cent. We do not see any basis to disagree with the parties that the ad valorem subsidization is in excess of 5 per cent. To the contrary, given that the luxury sales tax from which Timors are exempted is itself 35 per cent of the cost of the cars sold, it would appear inevitable that the ad valorem subsidization resulting from such an exemption would exceed 5 per cent by any reasonable calculation.

14.162 For the foregoing reasons, we find that the complainants are not precluded by Article 27 from seeking to demonstrate, by positive evidence, that Indonesia has caused, through the effects of the subsidies at issue in this case, serious prejudice to their interests.<sup>724</sup>

3. Like product analysis

14.163 As we have seen, both the European Communities and the United States claim that Indonesia has caused, through the subsidies provided under the National Car programme, serious prejudice to their interests. They further allege that this serious prejudice arises both from displacement or impedance of their exports of passenger cars to Indonesia and through significant price undercutting of their passenger cars by the subsidized Timor in the Indonesian market.

14.164 Article 6.3 provides in relevant parts as follows:

Serious prejudice in the sense of paragraph (c) may arise in any case where one or several of the following may apply:

(a) the effect of the subsidy is to displace or impede the exports of a like product of another Member into the Market of the subsidizing Member;

.....

(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;

..... (emphasis added).

It is clear from the text of Article 6.3 that any analysis of displacement or impedance or of price undercutting must focus on the effects of the subsidy vis à vis the like product to the subsidized product. In this case, the European Communities and the United States have alleged that the subsidies in question are conferred on the Timor. Accordingly, our analysis of the effects of these subsidies must be performed in relation to their effects on products which are "like products" to that passenger car.

(a) Types of Cars

14.165 The first "like product" issue presented by this dispute is which EC and US motor vehicles sold in Indonesia, if any, can properly be considered to be "like products" to the Timor within the meaning of the SCM Agreement. The parties have presented differing views as to how broadly or narrowly the concept of "like product" should be applied in this dispute.

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<sup>724</sup> Indonesia has also expressed the view that developing country Member subsidies are subject to a serious prejudice claim by virtue of the fact that they fall within the terms of Article 3.1(b) of the SCM Agreement. In light of the foregoing finding, we do not need to address that issue.

14.166 The European Communities assert that all motor vehicles falling within the category of "passenger cars" constitute a single category of "like product" for the purposes of the SCM Agreement, given that they all share the same basic characteristics and serve an identical end-use. The European Communities contend that there are virtually limitless variations with respect to passenger cars, and that any effort to divide passenger cars into two or more "like products" would inevitably yield arbitrary results because the Panel would be required either to choose among the criteria or to apply several criteria simultaneously. Further, the European Communities point out that there are continua of products with respect to many of these criteria, and drawing lines along those continua would be arbitrary regardless of where the lines were drawn. The European Communities argue in the alternative that, at the very least, the Opel Optima and Peugeot 306 must be considered to be "like" the Timor because, while not identical, they have physical characteristics which closely resemble those of the Timor.

14.167 The US approach to "like product" is narrower than that proposed by the European Communities. The United States contends that four US passenger cars sold or planned to be sold in Indonesia -- the Opel Vectra and Optima, the Ford Escort and the Chrysler Neon -- are "like products" to the Timor. In support of this conclusion, the United States contends that these products have similar end-uses (to transport passengers) and that, because the physical characteristics of these cars (e.g., size, weight, height, engine size) are similar or virtually identical to those of the Timor, they "closely resemble" that car. In support of its conclusions, the United States cites what it considers to be highly authoritative market segmentation analysis applied by the DRI Global Automotive Group and reflected in a number of DRI publications excerpts of which have been placed before the Panel,<sup>725</sup> under which the Timor, Optima, Escort and Neon are all classified as Segment C (Lower Medium Segment) passenger cars, while the Vectra is classified as Segment D (Upper Medium Segment) passenger cars.

14.168 Indonesia takes issue with both the EC and US approaches to the "like product" question. Indonesia considers that, because an affirmative finding of serious prejudice would deprive Indonesia of a conditional right to provide subsidies, the concept of "like product" must be very narrowly construed, and that the burden of proof on complainants is particularly high. Indonesia argues that the complainants have not met their burden of proving that products are like and of establishing acceptable like product categories. Indonesia does not appear to take issue with the principle that the analysis should be limited to passenger cars. However, it notes that while all passenger cars share certain basic characteristics, they are still highly differentiated on the basis of numerous other physical and non-physical characteristics and thus should not be treated as "like". In this case, Indonesia argues, because the Timor is highly differentiated from US and EC models and is thus non-substitutable, those products cannot be considered to be like products to the Timor. Rather, Indonesia considers that the Timor and the Bimantara Cakra are in a market segment by themselves, "small budget" cars, while even the US and EC cars closest to the Timor are in the "small normal/regular" market segment.

14.169 In assessing the arguments of the parties, we are cognizant that the complainants are required to demonstrate the existence of serious prejudice by positive evidence. Thus, we agree with Indonesia that the complainants bear the burden of presenting argument and evidence with respect to each element of their serious prejudice claims -- including the existence of effects on a "like product". This is consistent with the general principle, stated by the Appellate Body in *Shirts and Blouses*, that complainants must present evidence and argument sufficient to establish a presumption that a defending Member has acted in a manner inconsistent with its WTO

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<sup>725</sup> Asian Automotive Industry Forecast Report of June 1997; World Car Industry Forecast Report of February 1997.

obligations.<sup>726</sup> We do not agree, however, that the complainants bear a heavier than usual burden of proof in this dispute or that the concept of "like product" should be interpreted more narrowly than usual because Indonesia is a developing country Member. The special and differential treatment available to Indonesia is spelled out in Article 27 of the SCM Agreement, and it is substantial. But for that special and differential treatment, the subsidies in question would by Indonesia's own admission be prohibited under Article 3.1(b) of the SCM Agreement. Moreover, because Indonesia is a developing country Member, Article 27.8 requires complainants to demonstrate serious prejudice by positive evidence "in accordance with the provisions of paragraphs 3 through 8 of Article 6" rather than taking advantage of the rebuttable presumption of serious prejudice that otherwise would have applied under Article 6.1(a). Article 27 does not, however, impose a higher burden of proof on complainants than that normally applicable under Article 6, nor does it provide that the term "like product" is to be defined differently in the case of subsidization provided by a developing country Member.

14.170 Turning now to an analysis of the issue at hand, we note that the term "like product" is used in a variety of contexts within the WTO Agreement.<sup>727</sup> As it is used in most cases, the term is not defined, and numerous GATT and WTO panels have been required to apply the term to particular factual situations. The SCM Agreement, however, shares with the Agreement on Implementation of Article VI of GATT 1994 (ADP Agreement) a definition of the term "like product" that is not found elsewhere in the WTO Agreement. Note 46 to Article 5.1 of the SCM Agreement provides that:

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.

Although this definition appears in Part V of the SCM Agreement (relating to countervailing measures), the use of the clause "throughout this Agreement" makes clear that this definition is equally applicable to the provisions of Part III, including Article 6 relating to adverse effects.

14.171 The definition of "like product" found in the SCM Agreement first appeared in the Kennedy Round Anti-Dumping Agreement<sup>728</sup> and, in spite of proposals for modifications during various negotiations, was carried virtually unchanged into the Tokyo Round Anti-Dumping and Subsidies Codes<sup>729</sup> and hence into the WTO SCM and ADP Agreements. Thus, the definition of

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<sup>726</sup> *Shirts and Blouses*, op. cit., Appellate Body Report, p. 13.

<sup>727</sup> For example, Articles I and III of GATT. Article I:1: ". . . 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 contracting parties." Article III:2: "The products of the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products." Article III:4: "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin . . ."

<sup>728</sup> Kennedy Round Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, Article I.A(b).

<sup>729</sup> Tokyo Round Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, Article 2.2; Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, note 18 to Article 6.

"like product" applicable in this dispute has existed for thirty years. In light of this, and in spite of the fact that investigating authorities in anti-dumping and countervailing duty cases have been wrestling with the concept of "like product" for decades, it is surprising that no GATT or WTO panel has yet been required to apply this definition of "like product" to particular facts, or even to provide any detailed discussion regarding the meaning of the term or its clarification. Thus, we are operating in uncharted territory in our consideration of this issue.

14.172 In determining what criteria might be relevant to performing "like product" analysis under the SCM Agreement, our point of departure must of course be the text of the SCM Agreement. In this case, no party has argued that there is an "identical" product that should be treated as the "like product" to the Timor. Rather, the parties have focused on the question of which cars have "characteristics closely resembling" those of the Timor. On its face, this term is quite narrow. It is not enough that the products have characteristics which resemble the Timor; rather they must have characteristics which "closely" resemble the Timor. The parties have identified a wide range of physical characteristics which they consider may be relevant to this analysis. In addition, Indonesia considers certain "non-physical" characteristics, consumer perceptions and preferences to be relevant to the analysis. Further, there have been references to the uses to which a product may be put, to the substitutability of products, to price and to tariff classification principles.

14.173 In our view, the analysis as to which cars have "characteristics closely resembling" those of the Timor logically must include as an important element the physical characteristics of the cars in question. This is especially the case because many of the other possible criteria identified by the parties are closely related to the physical characteristics of the cars in question. Thus, factors such as brand loyalty, brand image/reputation, status and resale value reflect, at least in part, an assessment by purchasers of the physical characteristics of the cars being purchased. Although it is possible that products that are physically very different can be put to the same uses, differences in uses generally arise out of, and assist in assessing the importance of, different physical characteristics of products. Similarly, the extent to which products are substitutable may also be determined in substantial part by their physical characteristics. Price differences also may (but will not necessarily) reflect physical differences in products. An analysis of tariff classification principles may be useful because it provides guidance as to which physical distinctions between products were considered significant by Customs experts. However, we do not see that the SCM Agreement precludes us from looking at criteria other than physical characteristics, where relevant to the like product analysis. The term "characteristics closely resembling" in its ordinary meaning includes but is not limited to physical characteristics, and we see nothing in the context or object and purpose of the SCM Agreement that would dictate a different conclusion.<sup>730</sup>

14.174 Although we are required in this dispute to interpret the term "like product" in conformity with the specific definition provided in the SCM Agreement, we believe that useful guidance can nevertheless be derived from prior analysis of "like product" issues under other provisions of the WTO Agreement. Thus, we note the statement of the Appellate Body in *Alcoholic Beverages (1996)*<sup>731</sup> that, in this context as in any other, the issue of "like product" must be considered on a case-by-case basis, that in applying relevant criteria panels can only use their best judgement

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<sup>730</sup> This interpretation is confirmed by the negotiating history of this definition. As noted above, this definition of "like product" is virtually unchanged from that which first appeared in the Kennedy Round Anti-Dumping Code. Thus, the penultimate draft of that Code defined the term "like product" to mean a product which "has physical characteristics close to those of the exported product." T.64/NAB/W/16, dated 3 March 1967. In the revised draft of 28 March 1967, the word "physical" had been deleted from the text, which was revised to the formulation ("characteristics closely resembling") that exists today. T.64/NAB/W/17.

<sup>731</sup> Op. cit., pp. 19-23.

regarding whether in fact products are like, and that this will always involve an unavoidable element of individual, discretionary judgement. With this in mind, we now proceed to consider the application of these general principles to the case at hand.

14.175 Turning first to the argument of the European Communities that all passenger cars should be considered "like products" to the Timor, we consider that such a broad approach is not appropriate in this case. While it is true that all passenger cars "share the same basic physical characteristics and share an identical end-use", we agree with Indonesia that passenger cars are highly differentiated products. Although the European Communities have not provided the Panel with information regarding the range of physical characteristics of passenger cars, all drivers know that passenger cars may differ greatly in terms of size, weight, engine power, technology, and features. The significance of these extensive physical differences, both in terms of the cost of producing the cars and in consumer perceptions regarding them, is manifested in huge differences in price between brands and models. It is evident that the differences, both physical and non-physical, between a Rolls Royce and a Timor are enormous, and that the degree of substitutability between them is very low. Viewed from the perspective of the SCM Agreement, it is almost inconceivable that a subsidy for Timors could displace or impede imports of Rolls Royces, or that any meaningful analysis of price undercutting could be performed between these two models. In short, we do not consider that a Rolls Royce can reasonably be considered to have "characteristics closely resembling" those of the Timor.

14.176 The European Communities contend that we must consider all passenger cars to be "like" because any effort to differentiate between passenger cars with a multitude of differing characteristics would inevitably result in arbitrary divisions. We are aware that there are innumerable differences among passenger cars and that the identification of appropriate dividing lines between them may not be a simple task. However, this does not in our view justify lumping all such products together where the differences among the products are so dramatic. The parties to this dispute have submitted substantial data regarding a wide range of characteristics of the Timor and of the models that the European Communities and United States consider to be like products to the Timor. We must endeavour to find some reasonable way to assess the relative importance of the various differences in the minds of consumers and to devise some sensible means to categorize passenger cars.

14.177 One reasonable way for this panel to approach the "like product" issue is to look at the manner in which the automotive industry itself has analyzed market segmentation. The United States and the European Communities have submitted information regarding the market segmentation approach taken by DRI's Global Automotive Group, a company whose clients include all major auto manufacturers, including KIA, PT TPN's national car partner. DRI's Asian Automotive Industry Forecast Report of June 1997 ("Asian Forecast") divides passenger cars into five segments: Small Cars Segment (Segment A), Supercompact Segment (Segment B), Lower Medium Segment (Segment C), Upper Medium Segment (Segment D) and Executive Segment (Segment E). Three of those segments (C to E) are divided into subsegments 1 (lower end) and 2 (upper end). While the Asian Forecast does not identify the Timor, it does indicate that the Kia Sephia -- Timor's parent car -- falls within the C1 Segment (lower end of Lower Medium Segment).<sup>732</sup> The Asian Forecast also places the Optima and the 306 in the C1 Segment, while the Vectra is placed in the D1 (lower end of Upper Medium Segment). The Escort and Neon are not identified in the portion of the Asian Forecast (Table 6 relating to sales in Indonesia) before the

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<sup>732</sup> DRI identifies models sold in the Indonesian market by the more common model names used in other markets. However, it is clear from the sales data provided by DRI that the "Sephias" referred to in the Asian Forecast are in fact Timors imported from Korea or assembled in Indonesia.

Panel, presumably because they are not sold in Indonesia. However, market segmentation data from DRI's World Car Industry Forecast Report of February 1997 ("World Forecast"), which appears to follow the same market segmentation approach as the Asian Forecast, places the Escort in the C1 Segment, while it places the Neon in the C2 Segment (upper end of Lower Medium Segment).

14.178 The question remains whether the criteria used by DRI in arriving at its market segmentation are appropriate to a "like product" analysis under the SCM Agreement. We consider that they are. The Asian Forecast indicates that:

DRI's segmentation of passenger car demand is designed to identify sets of products which car consumers recognize as falling within competing categories. No single vehicle attribute defines any segment; rather the categorization is subjective, combining judgements on several items of vehicle specifications and purchaser perceptions. In choosing five market segments, we have sought to identify five product types of appeal to different customers.

The World Forecast provides some further explanation regarding DRI's market segmentation analysis. It states that:

This segmentation is effectively a hybrid in product space terms. This can be designed as a vector in vehicle size and price/market position. To identify the vehicle market position a little more clearly we have subdivided the segments C to E into lower end (1) and upper end (2).

Thus, DRI has in its analysis considered the physical characteristics of the cars in question when designing its segmentation. It has used as an initial filter the size of the vehicle, but it has then divided cars of a given size into upper and lower end categories, and has moved luxury cars, regardless of size, from lower segments to the E segment. We consider such an approach, which segments the market based on a combination of size and price/market position, to be a sensible one which is consistent with the criteria relevant to "like product" analysis under the SCM Agreement.

14.179 Indonesia notes that "like product" analysis may depend upon the market in question, and that DRI's segmentation analysis was developed for the European market. Indonesia further argues that the Timor sold in Indonesia is not in fact identical to the Kia Sephia, but is rather an older model of the Sephia with a smaller engine and fewer features than the new Sephia. In support of this proposition, it points to a US exhibit indicating that Sephia models sold in the United States beginning in 1996 had a larger 1.8 litre engine and new features such as an improved suspension and airbags. Indonesia also submitted data showing that the Sephia sold in the United States weighs from 68 to 103 kg. more than the Timor S-515. Indonesia has not presented any evidence regarding the size of the engine for Sephias sold in Europe, so the implications of this evidence for the validity of DRI's market segmentation analysis are unclear.<sup>733</sup> It does not appear, however, that

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<sup>733</sup> The United States placed into the record a number of articles from US publications (the Washington Post, New York Times and Car and Driver magazine) suggesting that the Neon and the Sephia were competing in the same market segment in the United States, while Indonesia identified a publication (Automotive News) placing the Sephia in a separate class (budget) from that of the Neon and Escort (small). None of these articles provided any explanation for the market segmentation selected. In this context, we take

DRI considered these differences sufficiently important to merit classifying the Timor sold in the Indonesian market differently from the Sephia sold in other markets. Further, DRI apparently considers its segmentation analysis to be applicable to the Asian market generally and to the Indonesian market in particular, as it applies that analysis in the Asian Forecast.

14.180 Indonesia further objects that the complainants have not submitted the full text of the Asian Forecast, and that the Panel should draw adverse inferences from this fact. However, the materials provided by the complainants appear to include that portion of the Asian Report relating to market segmentation, and Indonesia has not given the panel any reason to believe that relevant portions of the Asian Forecast have been excluded. Further, because the Asian Forecast is not a document to which the complainants can control access, resort to adverse inferences would not appear appropriate. Finally, Indonesia objects that the DRI approach is limited solely to physical dimensions, and fails to consider other physical characteristics much less "actual market forces or competition." As indicated by our discussion, however, Indonesia's argument on this score appears to be factually incorrect.

14.181 In our view, the DRI market segmentation analysis presented by the European Communities and the United States supports the view that all vehicles in the C1 Segment -- including the 306, Optima and Escort -- are "like products" to the Timor within the meaning of the SCM Agreement. By contrast, the DRI analysis places the Vectra and the Neon in different market segments (D1 and C2 respectively), and this in our view weakens the complainants' view that these products should be considered to be "like" the Timor.<sup>734</sup> The complainants have not provided any explanation as to why the Panel should consider DRI's market segmentation relevant yet overlook that segmentation where it is unfavourable to them. To the contrary, the United States' argument regarding the Vectra in particular damns with faint praise. The United States concedes that the Vectra "is positioned slightly higher in the market than the Timor", that it is longer and has a more powerful engine. The United States maintains only that the Vectra "is not all that dissimilar" to the Timor, a test which would appear to fall short of the SCM Agreement's definition.

14.182 While the DRI market segmentation analysis is useful, we are not prepared to rely on it without confirming, through an independent comparison of their physical characteristics, that the EC and US models in question are "like" the Timor. The European Communities, the United States and Indonesia have all provided the Panel with detailed comparative information regarding the physical characteristics and performance of the models at issue. This information varies in some details, and it is not always clear which versions of particular models are being compared with which.<sup>735</sup> Nevertheless, the information before us generally provides a good overview of the similarities and differences between the models in question. However, the parties have sometimes chosen to emphasize different physical characteristics and features or to characterize differently the significance of the differences that exist. In testing the DRI market segmentation approach, therefore, we will outline the Indonesian view of market segmentation in Indonesia and then test that view against the physical characteristics and other criteria identified by Indonesia as significant.

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note of evidence submitted by Indonesia regarding differences between the Sephia sold in the United States and the Timor.

<sup>734</sup> Neither the European Communities nor the United States sell any B Segment cars in the Indonesian market, and we have not been asked to decide whether such cars are like products to the Timor for the purposes of the SCM Agreement.

<sup>735</sup> The submissions of the parties refer to at least two versions of the Timor (S-515 and S-515i), three versions of the Optima (GLS, CDX and CDX A-BAG) and two versions of the 306 (M/T and A/T).

14.183 Indonesia's argument is that the Timor is a "low-technology no-frills budget car" which fills a unique niche at the bottom of the Indonesian market. Indonesia contends that a proper market segmentation for passenger cars would divide those cars into three classifications -- small, medium and large -- and that each of the classifications in turn should be divided into a budget, normal/regular and luxury categories. Indonesia contends that the Timor and one other model (the Bimantara Cakra) are alone in the budget small car category.<sup>736</sup> It considers that all of the specific EC and US models sold in Indonesia which are alleged to be "like" the Timor belong in a different category, that of small normal/regular cars.

14.184 Indonesia's analysis begins with a comparison of various physical features of the Timor with those of other models -- Escort, 306, Optima, Vectra, Neon -- specifically alleged by complainants to be "like products" to the Timor. Indonesia contends that there are four basic physical characteristics or specification groupings that differentiate passenger cars: passenger compartment, power plant, steering and suspension and safety features. Indonesia considers that an examination of these four specification groupings demonstrates that the five models identified above are not like products to the Timor. We will examine each set of specification groupings in turn.

14.185 With respect to passenger compartment, Indonesia considers that the relevant aspects are interior dimensions and number of passengers. Indonesia acknowledges that the Timor, Escort, 306, Optima and Neon are comparable in this regard. However, Indonesia contends (and the complainants have not contested) that the Vectra has a substantially larger interior and accommodates five passengers as opposed to four passengers for the other models.

14.186 With respect to power plant, the engine capacity of the Timor is 1498 cc. That of the other five models, in ascending order, are the Escort (1597 cc), 306 (1761 cc), Optima (1796 cc), Neon (1996 cc) and Vectra (1998 cc). Thus, the Timor does in fact have the smallest engine of the group. On the other hand, the record indicates the Timor has a sixteen-valve engine, and at least one of the Timor models sold in Indonesia (the Timor S-515i)<sup>737</sup> has a dual overhead cam engine. The other models all have single overhead cam engines, and the 306 and Optima have only an eight-valve engine. According to data submitted by the parties, while the power output of the Timor S-515 is 58kw/5500rpm, that of the Timor S-515i is 77kw/5500rpm, as opposed to 66 kw/5400 rpm for the Optima, 70kw/6000 rpm for the 306, 75kw/5500 rpm for the Escort, 85 kw/5400 rpm for the Vectra, and 97kw/6000rpm for the Neon.<sup>738</sup> Accordingly, it would appear that the engine of the Timor S-515i is actually more powerful than those of the Optima, 306 and Escort, but somewhat less powerful than those of the Vectra and Neon.

14.187 With regard to steering and suspension, Indonesia differentiates between the Timor and the Escort, Vectra and Optima on the grounds that the latter three have power steering. However, sales brochures for the Timor indicate that it has power steering as a standard feature, while the United States contends that the Escort has power steering as an option only. Thus, it would appear that with respect to this feature the Timor may actually be more advanced than the 306 and Neon.

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<sup>736</sup> According to the European Communities, the Cakra is a rebadged Hyundai Accent.

<sup>737</sup> Indonesia states in the Annex V process that the authorization to import the Timor from Korea applied both to the Timor S-515 and the S-515i and that the S-515i was the only national car produced in Indonesia. Thus, it is clear that at least some -- and perhaps most -- of the Timors to be sold in Indonesia are in fact the S-515i model.

<sup>738</sup> While in its rebuttal submission, Indonesia indicated that the Optima's engine generated 66kw/5400rpm, at another point it indicated that the Optima had a power of 87.3/5400rpm. It would appear to the Panel, however, that the 66kw/5400rpm is the correct figure.

Regarding suspension, although Indonesia's summary table suggests that there are differences between the Timor and all of the models compared to it, the detailed information supplied by Indonesia shows that all of the models have identical suspension: in the front "Independent MacPherson strut", and in the rear "fully independent multi-linked".<sup>739</sup>

14.188 With respect to "safety features", Indonesia identifies the braking system, fuel tank capacity and mileage, curb weight and passive restraints as relevant features. With respect to the braking system, all models would appear to have front disc and rear drum brakes. The Vectra has ABS, and it appears that some models of the Optima and 306 may also have ABS, while the Timor and Escort do not (the Neon offers ABS as an option). The fuel tank capacity, in ascending order, is: Timor (50 litres), Optima (52 litres), Escort (55 litres), Neon (57 litres), 306 (60 litres), and Vectra (61 litres). Data regarding fuel efficiency were unavailable for most models. The models weigh in at the following: Optima (980 kg), Timor (1055 kg), 306 (1100 kg), Neon (1102 kg), Escort (1110 kg) and Vectra (1150 kg). Documentation submitted by Indonesia shows that all models, except the Timor and 306, have airbags; however, the United States indicated that the Indonesian version of the Escort would not have been equipped with airbags, while documentation from the European Communities indicates that one Optima model has a single airbag while another does not.

14.189 In our view, the data provided by the parties tend to confirm the market segmentation analysis of DRI. Even limiting ourselves to those features on which Indonesia has chosen to focus, the Timor does not appear to be notably inferior to the 306, Optima or Escort, and in fact in some respects may be superior to those models. With respect to the Vectra, on the other hand, the superiority seems relatively clear -- the Vectra is the heaviest passenger car in the group (95 kgs more than the Timor), shares honours with the Neon for the largest engine (roughly 500 cc larger than the Timor's), is the only one of the vehicles identified as appropriate for 5 passengers, and has all the features identified by Indonesia (power steering, ABS, airbags). The case of the Neon is intermediate: it is heavier and has a larger engine than the Timor and most of the other models in question, but it is not notably better equipped than the Timor in other respects. Thus, the data fit well with DRI's assessment that the Vectra is in a distinct market segment from the Timor while the Neon is in the upper end of the same market segment as the Timor.

14.190 A number of other factors combine to suggest that the Timor in fact belongs in the C Segment. First, according to DRI's World Forecast, Kia -- producer of the Sephia, parent car to the Timor -- produces and sells in the Korean market a range of passenger cars, including entrants in Segments A (Morning) and B (Avella and Pride). Further, contrary to Indonesia's contention, DRI data show that several passenger cars classified by DRI in the B Segment (Suzuki Baleno, Toyota Starlet) are currently sold in the Indonesian market, and several others (Daihatsu Charade, Maleo Maleo) were sold in the Indonesian market as recently as 1996. We note that these B Segment cars would appear to be significantly smaller and, on the whole, less powerful than the Timor.<sup>740</sup> This undercuts Indonesia's arguments that the Timor and the Bimantara Cakra are in a class by themselves at the bottom of the Indonesian market.

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<sup>739</sup> Indonesia's summary table mentions differences in tyre size in the context of "steering and suspension". It is not clear that tyre size is related to suspension, or is otherwise an important factor in defining the like product. Moreover, Indonesia's detailed table treats tyre size as a separate feature, unrelated to suspension.

<sup>740</sup> It appears that the car identified by Indonesia as the Daihatsu G102 series is a rebadged Charade. According to figures supplied by Indonesia, the Starlet, Charade and Baleno weigh 725 kg, 845 kg and 965 kg (as opposed to 1055 kg for the Timor), and have engines generating 53, 56 and 87 kw respectively. The Timor S-515i generates 77 kw.

14.191 In addition to comparing physical characteristics, Indonesia argues that the Timor differs from the other models alleged to be "like products" in terms of a variety of non-physical characteristics. Although Indonesia does not clearly identify which characteristics it considers to be non-physical, among the factors listed by Indonesia which arguably are not "physical characteristics" are brand loyalty, brand image/reputation, status, after-sales service and resale value. However, the only evidence cited by Indonesia in support of its view that the Timor should be distinguished from the other models in question on these bases is a single sentence in a newspaper article submitted as an exhibit by the United States, stating that "dealers say consumers ask a lot of questions about the quality of the Timor and the after-sales service."<sup>741</sup> Further, it is by no means clear that the models alleged to be "like" the Timor would necessarily fare any better than the Timor with respect to these factors. For example, Ford and Chrysler do not have a well-established brand in Indonesia, while sales of Peugeots and Opels have also been relatively small. In short, Indonesia has provided almost no evidentiary support for its view that there are differences in non-physical characteristics which are important to this analysis.

14.192 Finally, Indonesia seems to suggest that the Timor's low price places it into a special market niche and thus renders it "unlike" the more expensive US and EC models. We do not preclude that price might be a relevant consideration in performing "like product" analysis, particularly where differences in price represent one way to assess the relative importance of differing physical characteristics to consumers. In this case, however, the complainants allege that the Timor is being sold at undercutting prices as a result of subsidization. If we were to conclude that the low price of the Timor in the Indonesian market were to render the Timor "unlike" other models which are similar in physical characteristics to the Timor but priced higher, the result would be that, in cases where the subsidization and resulting price undercutting were sufficiently high, price undercutting claims under Article 6 could never prevail. Thus, we do not consider that the Timor's lower price is a basis to conclude that it is unlike the models alleged by the complainants to be "like" the Timor.

14.193 In conclusion, we consider that the Optima, Escort and 306 are "like products" to the Timor within the meaning of the SCM Agreement. The Vectra, in contrast, is not a like product to the Timor within the meaning of the SCM Agreement. With respect to the Neon, the issue is more difficult. That model is not categorized in a different segment by DRI but is in the higher end of the C segment, and although it is larger and more powerful than the Timor, does not have the clear superiority in its features demonstrated by the Vectra. Thus, for the purposes of our further analysis, we will assume *arguendo* that the Neon is a like product to the Timor.

(b) Treatment of Cars Imported Unassembled

14.194 Indonesia maintains a duty of 200 per cent on imports of passenger cars, and as a result imports of CBU passenger cars (that is, completely-built-up cars) into Indonesia are very small. In fact, almost all passenger cars imported into Indonesia, including the 306 and the Optima, are imported as CKD (completely knocked-down) kits and assembled in Indonesia. The complainants have stated that the Escort and Neon would have been imported in CKD kit form and assembled in Indonesia as well. Article 6.3 provides that serious prejudice may arise 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" or is "a significant price undercutting by the subsidized product as compared with the price of a like product of another Member." Thus, in the context of a displacement or impedance claim, the question arises whether imports of CKD kits are "imports of a like product [to the Timor] of another Member" where the final passenger car assembled in

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<sup>741</sup> Indonesia's national-car plan sputters under gaze of WTO, in Nikkei Weekly, 17 November 1997.

Indonesia is a "like product" to the Timor. In the case of price undercutting, the related question is whether a passenger car assembled in Indonesia from an imported CKD kit is a "like product of another Member."

14.195 In response to questions posed by the Panel, the complainants provided the following information regarding the form in which their passenger cars were imported. The European Communities indicated that virtually all cars were exported to Indonesia in CKD kits. These kits include "almost all" the parts and components necessary for assembling the cars, the only parts and components purchased in Indonesia being low cost universal components such as batteries and tires, or accessories such as radios, CD-players and loudspeakers. Further, the European Communities stated (and Indonesia did not contest) that data provided by Indonesia during consultations indicated that the "local content" of EC passenger cars assembled in Indonesia ranged from 6.4 to 8.3 per cent in 1996 (it is unclear whether Indonesia considered the Optima to be a US or EC passenger car; the same data indicate that US passenger cars contained between 7.7 and 11.1 per cent local content in 1996).<sup>742</sup> The United States indicated that Escorts would have been ordered in groups of 20 vehicles, packaged in waterproof, pre-engineered cases. 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." The local content initially would have been well under 20 per cent, although Ford planned on increasing that over time. The Neon would have been shipped in lots of 72 vehicles, filling 85 boxes. The items to be sourced locally would have included such things as paint, oil, gasoline and other commodities. No US or EC passenger car has achieved the 20 per cent local content level required to enjoy lower tariffs on imported parts and components.

14.196 It is not contested by Indonesia that the CKD kits imported or allegedly planned for importation into Indonesia are products "of another Member." Thus, the issue is whether those kits "have characteristics closely resembling", and are thus "like", completed Timors. In this respect we note, first, that the end uses of the imported CKD kits are the same as those of finished passenger cars (although additional steps are required before that end use is achieved). Second, given that the local content of the CKD kits is quite low, the overwhelming majority of the components in the CKD kits not only closely resemble but are physically identical to those found in the final product, with the only difference being that those components are unassembled rather than assembled. Thus, the question is whether the unassembled components can properly be considered to be "like" the finished product assembled from those components, i.e., whether the difference between a product assembled and unassembled is sufficiently important that the unassembled product does not "closely resemble" the assembled product.

14.197 We do not consider that an unassembled product ipso facto is not a like product to that product assembled. Recalling the view of the Appellate Body that tariff classification may be a useful tool in like product analysis<sup>743</sup>, we note that, under the General Rules for the Interpretation of the Harmonized System:

Any reference in a heading to an article shall be taken to include a reference to that article complete or unfinished, provided that, as

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<sup>742</sup> According to Indonesia, "[t]he local content of cars assembled in Indonesia is based on local value added . . . . [E]ach part and component is given an average weighted value with reference to a finished car (weight averaged over each car category). The level of manufacturing that occurs in Indonesia also is factored into the local content calculation."

<sup>743</sup> Alcoholic Beverages (1996), op. cit., Appellate Body Report, p. 21.

presented, the incomplete or unassembled article has the essential character of the complete or unfinished article.

We think that a comparable approach to the relation between assembled and unassembled products makes good sense in the context of this dispute. It appears that, in order to avoid paying 200 per cent duties on CBU passenger cars, EC and US car producers ship to Indonesia virtually complete CKD kits that are effectively "cars in a box." Accordingly, we believe that they can properly be considered to have characteristics closely resembling those of a completed car.

(c) Products Not Originating in a Complaining Member

14.198 Before turning to an analysis of adverse effects, we must first consider whether the United States may claim that it has suffered serious prejudice as a result of displacement/impedance or of price undercutting with respect to a product which does not originate in the United States solely on the basis that the producer of that product is a "US company".

14.199 We have determined that US and EC companies sell, or allegedly would be selling but for the subsidies provided pursuant to the National Car programme, four passenger car models that are (or, in the case of the Neon, may be) "like products" to the Timor: the Escort, the Optima, the 306 and the Neon. During the course of the proceedings, both the European Communities and the United States asserted that they had suffered serious prejudice as a result of the displacement/impedance and price undercutting of the Optima and the Escort. In response to a question from the Panel, the United States confirmed that CKD kits for the Optima were sourced in the European Communities and that, had plans to sell the Escort gone ahead, those CKD kits also would have been sourced in the European Communities. The United States argues, however, that the producers of those CKD kits (General Motors and Ford) are undeniably US companies, and that serious prejudice to US interests may arise as a result of displacement/impedance or price undercutting with respect to their products, wherever sourced.

14.200 In considering this issue, our starting point is that both Article XVI of GATT and the SCM Agreement are Annex 1A multilateral agreements on trade in goods. It comes as no surprise, therefore that in its discussion of serious prejudice, Article XVI:1 focuses on the effects of subsidization on trade in goods. That article provides as follows:

If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. 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. (emphasis added).

This focus on the trade effects of subsidization is carried over into Part III of the SCM Agreement. Article 5 provides that no Member should cause, through the use of any subsidy, "adverse effects to the interests of other Members." One such adverse effect is "serious prejudice to the interests of another Member," which the SCM Agreement indicates is used in the same sense as in Article XVI:1.<sup>744</sup> Article 6.3 provides that serious prejudice may arise where one or several of four listed situations exist. As we have seen, the United States alleges two such situations, i.e., (i) that "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"; and (ii) that "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" (emphasis added).

14.201 In our view, the text of Article XVI and of Part III of the SCM Agreement make clear that serious prejudice may arise where a Member's trade interests have been affected by subsidization. We see nothing in Article XVI or in Part III that would suggest that the United States may claim that it has suffered adverse effects merely because it believes that the interests of US companies have been harmed where US products are not involved. The United States has cited no language in Article XVI:1 or Part III suggesting that the nationality of producers is relevant to establishing the existence of serious prejudice. Accordingly, given that serious prejudice may only arise in the case at hand where there is "displacement or impedance of imports of a like product from another Member" or price undercutting "as compared with the like product of another Member", we do not consider that the United States can convert such effects on products from the European Communities into serious prejudice to US interests merely by alleging that the products affected were produced by US companies.

14.202 In light of our view that the existence of alleged harm to US companies is not a basis for a claim of serious prejudice to the interests to the United States, the question remains whether one Member may bring a claim that another Member has suffered serious prejudice as a result of subsidization. In our view the answer is no. It will be recalled that Article 7 of the SCM Agreement sets forth the steps to be taken by a Member which believes that it has suffered adverse effects within the meaning of Part III. Article 7.2 provides that:

A request for consultations under paragraph 1 shall include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question, and (b) the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice [footnote omitted] caused to the interests of the Member requesting consultations.

It is clear from Article 7.2 that the dispute settlement procedures set forth in Article 7 may only be invoked by a Member where that Member believes that it has itself suffered serious prejudice as a result of subsidization.

14.203 Our view on these issues is confirmed by Article 6.7, which allows a subsidizing Member to raise a defence to a displacement/impedance claim where "imports from the complaining Member" or "exports from the complaining Member" are affected by such factors as export prohibitions or restrictions, natural disasters, and arrangements limiting exports. These provisions of Article 6.7 assume that the products subject to a claim of serious prejudice arising from displacement or impedance originate in the complaining Member.

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<sup>744</sup> SCM Agreement, Note 13 to Article 5.

14.204 For the foregoing reasons, we find that the United States cannot assert that it has suffered serious prejudice as a result of displacement/impedance or price undercutting with respect to products that do not originate in the United States.<sup>745</sup>

4. Should the Panel consider the effects of subsidies provided pursuant to the June 1996 Car Programme?

14.205 It will be recalled that the National Car programme provides a number of subsidies for the Timor. Under the February 1996 car programme, Timors assembled in Indonesia benefit from an exemption from import duties with respect to imported parts and components, as well as an exemption from the luxury sales tax, provided those Timors meet specified local content requirements. Under the June 1996 car programme, PT TPN was authorized to import up to 45,000 CBU Timors from Korea exempt from (200 per cent) import duties during the period 30 June 1996 to 30 June 1997 and to sell those Timors free of luxury sales tax provided that certain requirements regarding counter-purchase and use of Indonesian workers in Korea were satisfied. It will further be recalled that Indonesia submitted the results of an audit indicating that those requirements had not been met, and indicated that a process would begin to seek repayment of the subsidies provided with respect to those Korean-origin Timors. Indonesia now argues that the Panel should not consider the effects of the subsidies provided pursuant to the June 1996 car programme because it has now expired. Because assembly on a significant scale of the Timor in Indonesia has not yet begun,<sup>746</sup> subsidies pursuant to the "February 1996 programme" have yet to be provided to any substantial degree. Thus, Indonesia contends, no actual serious prejudice may be found to exist.

14.206 We do not agree with Indonesia that we are precluded from considering the effect of subsidies pursuant to the June 1996 car programme when analysing whether the subsidies in this case have caused serious prejudice to the interests of the complainants. We agree with the complainants that in this case there are a variety of different subsidy measures provided pursuant to a single National Car programme, and that it makes little sense to treat each one separately when analysing the existence of serious prejudice. Rather, we must assess the "effect of the subsidies" on the interests of another Member to determine whether serious prejudice exists, not the effect of "subsidy programmes." We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were "expired measures" while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice. Thus, we decline to proceed on the course suggested by Indonesia.<sup>747</sup>

5. Displacement and Impedance

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<sup>745</sup> We note that the issue addressed here is not whether the United States need demonstrate the existence of trade effects in order to establish the nullification or impairment of benefits arising from the violation of a provision of the WTO Agreement. It is well established that in such cases no demonstration of actual trade effects is required. Superfund, op. cit.. Rather, we are addressing a situation where the existence of adverse effects is the essence of the claim.

<sup>746</sup> PT TPN is temporarily assembling 1,000 units per year at a plant in Tambun. Its full-scale facility at Karawang, which will have an annual capacity of 63,000 Timors, was not to begin production until sometime in 1998.

<sup>747</sup> We recall that, late in the Panel process, Indonesia indicated that it had terminated subsidies pursuant to the National Car programme. For the reasons set forth in paragraph 14.9 supra, we nevertheless will proceed to consider whether subsidies pursuant to the National Car programme are causing serious prejudice to the interests of the European Communities and the United States.

14.207 Having determined that certain EC and US passenger car models are (or, in the case of the Neon, may be) like products to the Timor, we must next examine whether the complainants have demonstrated that the effect of the subsidies provided pursuant to the National Car programme has been to displace or impede the exports of those models from the Indonesian market.

(a) Market Share Data

(i) Relevance of Article 6.4

14.208 Before proceeding to an examination of the market share data submitted by complainants, we must consider the threshold legal issue of whether Article 6.4 of the SCM Agreement is relevant to a dispute, such as this, where the adverse effects alleged by the complainants relate to displacement or impedance of a like product into the market of the subsidizing Member under Article 6.3(a). That Article provides as follows:

For the purpose 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 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; (b) the market share of the subsidized product remains constant in circumstances in which, in the absence of the subsidy, it would have declined; (c) the market share of the subsidized product declines, but at a slower rate than would have been the case in the absence of the subsidy. (emphasis added).

The European Communities and the United States acknowledge that Article 6.4 on its face does not apply to the displacement and impedance claims in this dispute, as their claims are based on Article 6.3(a) (effect in the market of the subsidizing Member) while Article 6.4 only applies "for the purpose of" Article 6.3(b) (effects in the market of a third country). The complainants argue, however, that there is no reason why the type of analysis set forth in Article 6.4 should not be appropriate also in the case of claims of displacement and impedance of imports from the market of the subsidizing country. Indonesia, by contrast, contends that Article 6.4 is not relevant to this dispute.

14.209 The significance of this issue in terms of the obligations on the complainants is considerable. If the type of analysis set forth in Article 6.4 is appropriate in this case, then the complainants arguably could make a prima facie case of displacement or impedance simply by demonstrating that the market share of a subsidized product has increased over an appropriately representative period. If, on the other hand, the type of analysis set forth in Article 6.4 is not appropriate in this case, then the complainants must demonstrate that "the effect of the subsidy" is to displace or impede imports into Indonesia, that is, that they have lost export sales to Indonesia that they would otherwise have made and that those export sales were lost as a result of the subsidies provided pursuant to the National Car programme.

14.210 We agree with Indonesia that Article 6.4 is not relevant in this case. The drafting of the provision is unambiguous, and the specific reference to Article 6.3(b) creates a strong inference that an Article 6.4 type of analysis is not appropriate in the case of Article 6.3(a) claims. The complainants have identified nothing in the context of the provision or the object and purpose of the SCM Agreement that would suggest a different conclusion.

14.211 Our conclusion does not of course mean that market share data are irrelevant to the analysis of displacement or impedance into a subsidizing Member's market. To the contrary, market share data may be highly relevant evidence for the analysis of such a claim. However, such data are no more than evidence of displacement and impedance caused by subsidization, and a demonstration that the market share of the subsidized product in the subsidizing Member has increased does not ipso facto satisfy the requirements of Article 6.3(a).

(ii) Actual Sales and Market Share Data

14.212 Having determined that the EC and US models in the C1 Segment (and arguably those in the C2 Segment) are "like" the subsidized Timor, we consider it appropriate to analyze market shares for the C Segment.<sup>748</sup> A review of the data provided by Indonesia under the Annex V procedure demonstrates that the Timor quickly gained a very substantial share of the Indonesian C Segment passenger car market upon its introduction. As shown in Table 1, the Timor was not sold in 1995 and thus had a zero share of the C Segment market. In 1996, the year of introduction, the Timor captured a 16.9 per cent share of the Indonesian C Segment, while during the period January - May 1997 (the latest period for which we have been provided with data), that market share had climbed to 42.4 per cent. Table 2 breaks this market share data down on a quarterly basis. These data indicate that Timor had no sales until the fourth quarter of 1996. In that quarter, its market share in the C Segment reached 40.9 per cent. It dropped to 38.8 per cent for the first quarter of 1997 but during the partial second quarter for which we have data (April-May) that share had climbed to 47.7 per cent.

14.213 In assessing whether this change in market share in fact amounted to a displacement or impedance of imports of EC and US origin products into Indonesia, our starting point is actual market shares for the three EC models we have found to be like products, and for the one US model which we assume *arguendo* to be a like product, to the Timor. The Neon was never introduced into the Indonesia market (allegedly because of the National Car programme), and the market share of US-origin passenger cars in the C Segment of the Indonesian passenger car market was therefore zero. Because the Escort also was never introduced into the Indonesian market, the EC market share data are based solely on sales of the 306 and the Optima. As shown in Table 1, *infra* at p.385, the European Communities in 1995 had an Indonesian market share in the C Segment of 2.4 per cent. The EC share climbed to 5.7 per cent in 1996, but dropped to 3.7 per cent for the period for which we have data (January - May 1997). Table 2, *infra* at p. 386, breaks down these data on a quarterly basis. This analysis shows that in the first three quarters of 1996, EC market share in the C Segment ranged from 6.9 to 7.8 per cent. In the fourth quarter of 1996 (the quarter in which the Timor first entered the market), EC market share dropped to 3.7 per cent. In the first quarter of 1997, EC market share fell even further to 3.3 per cent, and remained at a relatively low 4.2 per cent in the partial second quarter for which we have data (April-May 1997).

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<sup>748</sup> According to data supplied during the Annex V process, only one passenger car model in the C2 Segment currently is sold in Indonesia (the Mitsubishi Lancer). Thus, excluding C2 Segment passenger cars when calculating market shares would increase the absolute market shares of the Timor and of EC C1 models somewhat, but would not affect the relative shares.

14.214 Focusing on market shares alone, the data before us show a potentially significant correlation between the introduction of the subsidized Timor and the decline in EC market share in the C Segment of the Indonesian market. The quarterly data show that the EC market share for C Segment cars in Indonesia increased substantially during the first three quarters of 1996, but that, in the fourth quarter of 1996, coincident with the introduction of the Timor, the European models' market share dropped to 3.7 per cent, where it remained on average during the first five months of 1997. Thus, there seems to be little question that the EC market share in the C Segment dropped substantially relative to that of the subsidized Timor, and the close correlation in time between the introduction of the Timor and the drop in EC market share suggests a causal link between the two.

14.215 If Article 6.4 of the SCM Agreement applied in this dispute, this showing of a change in relative market shares to the disadvantage of the non-subsidized like product might well have been sufficient to establish the European Communities' prima facie case of displacement or impedance.<sup>749</sup> In the absence of that article, however, it is not enough for the European Communities to demonstrate a decline in relative market share; rather, the European Communities must demonstrate that "the effect of the subsidy is to displace or impede the imports" of an EC-origin "like product" into the Indonesian market, i.e., that some imports that would have occurred did not occur as a result of the subsidies. While declining market share may be relevant to establishing such a situation, we consider that we must proceed further with the analysis and look at actual sales figures for the products in question.

14.216 In spite of their declines in market share, the absolute volume of sales of the relevant EC models did not significantly decline after the introduction of the Timor. Rather, sales of C Segment vehicles from the EC were 419 units in 1995 and 1,445 units in 1996. For 1997 we have full data from the Annex V process on the C Segment only for January - May, and this shows EC sales of 611 units, which amounts to 1,466 units on an annualized basis. We also have sales figures for the Optima (257 units) and 306 (656 units) for the period January - August 1997 from the European Communities. These figures, totalled and annualized, show sales of 1,370 units for 1997. On a quarterly basis, sales of the Optima and 306 remained relatively constant during the period from the fourth quarter of 1996 through May 1997 at between 300 and 400 units per quarter<sup>750</sup>.

14.217 The explanation for the loss of market share with no decline in absolute sales volume is that the size of the Indonesian market expanded after the introduction of the Timor. What is particularly relevant here is that the increase in the size of the market was largely attributable to sales of the Timor. In particular, between the third and fourth quarters of 1996, the market for C Segment cars increased by 6,326 units, of which the Timor accounted for 4,278 units (68 %). A similar pattern was evident during the first five months of 1997. Thus, relatively stable EC sales volumes in a rapidly expanding market resulted in market share declines but not in declines in absolute volumes.

14.218 We agree with the European Communities that a complainant need not demonstrate a decline in sales in order to demonstrate displacement or impedance. This is inherent in the ordinary meaning of those terms. Thus, displacement relates to a situation where sales volume has

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<sup>749</sup> Assuming that the eight months of post-Timor data were considered to be "an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned" within the meaning of Article 6.4.

<sup>750</sup> In fact, the quarterly figure for the partial second quarter, if it continued for the rest of the quarter, would actually be 423 units, the highest quarter in the period 1995-second quarter 1997. Treating the period June-August as a quarter, EC C Segment sales amounted to 302 units.

declined, while impedance relates to a situation where sales which otherwise would have occurred were impeded. The question before us is therefore whether the market share and sales data above would support a view that, but for the introduction of the subsidized Timor, sales of EC C Segment passenger cars would have been greater than they were.

14.219 In a usual case, a decline in market share in a stable or growing market, corresponding in time with the introduction of a subsidized product, might suggest that sales would have been higher but for the introduction of the subsidized product. This would be particularly the case where, in the period prior to the introduction of the subsidized product, the market share of the non-subsidized product had been rising. In this case, however, Indonesia contends that the introduction of the subsidized Timor was itself responsible for the rapid expansion of the market through the introduction of a new, highly affordable passenger car within the reach of first-time buyers. While the European Communities dismisses this argument as "purely speculative," the sales data in terms of volume of sales discussed above provide some support for this view. Thus, one possible interpretation of the data is that, if the subsidized Timor had not been introduced, the Indonesian C Segment market would have remained relatively stable or in any event would have posted during the last quarter of 1996 and the first eight months of 1997 more gradual increases, comparable to those experienced during the period between the first quarter of 1995 and the second quarter of 1996.

14.220 Assuming that, had the subsidized Timor not been introduced, the Indonesian C Segment market would have remained stable or grown at a more moderate rate during the period for which we have data, the question is whether sales of EC C Segment models in absolute terms would have been higher than those actually achieved. Here, the data are inconclusive. While the European Communities contend that its market share had been steadily increasing and that this trend would have continued but for the introduction of the subsidized Timor, actual sales consisted of only two models, the Optima and 306.<sup>751</sup> As Table 2 shows, quarterly sales data for the Optima do not demonstrate any clear upward trend in the six quarters prior to the introduction of the subsidized Timor.<sup>752</sup> Rather, the increase in EC sales was a result of the introduction of the 306 in the first quarter of 1996. While the European Communities state that 1996 sales of the 306 (1,086 units) were 400 units lower than planned, we have no knowledge of the basis for those sales forecasts. Sales of the 306 for partial year 1997 were at an annualized rate of between 984 units (January - August data) and 1,070 units (January to May data), down slightly from the annualized rate in the first half of 1996 of 1,214 units.<sup>753</sup> Thus, if we assume that in the absence of the Timor the market would have remained stable or continued a more gradual increase through August 1997,<sup>754</sup> and that the 306 would have maintained the market share it had achieved in the first half of 1996, these sales might have been expected to increase at most slightly. Such a conclusion is, in any event, highly speculative based on the facts available.<sup>755</sup>

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<sup>751</sup> The European Communities pointed in its submissions to the rapid growth in its overall share of the Indonesian passenger car market from 1993 (9.9 per cent) to 1995 (23.72 per cent). However, this rapid growth in market share, which reflects EC gains in high-end vehicles such as Mercedes and BMW, is not relevant to displacement or impedance of "like products" to the Timor.

<sup>752</sup> It is possible that Optima sales would have increased upon the introduction of a new model. We discuss Opel's plans to introduce a new model of the Optima in paragraphs 14.228 to 14.232 *infra*.

<sup>753</sup> The European Communities have stated that Opel has not ordered any new CKD Optimas since June 1996, although assembly of Optimas (presumably from inventory) continues.

<sup>754</sup> We note that the Indonesian economy entered a period of serious difficulties beginning in the late summer of 1997. Thus, we must treat the European Communities' figures for January-August 1997 cautiously, particularly in the absence of any overall figures for the Indonesian market after May 1997.

<sup>755</sup> Sales of the 306 actually climbed slightly from the third quarter (229 units) to the fourth quarter (250 units) of 1996, after the introduction of the Timor. It seems likely, however, that -- as argued by the

14.221 Finally, we note the limitations inherent in the data before us. Full information about sales in the C Segment of the Indonesian market is only available through May 1997, i.e., for less than three quarters after the introduction of the Timor. Additional information regarding sales of the Optima and 306 through August 1997 cannot be placed in the context of the overall market situation. Further, the volume of sales of the EC models in question is small, to the point where the statistical significance of the changes in volume may be questioned. We note, for instance, that the sales volume for the Optima in 1995 (a year not affected by the subsidized Timor) jumped from 36 units in the first quarter to 186 units in the second quarter before dropping to 98 and 99 units in the third and fourth quarters respectively.

14.222 In short, the dramatic fall in EC market share in the C Segment is not in this case decisive evidence of displacement or impedance, as the data lend some credence to the Indonesian view that the introduction of the subsidized Timor actually created much of the market growth. Thus, we are required to speculate as to how the market would have performed in the absence of the introduction of the Timor, and as to the share of the market which EC models could have been expected to obtain in that hypothetical situation. It is quite possible that the Indonesian market would have remained stable or increased somewhat in late 1996 and early 1997, even without the introduction of the subsidized Timor, and that EC models would have at least maintained their market share, such that EC sales would have increased slightly. This conclusion is however highly tentative, and does not in our view satisfy the requirement, in the present case, that serious prejudice be demonstrated by positive evidence.

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United States -- the market as a whole in the third quarter was depressed in anticipation of the introduction of the Timor. Thus, third quarter 1996 data may not be reliable.

Table 1

Analysis of Market Share for "C" Class Automobiles in Indonesia  
By Year

(Units)

Model	1995	1996	Jan-May 1997	Jan-August 1997
Toyota Corolla/Corona	8,415	7,116	2,537	N/A
Honda City/Civic	2,358	4,112	2,317	N/A
Nissan Sunny/Sentra	960	1,686	864	N/A
Ford Laser	2,814	3,597	1,720	N/A
Mitsubishi Lancer	1,597	1,360	149	N/A
Mazda 323/MR 90	868	597	80	N/A
Bimantara Cakra*	0	1,058	1,012	N/A
Daewoo Nexia*	0	20	305	N/A
Opel Optima	419	359	165	257
Peugeot 306	0	1,086	446	656
Timor*	0	4,278	7,058	N/A
Total	17,431	25,269	16,653	N/A
European models: Quantity	419	1,445	611	913
Market share	2.4%	5.7%	3.7%	N/A
Timor: Market share	0%	16.9%	42.4%	N/A

N/A Not available

\*The DRI sales figures, on the basis of which the "C" class models were identified, refer to the Bimantara Cakra as the Hyundai Accent, to the Daewoo Nexia as the Daewoo Cielo, and to the Timor as the Kia Sephia.

Source: AV/3, attachment A-39/1-B, except January-August data, which were provided by the European Communities

Table 2  
Analysis of Market Share for "C" Class Automobiles in Indonesia  
Quarterly

(Units)

Mfr/Model	1995				1996				1997		
	I	II	III	IV	I	II	III	IV	I	II (April- May)	III (June- August)
Toyota Corolla/Corona	2,093	2,451	2,044	1,827	2,405	1,687	1,420	1,604	1,448	1,089	N/A
Honda City/Civic	703	566	440	649	1,209	1,477	522	904	1,767	550	N/A
Nissan Sunny/Sentra	0	223	233	504	233	307	646	500	561	303	N/A
Ford Laser	0	748	799	1,267	611	1,179	759	1,048	951	769	N/A
Mitsubishi Lancer	543	204	421	429	100	357	231	672	75	74	N/A
Mazda 323/MR 90	54	107	322	385	181	183	147	86	69	11	N/A
Bimantara Cakra*	0	0	0	0	0	0	89	969	709	303	N/A
Daewoo Nexia*	0	0	0	0	0	0	0	20	163	142	N/A
Opel Optima	36	186	98	99	74	57	95	133	87	78	92
Peugeot 306	0	0	0	0	275	332	229	250	242	204	210
Timor	0	0	0	0	0	0	0	4,278	3,848	3,210	N/A
Total	3,429	4,485	4,357	5,160	5,088	5,579	4,138	10,464	9,920	6,733	N/A
European models: Quantity	36	186	98	99	349	389	324	383	329	282	302
Market share	1.1%	4.2%	2.2%	1.9%	6.9%	7.0%	7.8%	3.7%	3.3%	4.2%	N/A
Timor: Market share	0	0	0	0	0	0	0	40.9%	38.8%	47.7%	N/A

N/A - Not available.

\*The DRI sales figures, on the basis of which the "C" class models were identified, refer to the Bimantara Cakra as the Hyundai Accent, to the Daewoo Nexia as the Daewoo Cielo, and to the Timor as the Kia Sephia.

Source: .... AV/3, attachment A-39/1-B, except June-August 1997 data, which were provided by the European Communities.

(b) Non-introduction of New Models

14.223 The complainants' arguments of displacement and impedance are not limited to the effects of the subsidies provided pursuant to the National Car programme on models currently sold in Indonesia. Rather a key element of their arguments would appear to be that, but for those subsidies, they would have proceeded with plans to introduce new C Segment models, thereby increasing their sales and exports of passenger cars like the Timor to the Indonesian market. Specifically, the complainants contend that, but for the National Car programme, the Escort and Neon would have been introduced to the Indonesian market. It is further claimed that a new model of the Optima would have been introduced.

14.224 As previously noted, we consider that displacement and impedance may exist not only where there has been a decline in sales, but also where it is demonstrated that, in the absence of a subsidy, sales would have increased. Of course, the complainants have the burden to demonstrate their serious prejudice claim by positive evidence. With this in mind, let us examine the information presented by the complainants in support of these contentions.

(i) EC-Origin Model

14.225 The complainants have argued that Ford would have introduced the EC-origin Escort in the Indonesian market but for the subsidies provided under the National Car programme to the Timor. Specifically the European Communities have alleged that, "[a]t the time the National Car programme was adopted, Ford was about to start importing CKD Escorts made at its plant in Saarlouis (Germany)." Both the European Communities and the United States have stated that Ford had already committed US\$1 million to the Escort programme. The source for these statements would appear to be a joint letter from GM and Ford to the US Trade Representative, dated 27 November 1996.<sup>756</sup> This letter indicates that the US\$1 million commitment "included production and assembly equipment, tooling, component parts and engineering, all of which were in Indonesia prior to the National Vehicle programme." It further indicates that Ford had "an approved investment plan of \$US56.0 million with the feasibility of future investment in assembly to be determined based upon the needs of the market and manufacturing requirements," and that "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% by the fourth year." The European Communities indicated that, under a 1995 business plan, Ford would have exported substantial quantities of CKD Escorts to Indonesia,<sup>757</sup> while the joint letter indicated projected sales of 15,100 Escorts in the first four years.<sup>758</sup>

<sup>756</sup> See paragraph 8.298 of the Descriptive Part.

<sup>757</sup> The European Communities contend that, according to a business plan adopted in 1995, Ford would have exported to Indonesia the following quantities of CKD Escorts:

1996	1,323	1997	3,468	1998	5,156	1999	7,370	2000	12,026	2001	13,867
2002	16,026	2003	18,433								

<sup>758</sup> The joint letter also makes a variety of broader statements regarding Ford's commitment to the Indonesian market. However, in light of evidence in the record suggesting that Ford sources its Indonesian products in a number of countries, including Japan, these more general claims are of limited value to a specific assessment of whether EC-origin like products to the Timor would have been sold in the Indonesian market.

14.226 The complainants have also alleged the existence of plans to replace the existing Optima with a new model. The European Communities state that Opel had "advanced plans" to expand and upgrade its assembly facilities in Indonesia, including the introduction of a new model of the Optima, while the United States states that GM "was considering investing in plant expansion, and had approval to bring in new models of the Opel Optima and Opel Vectra." The United States asserts that, while the precise figures are confidential, GM's business plan called for sales of Optimas and Vectras "in excess of 1,000 cars in 1996 and around 3,000 cars in 1997, with progressive increases in subsequent years." The joint letter discussed above contains similar information. The parties have not informed the Panel what portion of these planned sales would have been of the Optima.

14.227 In the context of a claim of serious prejudice arising from displacement or impedance, we must review the above information with an eye to whether it demonstrates that (i) there were concrete plans to increase sales of EC-origin passenger cars to the Indonesian market through the introduction of new models; and that (ii) the new models were not introduced because of the subsidies pursuant to the National Car programme.

14.228 Several factual elements have been alleged which could support the European Communities' assertions regarding the existence of concrete plans to introduce the Escort into Indonesia. We note the European Communities' statement that there was an "approved plan" to invest \$US56 million for assembly of the Escort in Indonesia. Clearly, such information could be highly relevant to our analysis. The factual information before us with respect to such a plan is, however, extremely limited, and supporting documentation non-existent. Thus, we do not know, for instance, by whom and at what level this plan was "approved."<sup>759</sup> Similarly, the fact that Ford projected substantial sales of the Escort in Indonesia could be highly relevant, but we know nothing about the bases for the projections. Under these circumstances, it is difficult for the Panel to judge the weight to be given to these factors. The concreteness of Ford's plans is to some extent confirmed by the statement of the European Communities that Ford had already spent US\$1 million to acquire production equipment which was already in Indonesia; such a commitment of resources suggests the Ford had moved beyond mere consideration of the Escort project and was in the process of implementation.<sup>760</sup> With respect to the reasons why Ford abandoned its plans to introduce the Escort into Indonesia, however, no direct evidence has been presented by the complainants. The United States cites Ford estimates that, if it had introduced the Escort in the Indonesian market, the Timor would have undercut the price of the least expensive version by at least US\$5000. We have no basis to judge, however, whether this assessment had been made at the time Ford abandoned its project nor whether it represented the basis for the abandonment of those plans.

14.229 With respect to the Optima, there is even less factual evidence to support the European Communities' assertions than with respect to the Escort. Basically, the complainants are asking the Panel to conclude that the new model of the Optima would have been introduced but for the National Car programme on the basis of a statement regarding the existence of "advanced plans" and a statement that GM had approval to bring in the new model of the Optima. While this type of information could be highly relevant to the issue, the Panel again lacks any detailed evidence. We

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<sup>759</sup> The plan apparently was not "approved" by the Government of Indonesia, as Indonesia has stated that Ford "did not submit a single application for approval of the development of passenger car production or assembly facilities in Indonesia during the period 1993 to the present." See paragraph 8.357 of the Descriptive Part.

<sup>760</sup> Indonesia does not challenge that this is a factually correct statement. It does, however, seek to discount the significance of the amount involved in light of Ford's size and huge global sales volume.

have been presented with virtually no information about these "advanced plans," e.g., whether a final decision had been taken within GM management and whether funds had been committed. With respect to the question of approval to bring in the Optima, we assume that this means approval by the Government of Indonesia, but we have no further information. Regarding the reasons why these plans were abandoned, again we have no evidence beyond the statements of company representatives in the joint letter and in newspaper articles.<sup>761</sup>

(ii) US-Origin Models

14.230 The only US-origin model which the United States has alleged would have been sold in the Indonesian market but for subsidies provided pursuant to the National Car programme is the Neon. The following represents the argument and record before the Panel with respect to that allegation.

14.231 The United States stated in its first submission that, prior to the introduction of the National Car programme, Chrysler assembled Jeeps in Indonesia, and that Chrysler "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." Its cited sources for this statement were articles in two publications,<sup>762</sup> which contain no further information beyond that found in the US submission. In its second submission, the United States repeated 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." In its response to a question from the Panel, the United States stated that "the Chrysler Neons would have been sourced from the United States; specifically, from Chrysler's plant in the state of Illinois." The United States indicated in its oral statement at the Panel's second meeting that "Chrysler's plan called for 1,000 - 2,000 Neons in 1997", and in response to a question from the Panel indicated that, "[a]ccording 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." Finally, the United States at the second meeting submitted as an exhibit a letter from Chrysler dated 19 December 1997 stating that, "[a]s noted in the attachment, announcement of the National Motor Vehicle Programme rendered non-viable Chrysler plans for additional investment in Indonesia." The full text of that attachment is as follows:

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.

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<sup>761</sup> The European Communities attaches as an exhibit in support of this statement an article in the Financial Times, GM Halts Indonesia Move Over National Car Policy (date illegible). That article quotes a GM official extensively regarding plans to halt new investments as a result of the National Car programme; however, it states that the official "did not indicate the scale or nature of the expansion being put on hold."

<sup>762</sup> See paragraph 8.300 of the Descriptive Part.

- 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.

14.232 The evidence before the Panel regarding the intention to introduce the Neon to the Indonesian market is in our view extremely limited. We are told that Chrysler was "studying" an assembly joint venture to assemble the Neon in Indonesia, but we have no basis to judge how concrete those plans were.<sup>763</sup> With respect to the reason why those plans were cancelled, we are presented with no supporting argumentation or evidence beyond the bald statements of the United States and of Chrysler.

(iii) Assessment

14.233 The Panel notes certain factual elements which indicate the existence of plans to introduce the Escort, a new model of the Optima and the Neon to the Indonesian market. This information, if properly developed and documented, might have been highly probative. However, the evidence is very general, and supporting documentation, with the exception of newspaper reports and letters prepared by GM, Ford and Chrysler for the purpose of this dispute, is non-existent. This makes it very difficult for the panel to assess the degree of commitment of the companies to the plans, much less the reasons why those plans were abandoned.<sup>764</sup>

14.234 We do not mean to suggest that in WTO dispute settlement there are any rigid evidentiary rules regarding the admissibility of newspaper reports or the need to demonstrate factual assertions through contemporaneous source information. However, we are concerned that the complainants are asking us to resolve core issues relating to adverse trade effects on the basis of little more than general assertions. This situation is particularly disturbing, given that the affected companies certainly had at their disposal copious evidence in support of the claims of the complainants, such as the actual business plans relating to the new models, government documentation indicating approval for such plans (assuming the "approval" referred to by the complainants with respect to the Optima means approval by the Indonesian government), and corporate minutes or internal

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<sup>763</sup> As with respect to Ford, Indonesia states that Chrysler had not applied for approval to develop passenger car production or manufacturing facilities since 1993.

<sup>764</sup> Indonesia offered a variety of explanations why in its view Chrysler, Ford and GM did not proceed with their plans to introduce new models into the Indonesian market. These included the small size and dominance of Japanese manufacturers in that market; inadequate return on investment resulting from low profit margins on entry-level cars; and more attractive investment incentives in other Asian countries. In the absence of adequate evidence from the complainants, the Panel lacks a factual basis to accept or reject these alternative explanations.

decision memoranda relating both to the initial approval, and the subsequent abandonment, of the plans in question.<sup>765</sup>

14.235 We note the United States' stated concern for the confidentiality of company business plans. However, an invitation by the Panel for proposals to ensure adequate protection of such information was not taken up.<sup>766</sup> While complainants cannot be required to submit confidential business information to WTO dispute settlement panels, neither may they invoke confidentiality as a basis for their failure to submit the positive evidence required, in the present case, to demonstrate serious prejudice under the SCM Agreement.

(c) Conclusion

14.236 In the view of the Panel, neither the European Communities nor the United States has demonstrated by positive evidence that the effect of subsidies to the Timor pursuant to the National Car programme has been to displace or impede imports of like passenger cars from the Indonesian market within the meaning of Article 6.3(a) of the SCM Agreement.

6. Price Undercutting

14.237 In addition to arguing that serious prejudice has been caused to their interests through displacement or impedance of their exports to Indonesia, the complainants assert that the subsidized Timor significantly undercuts the prices of EC and US like products in the Indonesian market.

14.238 In determining whether serious prejudice within the meaning of Article 5(c) arises from price undercutting, we must first consider Article 6.3(c) of the SCM Agreement. That provision states that

"serious prejudice in the sense of paragraph 5(c) may arise in any case where one or several of the following apply:

.....

(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;

.....

Further elaboration on the application of Article 6.3(c) is provided in Article 6.5 of the SCM Agreement, which provides as follows:

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

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<sup>765</sup> For example, if Ford and Chrysler in fact abandoned their plans to introduce the Escort and Neon after determining that the Timor would undercut the prices of those models by US\$5000, contemporaneous company documents reflecting this assessment could have been submitted and might have been highly probative.

<sup>766</sup> See paragraphs 14.5 to 14.8, supra.

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.

(a) United States

14.239 As noted in paragraph 14.213, no U.S.-origin passenger car that is a "like product" to the subsidized Timor currently is sold in Indonesia. In the absence of any such sales in the Indonesian market, the United States by definition cannot demonstrate that the effect of the subsidies provided pursuant to the National Car programme was a significant price undercutting by the subsidized product as compared with the price of a like product of the United States in the Indonesian market. In any event, we note that the United States did not present any information regarding the price at which the Neon, the sole US-origin passenger car allegedly planned for sale in Indonesia, would have been sold in that market. Rather, the United States merely made the unsubstantiated statement that, if Chrysler had gone ahead with its plans to sell the Neon in Indonesia, the Timor would have undercut the price of the least expensive model of the Neon by more than US\$5000. We do not consider that such a conclusory statement, unbacked by any supporting explanation, calculations or documentation, is sufficient to meet the United States' burden to demonstrate the existence of a significant price undercutting by positive evidence.

14.240 For the foregoing reasons, we find that the United States has not demonstrated through positive evidence that the effect of the subsidies to the Timor pursuant to the National Car programme was to cause serious prejudice to the interests of the United States through a significant price undercutting as compared with the price of US-origin like products in the Indonesian market.

(b) European Communities

14.241 We now turn to the EC argument that the prices of the subsidized National Cars significantly undercut the prices of like passenger cars imported from the European Communities. In support of their price undercutting arguments, the European Communities rely on data regarding the list and market prices for passenger cars sold in Indonesia which show that the Timor has both a list and a market price which are much lower than the list and market prices for the 306 and the Optima, which we have determined to be like products (of another Member) to the Timor.

14.242 With respect to list prices, data submitted by Indonesia during the Annex V process show that the Timor had the lowest list price of any passenger car in the Indonesian market except the Mazda MR-90 as of November 1996 and March 1997. As shown in Table 3, the list prices for the Timor (ranging from 33 million rupiahs for the S-515 to 36.9 million rupiahs for the S-515i Metallic) were far lower than that of the Optima (70 million rupiahs) and the lowest-priced model of the 306 (59.5 million rupiahs).<sup>767</sup>

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<sup>767</sup> See paragraphs 8.384 to 8.387 of the Descriptive Part.

Table 3  
List Prices  
 (Rupiah)

Model	August 1995	November 1996	March 1997
TIMOR			
S 515 1500 cc Solit	-	33,000,000	33,000,000
S 515 1500 cc Metalic	-	33,500,000	33,500,000
S 515i 1500 cc Solit	-	-	36,400,000
S 515i 1500 cc Metalic	-	-	36,900,000
PEUGEOT			
306 M/T, 1761 cc	-	62,500,000	63,000,000
306 A/T, 1761 cc	-	64,750,000	65,500,000
306 M/T, 1761 cc	-	59,000,000	59,500,000
OPEL			
Optima GLS 1900 cc	65,500,000	69,500,000	70,000,000

14.243 With respect to market prices, the data before the Panel relate only to the last quarter of 1996 and were provided by the European Communities during the Annex V process (see Table 4).<sup>768</sup> These data do not indicate whether the model under consideration is the S-515 or the S-515i. It would appear from the list price information, however, that in November 1996 the Timor S-515i was not yet available in the Indonesian market, and it thus seems probable that the price identified for the Timor is for the S-515. The data show that the Timor's market price was the same as its list price, while the Optima and 306 both sold at a discount from list price. Even after those discounts, however, the Timor S-515 had a price advantage of 27.25 million rupiahs over the model of the 306 for which we have market price information and of 23.25 million rupiahs over the lowest-price model of the Optima.

<sup>768</sup> See paragraphs 8.289-8.290 of the Descriptive Part.

Table 4  
List and Market Prices  
(Fourth Quarter 1996; Rupiah)

Model	List price	Market price
Kia Timor	35,750,000	35,750,000
Peugeot 306 PST	64,000,000	63,000,000
Opel Optima GLS	69,500,000	59,000,000
Opel Optima CDX	74,000,000	62,000,000
Opel Optima CDX - A-Bag	76,000,000	64,000,000

14.244 Article 6.5 of the SCM Agreement requires that, when performing an analysis of price undercutting under Article 6.3(c), "[t]he comparison [of prices] shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability." In this case, the 306 and Optima are imported in CKD form, and if the prices of these CKD cars were compared to prices of finished Timors, the difference between the assembled and unassembled cars clearly would be a factor affecting price comparability. Further, to the extent that there are transaction prices for the CKD cars, these would presumably be at a different level of trade than the retail prices for the finished Timor. These potential problems of comparability do not arise in the price comparisons proposed by the European Communities, however, as the prices they propose for comparison are retail prices for finished 306s, Optimas and Timors. It would appear that the prices are in fact at the same level of trade and at comparable times, and Indonesia has raised no concern in this regard. Rather, the key issue with respect to this claim would appear to be whether the European Communities have taken due account of other factors affecting price comparability.

14.245 Indonesia argues that Article 6.5, taken in conjunction with the positive evidence standard set forth in Article 27.8, means that the European Communities have the burden of quantifying and making appropriate price adjustments for the physical characteristics and consumer preferences and perceptions that distinguish the Timor from the Optima and the 306. Indonesia submitted a table identifying specific physical differences between the three models. In addition, it submitted a second table listing various physical and non-physical characteristics (power, technology, comfort, safety, workmanship, brand image) and rating the three models with respect to the characteristics on a scale of L (low) through H2 (high). In Indonesia's view, the Timor ranked low in all these regards, while the Optima and the 306 ranked medium or medium-high.<sup>769</sup> In Indonesia's view, the European Communities have failed to meet their burden with respect to adjustments for these differences and accordingly have failed to demonstrate the existence of a significant price undercutting through apples-to-apples comparisons. The European Communities argue that there are no relevant physical differences which may affect significantly price comparability and state that there are no physical or other product differences, or any other factor, that could account for the 43-52% price undercutting which they allege to exist.

14.246 In examining the arguments of the parties, we first turn to the issue of identifiable physical differences between the Timor, the Optima and the 306. The record in this dispute includes

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<sup>769</sup> See paragraphs 8.221 to 8.225 of the Descriptive Part.

extensive information about the physical characteristics of the models in question,<sup>770</sup> and this information reflects a variety of potentially significant differences in physical characteristics between the models. These include differences between the Timor and one or both of the other models in terms of the size, features and power of the engines; tyre size; safety features (ABS, airbags); and extra features (alarm system, rear folding seats, interior trim). While these differences are not sufficient to render the three models unlike, they must clearly affect price comparability to some extent.

14.247 Given that the existence of these physical differences is clear from the record, and that the burden in this case is on the complainants to demonstrate the existence of serious prejudice by positive evidence, it would have greatly facilitated the work of the Panel had the European Communities made some effort to quantify the impact of these differences on price comparability. We specifically requested the European Communities to identify any differences, including differences in physical characteristics, that could affect price comparability, and to explain how allowance should be made with respect to them.<sup>771</sup> Their failure to respond in detail to this request has resulted in a thin record with respect to this issue, and in a closer case where the degree of the price differential was not so large might well have been fatal to their claim.

14.248 Nevertheless, the information on the record in this dispute does allow us to take account of some of the salient physical differences between the three models. In this respect, we first note that the seemingly most significant difference between the Timor on the one hand and the Optima and the 306 on the other is engine size. Specifically, the Timor's engine is 263cc smaller than that of the 306 and 298cc smaller than that of the Optima. The European Communities have argued, the record confirms, and Indonesia has not contested, however, that any potential advantage of the Optima and the 306 over the S-515 in terms of power due to their larger engine size was compensated for by the introduction of a sixteen-valve, dual overhead cam injection engine in the S-515i; in fact, the S-515i's engine generates more power than that of either the Optima or the 306. As indicated above, only list price (and not market price) information is available with respect to the Timor S-515i. However, we note that the difference in the list prices of the S-515 and 515i provides an indication of the possible difference in market prices of the two models. In particular, the difference in list price between the S-515 (which is equipped with an engine less powerful than those of the Optima and 306) and the S-515i (which, as previously noted, is equipped with an

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<sup>770</sup> See Section VIII.B.3 of the Descriptive Part.

<sup>771</sup> At its first meeting with the parties, the Panel asked the parties the following question:

In its first submission, the EC states that the Timor S-515 significantly undercut the prices of the closest EC models, the Peugeot 306 and Opel Optima. . . . Article 6.5 of the SCM Agreement states that, when performing a price comparison, "due account shall be taken of any other factor affecting price comparability." Are there factors that affect price comparability? Specifically, are there any differences between the models which must be taken into account when comparing these prices? If so, please identify these factors, and explain in detail how these factors should be taken into account when performing the price comparison.

The European Communities responded that:

The EC 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 one hand, the Opel Optima and 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%.

engine more powerful than those of the Optima and the 306) was 3.9 million rupiahs in March 1997. Thus, by adjusting the market price for the Timor S-515 upward by this difference in list prices between the S-515 and S-515i, we can take account of the differences between the Timor S-515, the Optima and the 306 with respect to engine power.

14.249 Indonesia notes that the Timor does not come equipped with airbags, while one model of the Optima does. With respect to this feature, however, we know from price list information provided by Indonesia that the Optima CDX with airbag costs two million rupiahs more than the same model without an airbag, and that the Optima GLS does not come equipped with an airbag at all; thus, we can also discount for this physical difference by restricting our comparison to the price of the Optima GLS, which does not come equipped with an airbag.

14.250 What of the remaining physical differences? Although the record is conflicting, it would appear that some models of the Optima and the 306 may have ABS (anti-skid braking system), while the Timor S-515i does not. The Optima comes equipped with an alarm system, while the Timor S-515i does not. The fuel tanks of the Optima and 306 are slightly larger than those of the Timor S-515i. The rear seats of the Optima and the 306 fold down, while that of the Timor S-515i does not. The Optima and the 306 have larger tires than the Timor S-515i. The Timor S-515i has cloth seats, while the Optima has velour seats and one model of the 306 has leather seats. Some versions of the Optima and the 306 have light alloy wheels, while that is an option for the Timor S-515i. The Optima has "additional headlamps", while the Timor S-515i does not.

14.251 These foregoing differences, for which the European Communities have not made allowance in their price comparisons, are not insignificant, and it seems clear to us that consumers would be willing to pay a premium for some of them at least. However, we note that the United States has identified and sought to place a value on a number of features of the S-515i (such as tilt steering, mud flaps, colour key bumpers, and colour key/foldable mirrors) which the Optima at least lacks, and which may to some extent offset the value of some of the features of the Optima. More fundamentally, looking specifically at the November 1996 market prices for the Timor S-515, the Optima and the 306, and even after adding 3.9 million rupiahs to the price of the Timor S-515 to account for the differences in engine power between that model and the S-515i, the price of the Timor undercuts the price of the least expensive Optima (without airbag) by 19.35 million rupiahs (33 per cent)<sup>772</sup> and undercuts the price of the 306 by 23.35 million rupiahs (37 per cent)<sup>773</sup>. While the physical differences between the Timor, the Optima and the 306 for which we have not been able to make due allowance clearly would affect their prices, we agree with the European Communities that the differences identified in the preceding paragraph could not possibly account for these enormous differences in price.

14.252 This is confirmed by the fact that, according to price data submitted by Indonesia, the Timor not only is priced lower than the C Segment Optima and the 306, but in March 1997 had a list price in the Indonesian market<sup>774</sup> that was also significantly lower than the list prices of such B Segment cars as the Toyota Starlet (48.1 million rupiahs) and the Suzuki Baleno (44.75 million rupiahs). A comparison of the physical characteristics of the Timor S-515 with those of the Starlet

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<sup>772</sup> Market price of Optima GLS (59 million rupiahs) [minus] market price of Timor S-515 (35.75 million rupiahs) [plus] the difference between list price of Timor S-515 Solit and Timor S-515i Metallic (3.9 million rupiahs) [equals] 19.35 million rupiahs.

<sup>773</sup> Market price of the 306 PST (63 million rupiahs) [minus] market price of Timor S-515 (35.75 million rupiahs) [plus] the difference between list price of Timor S-515 Solit and Timor S-515i Metallic (3.9 million rupiahs) [equals] 23.35 million rupiahs.

<sup>774</sup> 33 million rupiahs for the S-515i Solit, 36.9 million rupiahs for the S-515i Metallic.

is particularly instructive. The Starlet is a lesser car than the Timor S-515 in almost every respect, including length (3.72 metres for the Starlet, 4.36 metres for the Timor); weight (725 kg for the Starlet, 1,055 kg for the Timor); engine size (1,296 cc for the Starlet, 1,498 cc for the Timor); and engine power (53 kw/6,200 rpm for the Starlet, 58 kw/5,500 for the Timor S-515, 77 kw/5500 rpm for the Timor S-515i). Like the Timor, the Starlet lacks ABS and airbags. Yet the list price of the top-of-the-line Timor S-515i is 11.2 million rupiahs less than that of the Starlet.

14.253 Indonesia also argues the existence of numerous non-physical differences between the Timor, the Optima and the 306. We note, however, that while the record clearly demonstrates the existence of differences in physical characteristics between the models in question, Indonesia has presented little if any evidentiary support for their proposition concerning non-physical differences (such as brand image or after-sales service) between the models. While we agree with Indonesia that the European Communities bear the burden of proof to demonstrate the existence of all elements of their serious prejudice claim, including the existence of price undercutting, the record does not show that there are any significant non-physical differences for which due allowance must be made, much less any differences that could account for the extent of the differences in price between the Timor, the Optima and the 306.

14.254 We note that under Article 6.3(c) serious prejudice may arise only where the price undercutting is "significant." Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice. This clearly is not an issue here. To the contrary, it is our view that, even taking into account the possible effects of these physical differences on price comparability, the price undercutting by the Timor of the Optima and 306 cannot reasonably be deemed to be other than significant.

14.255 Finally, we note that serious prejudice may arise under Article 6.3(c) only where the price undercutting is "the effect of the subsidy." In this case, we agree with the European Communities that Indonesia, in information that it provided in the Annex V process effectively concedes that the tariff and tax subsidies under the National Car programme are responsible for the significant level of price undercutting. The table cited by the European Communities contains data for 1998 and 1999 regarding the Timor S515i that will be assembled at the Karawang facility. Row 4 of that table (Unit Dealer Price) indicates that the effect of the tariff and tax subsidies of the National Car programme is to lower the price of the Timor S-515i by US\$7,243-9,158, i.e., by approximately 33-38 per cent.<sup>775</sup>

14.256 For the foregoing reasons, we find that the effect of the subsidies to the Timor pursuant to the National Car programme is to cause serious prejudice to the interests of the European Communities in the sense of Article 5(c) of the SCM Agreement through a significant price undercutting as compared with the price of EC-origin like products in the Indonesian market.

## 7. Threat of Serious Prejudice

14.257 The European Communities argue that, if the Panel were to find that the evidence did not warrant a finding of actual serious prejudice, the facts support a finding that subsidies provided pursuant to the National Car programme pose a threat of serious prejudice to the interests of the European Communities. In light of our affirmative finding of actual serious prejudice, it is not necessary to reach this alternative claim.

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<sup>775</sup> See paragraphs 8.395 and 8.408 of the Descriptive Part.

I. Claims under Article 28 of the SCM Agreement

14.258 Finally, we turn to the United States' claim under Article 28 of the SCM Agreement. The United States argues that, via Decree No. 223/1995, Decree No. 82/1996, and Regulation No. 36/1996, Indonesia has extended the scope of its local content-based tariff and tax subsidies for certain motor vehicles in violation of Article 28.2. Indonesia responds that Article 28.2 applies only to subsidies that are "inconsistent" with the SCM Agreement, and since Article 27.3 of the SCM Agreement exempts Indonesia's local content subsidies from the prohibition that would otherwise apply under Article 3.1(b), these subsidies are not "inconsistent" with the Agreement and thus not subject to Article 28.

14.259 Article 28 of the Agreement provides as follows:

Existing Programmes

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).

14.260 Article 28.1 of the SCM Agreement specifies that subsidy programmes which are "inconsistent with the provisions of this Agreement" must be notified to the Committee within 90 days after the date of entry into force of the WTO Agreement for the Member and brought into conformity with the provisions of the SCM Agreement within three years of that date. Article 28.2 specifies that no Member shall extend the scope of "any such programme." In our view, this reference to "any such programme" can only refer back to the types of programmes identified in Article 28.1. Accordingly, the question we must address is whether Indonesia has extended the scope of a subsidy programme which is "inconsistent" with the provisions of the SCM Agreement.

14.261 We consider that the ordinary meaning of the term "inconsistent with the provisions of this Agreement", when read in its context, cannot reasonably be considered to extend to the Indonesian subsidy programmes under review in this dispute. The United States concedes that, under Article 27.3 of the SCM Agreement, the prohibition of paragraph 3.1(b) of the SCM Agreement does not apply to the Indonesian programmes for a period of five years from the date of entry into force of the WTO Agreement, i.e., until the year 2000. The United States contends that the term "inconsistent" is not synonymous with "prohibited", and implies that a subsidy programme may be inconsistent with the provisions of the SCM Agreement if it satisfies the substantive conditions of Article 3, whether or not the Article 3 prohibitions are applicable. In the SCM Agreement, however, the drafters have chosen to express the concept of subsidies meeting the substantive conditions of Article 3 by referring to subsidies "falling under the provisions of Article 3" (See

Article 2.3). If they had intended to express the same concept in Article 28, they could have used comparable language.

14.262 Because we consider that the Indonesian subsidy programmes under review in this dispute are not "inconsistent" with the provisions of the SCM Agreement within the meaning of Article 28, we reject the claims of the United States that Indonesia has extended the scope of certain subsidy measures in violation of Article 28.2 of the SCM Agreement.

J. Claims under the TRIPS Agreement

14.263 As we understand it, the United States is making the following claims:

- Indonesia is in violation of its obligations under Article 3 of the TRIPS Agreement on national treatment because the provisions of its National Car Programme discriminate against nationals of other WTO Members with respect to the acquisition and maintenance of trademarks, and the use of trademarks as specifically addressed in Article 20 of the TRIPS Agreement;
- Indonesia is in violation of its obligations under Article 65.5 of the TRIPS Agreement because provisions of the National Car Programme which were introduced by Indonesia during its transition period under the TRIPS Agreement put special requirements on nationals of other WTO Members in respect of the use of their trademarks which are inconsistent with the provisions of Article 20 of the TRIPS Agreement.

1. Article 3

14.264 Article 3 of the TRIPS Agreement, entitled "National Treatment", reads as follows:

"1. 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<sup>3</sup> of intellectual property, subject to the exceptions already provided in, respectively, the Paris Convention (1967), the Berne Convention (1971), the Rome Convention or the Treaty on Intellectual Property in Respect of Integrated Circuits. In respect of performers, producers of phonogram and broadcasting organizations, this obligation only applies in respect of the rights provided under this Agreement. Any Member availing itself of the possibilities provided in Article 6 of the Berne Convention (1971) or paragraph 1(b) of Article 16 of the Rome Convention shall make a notification as foreseen in those provisions to the Council for TRIPS.

2. Members may avail themselves of the exceptions permitted under paragraph 1 in relation to judicial and administrative procedures, including the designation of an address for service or the appointment of an agent within the jurisdiction of a Member, only where such exceptions are necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of this Agreement and where such practices are not applied in a manner which would constitute a disguised restriction on trade.

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<sup>3</sup>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."

14.265 As mentioned earlier, in regard to matters covered by the expression "protection of intellectual property" in respect of which WTO Members are required to grant national treatment, the United States has made claims in regard to three of the items specified in the footnote, namely "acquisition", "maintenance", and "those matters affecting the use of intellectual property rights specifically addressed in this Agreement", in this case in Article 20.

14.266 As a preliminary point, we note that Indonesia has been under an obligation to apply the provisions of Article 3 since 1 January 1996, Article 3 not benefiting from the additional four years of transition generally provided by Article 65.2 to developing country Members.

(a) Acquisition of trademarks

14.267 According to the United States, Indonesia discriminates against foreign nationals in respect of the acquisition of trademarks, because any trademark that could apply to a "national motor vehicle" must be acquired by an Indonesian company, be that company a joint venture or a wholly-owned Indonesian company.

14.268 The TRIPS Agreement requires WTO Members to provide certain treatment to the nationals of other WTO Members in respect of the protection of their intellectual property. The issue to be examined therefore in regard to the United States' claim relating to the "acquisition" of trademarks is whether, under the Indonesian law and practice which is before us, the treatment accorded to foreign nationals in respect of the acquisition of trademark rights, through the applicable procedures, is less favourable than that accorded to the Indonesian company in the National Car Programme. We do not consider that any evidence has been produced in this case to support such a claim. The facts brought before us do not point to any difference in the applicable law for acquiring trademark rights between that applying to companies of other WTO Members and that applying to the company operating under the National Car Programme. It is true that the cars marketed under the National Car Programme have to bear a trademark belonging to an Indonesian-owned company which has created that trademark, and, therefore, that trademarks owned by United States' and other foreign companies may not be employed for this purpose. While this may give rise to questions regarding the scope for the use of trademarks owned by United States' companies on cars under the National Car Programme, it does not, in our view, pose a problem regarding the acquisition of trademark rights. The fact that only certain signs can be used as trademarks for meeting the relevant qualifications under the National Car Programme, and many others not, does not mean that trademark rights, as stipulated in Indonesian trademark law, cannot be acquired for these other signs in a non-discriminatory manner.

14.269 We therefore find that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the acquisition of trademark rights.

(b) Maintenance of trademarks

14.270 The United States has advanced two arguments as to why, in its view, the Indonesian system discriminates against United States nationals in respect of the maintenance of trademark rights. The first argument is that the Indonesian system puts United States companies in a position

that, if they were successful in becoming a partner in the National Car Programme, they would be unlikely to use in Indonesia the mark normally used ("global" mark) on the vehicle marketed as a "national motor vehicle" in Indonesia, for fear of creating confusion (i.e., confusion resulting from using different marks on the same car), and consequently it was more likely that the "global" mark would be subject to cancellation for non-use in Indonesia.<sup>776</sup>

14.271 We do not accept this argument for the following reasons. First, no evidence has been put forward to refute the Indonesian statement that the system, in requiring a new, albeit Indonesian-owned, trademark to be created, applies equally to pre-existing trademarks owned by Indonesian nationals and foreign nationals. Second, if a foreign company enters into an arrangement with a Pioneer company, it would do so voluntarily, with knowledge of any consequent implications for its ability to maintain pre-existing trademark rights, as indeed the United States itself has acknowledged in its submissions to the Panel (see paragraph 11.32 above).

14.272 The second argument advanced by the United States relating to discrimination in respect of the maintenance of trademark rights is that foreign holders of trademarks in Indonesia are at a de facto disadvantage in meeting use requirements in relation to the Indonesian holder of a trademark satisfying the National Car Programme requirements, because the tariff, internal tax and other benefits to which the Indonesian company is entitled give it a competitive advantage in the marketing of cars bearing trademarks over foreign companies.

14.273 In considering this argument, we note that any customs tariff, subsidy or other governmental measure of support could have a "de facto" effect of giving such an advantage to the beneficiaries of this support. We consider that considerable caution needs to be used in respect of "de facto" based arguments of this sort, because of the danger of reading into a provision obligations which go far beyond the letter of that provision and the objectives of the Agreement. It would not be reasonable to construe the national treatment obligation of the TRIPS Agreement in relation to the maintenance of trademark rights as preventing the grant of tariff, subsidy or other measures of support to national companies on the grounds that this would render the maintenance of trademark rights by foreign companies wishing to export to that market relatively more difficult.

14.274 For the above reasons, we find that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the maintenance of trademark rights.

(c) Use of trademarks as specifically addressed in Article 20

14.275 As is made clear by the footnote to Article 3 of the TRIPS Agreement, the national treatment rule set out in that Article does not apply to use of intellectual property rights generally but only to "those matters affecting the use of intellectual property rights specifically addressed in this Agreement". In putting forward its claim on this point, the United States has developed arguments relating to the use of trademarks specifically addressed by Article 20 of the TRIPS Agreement. It is the first sentence of this Article, which is entitled "Other Requirements", to which the United States has made reference. This sentence reads as follows:

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<sup>776</sup> Many countries provide in their national legislation that failure to use a trademark during a certain period of time (under the TRIPS Agreement a minimum of three years) may lead to the cancellation of the registration of the mark. The purpose is to avoid the trademark register becoming clogged with unused marks. Various provisions of the TRIPS Agreement relate to this matter, notably Article 19.

"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."

14.276 The main issues before us in examining this claim of the United States are therefore: first, is the use of a trademark to which the Indonesian law and practices at issue relates "specifically addressed" by Article 20; and, second, if so, does this aspect of the system discriminate in favour of Indonesian nationals and against those of other WTO Members.

14.277 In taking up the first of these questions, the issue to be considered initially is whether the Indonesian law and practices in question constitute a special requirement that might encumber the use of the trademarks of nationals of other WTO Members in terms of Article 20 of the TRIPS Agreement. The United States has put forward two basic arguments on this question, which are similar to the arguments it has put forward also in regard to the maintenance of trademarks (see paragraphs 14.270 and 14.270 above). The first argument is that a foreign company that enters into an arrangement with a Pioneer company would be encumbered in using the trademark that it used elsewhere for the model that was adopted by the National Car Programme. We do not accept that this argument establishes an inconsistency with the provisions of Article 20, for the reason, as indicated in paragraph 14.271 above, that, if a foreign company enters into an arrangement with a Pioneer company it does so voluntarily and in the knowledge of any consequent implications for its ability to use any pre-existing trademark. In these circumstances, we do not consider the provisions of the National Car Programme as they relate to trademarks can be construed as "requirements", in the sense of Article 20.

14.278 The second United States argument is that non-Indonesian car companies are encumbered in using their trademarks in Indonesia by being put at a competitive disadvantage because the cars produced under the National Car Programme bearing the Indonesian trademark benefit from tariff, subsidy and other benefits flowing from that programme. In regard to this argument, we also feel that the points developed in our earlier discussion of the United States claims regarding the maintenance of trademarks are relevant, in particular in paragraph 14.273 above. Moreover, the United States has not explained to our satisfaction how the ineligibility for benefits accruing under the National Car Programme could constitute "requirements" imposed on foreign trademark holders, in the sense of Article 20 of the TRIPS Agreement.

14.279 For the reasons outlined above, we find that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the use of trademarks specifically addressed in Article 20.

## 2. Article 65.5 in Conjunction with Article 20

14.280 Article 65.5 of the TRIPS Agreement reads as follows:

"5. 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 practice made during that period do not result in a lesser degree of consistency with the provisions of this Agreement."

14.281 The question, therefore, to be examined in considering this claim of the United States is whether during the transitional period to which Indonesia is entitled in respect of the application of

the provisions of Article 20 Indonesia has made any changes in its laws, regulations and practice that have resulted in a lesser degree of consistency with the provisions of that Article.

14.282 The arguments put forward by the United States in support of its claim are essentially the same as those that have been considered in paragraphs 14.277 and 14.278 above. For the reasons set out in those paragraphs above, we find that the United States has not demonstrated that measures have been taken that reduce the degree of consistency with the provisions of Article 20 and which would therefore be in violation of Indonesia's obligations under Article 65.5 of the TRIPS Agreement.

## XV. CONCLUSIONS AND RECOMMENDATIONS

15.1 In the light of the findings above,

(a) We conclude that the local content requirements of the 1993 and of the 1996 February car programmes to which are linked (i) sales tax benefits on finished motor vehicles incorporating a certain percentage value of domestic products or on National Cars and (ii) customs duty benefits for imported parts and components used in finished motor vehicles incorporating a certain percentage value of domestic products or used in National Cars violate the provisions of Article 2 of the TRIMs Agreement.

(b) We conclude that the sales tax discrimination aspects of the 1993 and the February and June 1996 car programmes in favour of domestic motor vehicles incorporating a certain percentage value of domestic products and National Cars violate the provisions of Article III:2 of GATT.

(c) We conclude that the customs duty and sales tax benefits of the June 1996 car programme in favour of imported National Cars and the customs duty benefits of the February 1996 car programme in favour of imported parts and components to be used in National Cars assembled in Indonesia violate Article I of GATT.

(d) We conclude that the European Communities have demonstrated by positive evidence that Indonesia has caused, through the use of specific subsidies provided pursuant to the National Car programme, serious prejudice to the interests of the European Communities within the meaning of Article 5(c) of the SCM Agreement.

(e) We conclude that the United States has not demonstrated by positive evidence that Indonesia has caused, through the use of specific subsidies provided pursuant to the National Car programme, serious prejudice to the interests of the United States within the meaning of Article 5(c) of the SCM Agreement.

(f) We conclude that Indonesia has not violated Article 28.2 of the SCM Agreement.

(g) We conclude that the United States has not demonstrated that Indonesia is in breach of its obligations under Article 3 of the TRIPS Agreement in respect of the acquisition of trademark rights or the maintenance of trademark rights or in respect of the use of trademarks specifically addressed in Article 20 of the TRIPS Agreement nor has it demonstrated that measures have been taken that reduce the degree of consistency with the provisions of Article 20 and which would therefore be in violation of Indonesia's obligations under Article 65.5 of the TRIPS Agreement.

15.2 Under Article 3.8 of the DSU, in cases where there is infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of

nullification or impairment of benefits under that agreement. Accordingly, we conclude that to the extent that Indonesia has acted inconsistently with the provisions of covered agreements, as described in the preceding paragraph, it has nullified or impaired the benefits accruing to the complainants under those agreements.

15.3 With respect to the conclusion of serious prejudice to the interests of the European Communities, Article 7.8 of the SCM Agreement provides that, “[w]here a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining the subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.”

15.4 The Panel recommends that the Dispute Settlement Body request Indonesia to bring its measures into conformity with its obligations under the WTO Agreement.

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